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Submission – Crowd Sourced Equity Funding – Minter Ellison Lawyers

Minter Ellison Lawyers appreciates the opportunity to comment on the discussion paper Crowd Sourced Equity Funding issued by the Corporations and Markets Advisory Committee (**CAMAC**) in September 2013 and updated in October 2013 (the **Paper**).

Introduction

Crowd funding has undergone rapid global growth in the past couple of years and this looks set to continue.

Crowd sourced equity funding (**CSEF**) is a key component of the broader crowd funding picture. Entrepreneurs are increasingly seeking to offer crowd funding investors an equity interest in the underlying business as an incentive to attract funding and remain competitive in the global crowd funding market.

Overseas crowd funding projects are open, not only to local investors in that overseas jurisdiction, but also to Australian investors. This is because crowd funding traverses geographic and jurisdictional borders as it essentially exists entirely within the internet. Australia's crowd funding entrepreneurs are at a competitive disadvantage to their overseas counterparts because a key component, CSEF, is not readily accommodated under Australian law.

Crowd funding is undergoing rapid evolution. Other countries (including the United States) have responded quickly to update their laws to accommodate CSEF. In the current uncertain global economic environment, Australia should act promptly to accommodate CSEF and not fall too far behind the rest of the world.

This submission discusses each of the five options for reform contained in the Paper and suggests that the fifth option may be the best choice. Those five options are:

- no regulatory change;
- liberalising the small scale personal offers exemption in the fundraising provisions;
- confining CSEF exemptions to sophisticated, experienced or professional investors;
- making targeted amendments to the existing regulatory structure for CSEF open to all investors; and
- creating a self contained statutory compliance structure for CSEF open to all investors.

Which option is best?

The first option, no regulatory change, is potentially problematic. The current Australian framework is simply not designed to accommodate crowd funding and, therefore, is not a suitable long-term solution. If crowd funding continues to evolve in Australia, the regulatory framework will need to be substantially updated and refined to accommodate this new form of capital raising.

The second option involves increasing the 20 investor ceiling. This would facilitate CSEF if the 20 investor ceiling were raised significantly. However, because CSEF involves small investments from as little as A$1 from each participant, the 20 investor ceiling would need to be raised significantly to allow for a meaningful level of capital to be raised. Raising the 20 investor ceiling to specifically accommodate CSEF may also distort a rule that has been in place for more than 20 years.

The third option involves restricting CSEF investment to sophisticated, experienced or professional investors. Although the third option is attractive from an investor protection perspective, it has the limitation that it will not allow CSEF fundraisers in Australia to attract 'small' contributions from ordinary internet users. This is a significant limitation because most crowd funding schemes rely on several small contributions (eg between A$1 and A$100) and the restricted pool of sophisticated, experienced or professional investors is unlikely to allow for a meaningful level of capital to be raised.

The fourth option involves maintaining the existing regulatory structure while 'cherry picking' CSEF regulatory initiatives from other jurisdictions. This option may lead to specific provisions to better facilitate CSEF within the existing regulatory framework by targeting areas of current Australian law that create difficulties for CSEF, including the following areas:

- fundraising by proprietary companies;
- compliance requirements for public companies that fundraise;
- managed investment schemes; and
- financial services licensing.

However, targeted amendments to our current framework may not be the most effective mechanism to facilitate CSEF and may consequentially cause difficulties for the regulation of other financial products and securities within an already complex framework.

Fifth option may be best

The fifth option involves creating a new, possibly standalone regime for the regulation of CSEF. This regime could be constructed to provide benefits for CSEF in Australia including:

- a definition of CSEF that essentially covers CSEF issuers that are granted a license by a specialist regulator (licenses could be granted according to fluid guidelines designed to capture the currently evolving nature of crowd funding);
- an exemption to existing fundraising disclosure and compliance requirements that covers all CSEF issuers that are licensed;

- clarity in the laws and regulations that apply specifically to CSEF (ie those laws drafted by the specialist regulator and enforced on licensed CSEF issuers);

- the ability to make future specific regulatory changes to CSEF laws that avoid any adverse impacts on the existing legal framework that applies to other regulated financial products and securities;

- the ability to specifically control the activities of Australian CSEF investors, issuers and intermediaries and determine investor protection measures to be implemented between these parties; and

- the ability to collect data on CSEF in Australia and allow for data analysis to measure risk, sector growth and to allow for more thoroughly informed and targeted law reform in this rapidly changing area.

This standalone regime would also be best placed to incorporate regulatory features specific to CSEF, as considered for incorporation into overseas CSEF regulatory regimes, including:

- allowing for flexibility in the event that a CSEF issue is oversubscribed (if oversubscription is dealt with under general Australian securities law, this may lead to less then optimal outcomes for CSEF issuers and investors (eg additional disclosure requirements if certain thresholds are breached));

- allowing for non-CSEF investors wishing to invest significant funds, into a business that has already obtained CSEF fundraising, to sit outside the CSEF regulatory regime (while not allowing the completed CSEF fundraising to distort the application of Australian securities laws to non-CSEF investors);

- establishing and maintaining a forum to encourage communication amongst the 'crowd' (this would allow greater investor protection by tapping into the key beneficial feature of CSEF, 'the wisdom of the crowd,' to ensure optimum investor analysis is available to all CSEF investors); and

- allowing insignificant non-compliance to be dealt with in a flexible and efficient manner that does not unnecessarily penalise small businesses for errors that are of little consequence for investor protection (and that does not require small businesses to obtain expensive and complex legal advice before commencing CSEF for relatively simple business ventures).

Incorporating these features directly into general securities law in Australia could introduce further distortions into existing laws that may be inconsistent with their original design, potentially adding further uncertainty to an already complex framework. A new, standalone regime for the regulation of CSEF could keep these features separate from general securities law in Australia avoiding these potential difficulties.

Conclusion

The key to effective crowd funding regulation is recognising that all crowd funding investors are subject to a higher risk of issuer default because crowd funding issuers are generally not well established. Limiting the risk exposure for participants in CSEF is rightly a key priority. However, CSEF should be governed by different investor protection mechanisms compared to other regulated financial products and securities. A key priority should also be to cultivate CSEF as a vehicle for economic growth and innovation, with appropriate protection for investors, while

minimising compliance obligations, legal complexity and uncertainty and liability risks for issuers.

Yours faithfully
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Innovation Australia

Submission to the Review of Crowd Sourced Equity Funding being undertaken by the Corporations and Markets Advisory Committee

Declaration of Interest

Innovation Australia is an independent statutory body established under the Industry and Research Development Act 1986. The mission of Innovation Australia is to increase the economic return from successful technology-based enterprises in Australia by guiding the Australian Government's investment in the commercialisation of the nation's research and development and innovation.

Introduction

Driving innovation is critical to maintaining and improving Australia's competitiveness. Access to finance is the principal barrier faced by innovative technology based companies in the early stages of their business development. It also represents a significant challenge to a broader range of small and medium sized businesses. Crowd sourced equity funding has the potential to provide access to wider sources of finance for these Australian businesses. We therefore believe it is important that regulatory measures are established to enable crowd sourced equity funding in Australia. We note that a number of countries are introducing regulation or examining options in advance of doing so and it is important that Australian technology startups and other businesses are not placed at a disadvantage to their international counterparts.

We consider that a statutory and compliance structure specific to crowd sourced equity funding should be established to allow share transactions across an online platform, as this will enable the full potential of the crowd to be harnessed. A regulatory regime needs to strike an appropriate balance between investor protection and the compliance costs to issuers and intermediaries.

We believe that the regulatory settings should seek to:

- facilitate the greater opportunities that crowd sourced equity funding offers for:
    - entrepreneurs, startups and early stage businesses to access finance;
    - investors to make modest investments across a range of investment options ;
    - other potential benefits to emerge for businesses and investors, such as market validation;
    - economic benefits to be gained in Australia;

  and

- provide protection to issuers, intermediaries and investors.

The current regulation of investment is based on mandatory disclosure, which feeds into a due diligence model. In practice, many investors do not carry out the due diligence themselves, but rely on the services and reputations of other parties, such as financial advisers or market analysts and commentators; that is, there is a division of labour on due diligence. When designing the regulation of crowd sourced equity funding there is an opportunity to recognise that disclosure of information, on its own, is not sufficient for the market to operate efficiently. What is also needed is the division of labour on due diligence. This cannot exist without information being available in the marketplace to establish the reputations of those that turn the detailed information for due diligence into a form that many investors prefer to access. (See Box 1 for further discussion).

To achieve the desired outcomes of facilitation and protection, a balanced approach to regulatory policy settings should be designed that:

- facilitates a market with lower transaction costs;
- is proportionate, based on risk and limitation of damage;
- is outcomes-based, not prescriptive;
- ensures transparency and flows of information, in particular to facilitate a market based on reputations.

We believe that the extent to which crowd sourced equity funding is mobilised in Australia will be determined by the market and will depend, ultimately, on the appetite of investors to transact the purchase of shares in a diverse range of companies across an online platform. For technology startups, this appetite will be influenced by the track record that platform providers are able to establish for selecting companies which deliver returns and innovative new products and services.

Box 1 The significance of reputation

In highly complex fields, citizens often cannot or do not want to do "due diligence" on all their decisions. Here they typically make decisions by relying on reputations. Indeed economist John Kay argues that reputation is the "normal market mechanism for dealing with asymmetric information." ...

In many ways reputation can be understood as a particularly important aspect of the division of labour. As the world becomes more complex and as our expertise grows, markets for information become richer – more intermediated. As our expertise grows new areas of specialism grow. The individual actor in the economy cannot realistically exercise "due diligence" in all their choices. Instead they require access to expertise which is mediated. Once the need for expertise is identified, the question that then arises is how one should choose an expert.

Most professional services are heavily regulated often at substantial cost with little clear benefit. And yet very little if any of that regulation is directed towards improving the quality of the information on which reputations for expertise are based.

Those seeking to maximise transparency should also consider the architecture of the information ecology. For there are many things that can be done to create a situation where information that would be useful comes into existence and is disseminated to those who can benefit from it – and those who can discipline others to perform better with their buying and other choices. Thus for instance if investment advisors and/or share brokers kept independently auditable 'sample portfolios', we could, over a period of time, measure their performance. (Extracts from *The Ecology of Information and the Significance of Reputation*, *Dr Nicholas Gruen*).

Suitability of crowd sourced equity to finance technology startups

There are challenges to be addressed in applying the crowd funding model to equity investing. The success and recent proliferation of other types of crowd funding, for example the donation, reward and loan based variants, may not translate into a similar enthusiasm for crowd sourced equity investing. Some of the reasons for this include:

- the complex nature of equity investing;
- the challenges that widened share ownership will bring to small, hitherto closely owned enterprises in relation to management and compliance issues (including the cost to the issuer of dealing with the intermediary, of maintaining a share register and obtaining shareholder agreements);
- the impact on subsequent capital raising and the eventual sale of the company.
- increased exposure to intellectual property theft following the disclosure of information to a wide audience on the internet; premature exposure to competition and to copycat activities.

Where the business activities of a company involve significant research development and testing, are capital intensive and require a long runway to market, the founders need informed shareholders who comprehend fully the risks of early stage investing and the time to realisation of the investment. Existing business owners will need to weigh these considerations against the need for capital and the market validation that a successful crowd fundraising may offer.

Frequently, the individual who contributes money to a crowd funded project does so to support a cause to which some attraction is felt. This is termed "donation funding" in the Discussion Paper and is arguably the variant of crowd funding where the interest and imagination of large numbers of people is most likely to be captured to deliver the large numbers of small monetary contributions on which the concept of crowd funding rests. The use of crowd funding to attract donations to fund university research projects is an interesting development which is gathering pace in the United States. The collaboration between Deakin University and the crowd funding platform provider Pozible is an example in Australia.

If crowd sourced equity investing attracts sufficient interest, the benefit to the company seeking finance will be access to a significantly larger pool of investors. This would translate into large numbers of small shareholders (as noted in the Discussion Paper, this would require legislative change as the number of shareholders a private company may have is currently limited to 50). This would present issues for a technology startup which may need to raise larger amounts of capital in a later funding round. These matters will need to be addressed through some form of nominee and pooling or other arrangements, including possibly a variation of the class rights attaching to crowd equity investors.

For these reasons, while online crowd sourced funding platforms offer opportunities for linking angel and high net worth investors with technology start-up companies, and for building on existing networks and developing new ones, some have argued that crowd funding is less likely to open up early stage investing to large numbers of small investors. The counter argument is that issues which

are presented as potential obstacles ought not to be insurmountable. The ingenuity of financial markets would tend to support the latter view.

Crowd sourced equity funding for SMEs

In the case of the more typical small closely held business (i.e. not technology startups), the owner will be unlikely to want to offer equity to external investors that would have the effect of diluting the ownership of the company. A more attractive option would be loan finance via an online crowd funding platform, subject to having a sufficient revenue stream from which to make interest payments. More widely held ownership is likely to be of less concern where the venture is a new community focussed cooperative to address a geographically local need and where the likelihood of raising finance through other means is remote.

Conclusion

Despite the uncertainties that arise and the attendant challenges in adapting crowd sourced funding to raise equity capital for companies, the difficulty that small companies face in accessing finance from traditional sources suggests that governments will want to look carefully at the potential of crowd funding to open up new sources of capital, facilitated through an appropriate regulatory regime. This would allow the market to decide how, and the extent to which, the concept should be developed and applied in practice within the boundaries of that regulatory regime.

Responses to questions posed in the Discussion Paper

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?

Response

Yes, provision should be made in the corporations legislation to accommodate or facilitate CSEF. CSEF has potential to improve access to finance for some early stage knowledge rich companies and for a broader range of SMEs. The full extent of this potential will become clearer over time as the market develops and responds to the new opportunities of an enabling regulatory framework. Other countries are taking steps to introduce enabling regulatory regimes and it is desirable that, in Australia, we should examine the options for a workable facilitative framework. The question should be viewed in the broader context of the need to ensure the existence of a competitive business environment for entrepreneurs seeking to establish and build innovative new companies. Seen through this prism, CSEF is a piece of the jigsaw. The popularity and recent rapid growth of existing online crowd sourced funding platforms would not have been predicted by many. It would be wrong to assume that the equity based model will not generate interest and establish a presence. As noted in our introductory remarks, the market should ultimately determine how, and the extent to which, CSEF should be developed and applied in practice, within the boundaries of an enabling regulatory regime.

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

Response

Investment in early stage companies tends to revolve around trusted networks of investors, professional advisers, experienced executives and entrepreneurs. These relationships are built up over time. From this perspective, it may be argued that a variation of the small scale offering exemption (see Discussion Paper, page 19) coupled with a limitation to sophisticated investors (albeit possibly with some expansion of the existing definition) would adequately serve the early stage company sector. Nevertheless, for the reasons noted in response to Question 1 and also the fact that CSEF has the capacity to serve a much broader range of enterprises than the technology start up alone, we consider that it is appropriate that a self-contained statutory and compliance structure for CSEF, open to all investors be established (that is, Option 5 identified in the Discussion Paper). This regime should require that an offer for securities is conducted through a sole intermediary, operating online only, consistent with the proposed crowd funding rules published by the US SEC and as noted in the discussion paper (first update version). This model is appropriate to harness the full potential of the crowd. Variations to the small scale offering exemption and/or confining CSEF to sophisticated investors will not enable CSEF in the true sense but will deliver crowd funding without the crowd. They will not capture the enthusiasm and the scale that the crowd has to offer and that have been demonstrated in the high growth in non-equity crowd funding activity over the past two years. CSEF not only offers potential to broaden access to capital, it will also provide an opportunity for some market validation of the product at an early stage. This latter aspect may assist in attracting investors in a second fund raising round.

Furthermore, this approach supports transparency and a level playing field by ensuring that all investors have access to the same information in a single location. It is also the model which best enables the collective wisdom of the crowd to be mobilised by facilitating online communication between investors. By enabling the sharing of knowledge and information among investors, this helps to disseminate information that will form reputations about issuers, intermediaries and other actors, which is critical given the division of labour in the due diligence process.

Subject to due regulatory safeguards, it should be left to the market to decide who invests and where. The principal protection to investors will be caps on the amount that may be invested in any year according to an individual's net income.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (iii), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Response

(i) The shareholder cap should be raised to enable large numbers of investors to contribute relatively small amounts of money. If this change is not made, while companies will be able to choose from a larger pool of investors, they will not be able to aggregate significant amounts of capital by raising small contributions from many investors (the current cap for a small proprietary company being 50 non-employee shareholders).

(ii) The need to facilitate access to CSEF by unlisted public companies is less apparent and of a lower order priority, albeit that these companies do not have the same options for raising capital as a listed public company. Nevertheless, a decision has been made to become an unlisted public company in the knowledge of the attendant regulatory and compliance obligations and this itself could be indicative of a degree of confidence in the ability of the company to raise capital as an unlisted public company through existing means. A regulatory regime for CSEF should not preclude public unlisted companies from participating.

(iii) Managed investment schemes involving pooled investment through a trust framework are not well-suited as a vehicle for crowd sourced equity investing. Investments are held on trust for the scheme members by the responsible entity and this divorces the retail investor from the investee company. An important feature of, in particular, the donor-based crowd funding model, is the connection or affiliation the individual contributor has towards the funded project. It would not be desirable to introduce a regime which might remove or weaken this connection. This said, a regime might allow access by managed investment schemes to online CSEF platforms as an additional feature. This would enable people who preferred to invest through a managed scheme to do so.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) types of issuer: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

(ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF

(iii) maximum funds that an issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors

(v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer

(vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

(viii) any other matter?

Response to Question 4

(i) **types of issuer:** We would urge against confining CSEF to a particular class of company, as in Italy where access is limited to "innovative start-ups". Apart from issues of definition which arise with the adoption of generic descriptions when it is sought to set parameters for eligibility, it is desirable that Australian companies should have access to the broadest range of sources of capital and markets. Investment fund companies should be excluded as under the US JOBS Act 2012 and as proposed for the Canadian regime. The regime should be limited to Australian incorporated issuers. If CSEF is facilitated through regulation in Australia, this will be done to improve access to finance for Australian SMEs principally. It would be difficult and costly to perform due diligence on foreign companies and similarly to enforce local regulatory provisions.

We also note the US SEC has proposed that companies without a specific business plan or a plan which is simply to engage in a merger or acquisition with an unidentified entity should be excluded. The basis for this is to ensure that investors are provided adequate information to make an informed decision. We would support a similar exclusion in an Australian regime for like reason.

(ii) **types of permitted securities:** ordinary shares; non-convertible preference shares; non-convertible debt securities that are linked only to a fixed or variable interest rate; and, shares that are convertible into ordinary shares or non-convertible preference shares. This is consistent with the Canadian proposal and recognises that the exemption is intended to facilitate capital raising by small and medium sized companies and that, accordingly, complex products need not and ought not to be accommodated under this exemption. Furthermore, such products are less likely to be well understood by the majority of retail investors and therefore the associated investment risks not properly appreciated.

(iii) **maximum funds that an issuer may raise:** a limit of no more than $1.5 million in a 12 month period would constitute an appropriate ceiling, in line with the current Canadian proposal. It will be consistent with the capital requirements of many start-ups and pitched at a level which is able to help to bridge the gap between founders and angel finance and formal venture capital. It will also be suitable to meet the capital requirements of a broader range of small businesses which may wish to raise capital via a crowd funding platform.

The ceiling could exclude funds raised under the small scale personal offers exemption given the conditions which apply, including the limitation to 20 investors.

(iv) **disclosure by the issuer to investors:** there is a premium to be gained from low transaction costs for issues of securities. In all cases when designing regulation of financial markets, there is a balance to be struck between, on the one hand, the need to provide reliable and useful information to the investor and, on the other hand, the costs the issuer has to bear in providing the information to

meet the relevant disclosure requirements. The use of investor and issuer financial caps and the facilitation of information sharing over online communication channels are important features of CSEF which ought to enable regulation with less costly compliance burdens on the issuer.

The stepped approaches provided under the US JOBS Act and in the Canadian proposal are an attempt to strike this balance. Of these two, we believe the approach taken in the US legislation is to be preferred. The issuer must provide financial statements, certified by an officer of the issuer if the specified target offering amount is $100,000 or less, reviewed by an accountant if that amount is up to $500,000 and audited if that amount is over $500,000. Noting that many investors will not undertake due diligence themselves, information available to the investor (and actors that the investor relies on, by reputation, to interpret the information) should include the principal risks facing the issuer as well as recent financial statements. Information should also be provided about the key personnel of the issuer, including recent experience. We note, for example, that the US SEC is proposing to require disclosure of the business experience of directors and officers of the issuer during the last three years.

We also strongly urge consideration of the establishment of a lower tier of investment which would be accompanied by only very limited issuer disclosure requirements. This tier might be capped at, say, a maximum investment of $250 and would facilitate investment in social enterprise, while not being confined to that sector. Similarly, this tier would enjoy exemption from the income or net wealth qualifications applying to individuals making larger investments.

Ongoing disclosure should include provision of annual statements. The issuer should also maintain books and records which contain: information on shares and securities issued by the issuer, the price and date; the names of all holders of shares and securities and the size of their holdings; and, the use of funds raised.

We do not comment further on the disclosure to be provided by the issuer save to observe that, in the context of early stage investing there are certain key matters about which it is important for investors to have information and these matters should guide the information that issuers provide. Not all of these matters need to be the subject of obligatory disclosure but there is unlikely to be any harm in requiring disclosure, or establishing a system that rewards disclosure (through information that forms good and bad reputations - see earlier discussion). They include:

- explanation of the product, process or service and basic description of any technology it is dependent on for its functionality
- what is the edge or competitive advantage over what is currently available in the market that will make it successful
- what are the principal risks the company faces including any risks associated with the technology
- any estimates prepared of size of market
- milestones and path to market
- what the capital raised will be used for
- key personnel (directors and senior executive management) and the roles of, including the continued involvement of the inventor of any relevant technology

- how any intellectual property is protected and whether the issuer is aware of any disputes concerning it or challenges to the validity of any associated patents or other forms of intellectual property protection

- anti-dilution, "tag along" and "drag along" rights

(v) **controls on advertising by the issuer:** we support the controls provided under the US JOBS Act. In particular, we consider it important that the intermediary's online platform is the sole location for access to information about the offer. This will assist with overall regulation and the provision of a level playing field for all investors.

(vi) **liability of issuers:** we comment that investor protection and confidence demands that issuers should be liable for statements they make which they know or ought to have known were false or misleading.

(vii) **ban on a secondary market:** CSEF should be limited to new issues, excluding on-selling of existing securities. The primary purpose of enabling CSEF should be to improve access to capital for small companies, that is, via new issues.

(viii) **any other matter?** No other comments are made.

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

Response

We comment in broad terms that the licensing requirements need to reflect the role of the operator of an online CSEF platform. The principal role should be to host investment opportunities in an efficient and transparent manner for the benefit of issuer and investor. Some platform providers may offer additional services such as access to mentors and other advisers. However, we suggest that they should not hold investors' funds. This allows for less stringent licensing arrangements while not compromising investor protection, but being sufficient to ensure the integrity of the CSEF regime.

Pending fundraising targets being met, investors' funds should be held by an external agent appropriately licensed for such purpose. We note the proposed US SEC rules require transmission of funds by the investor directly to an account with a qualified third party bank. Platform providers should also not provide financial or investment advice. A licensing regime should recognise this limited role but nevertheless require a platform provider to demonstrate that it has adequate capital, human and technological resources to perform its function. This should enable overly burdensome regulatory arrangements to be avoided.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of intermediary (also relevant to Question 5):

(a) should CSEF intermediaries be required to be registered/licensed in some manner

Response

Our comments below are to be read with our response to Question 5. We believe there should be a licensing regime. An appropriate approach would be to require for platform operators (intermediaries) to register with the Australian Securities and Investments Commission to enable a central register of platform operators to be maintained and to address investor protection issues including integrity, proficiency and solvency requirements. The degree of regulation will depend on whether intermediaries will be permitted to hold investors' funds or securities, as to which, we have expressed the view that they ought not to be (see Response to Question 5). The discussion paper suggests some alternative approaches for handling investors' funds at paragraph 2.2.3.

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

Response

We do not comment in detail but would note that in all cases there will need to be a sufficient minimum level of human, technology and risk management capabilities to ensure that investors are able to have confidence in the CSEF market. At the same time it is desirable to avoid over regulation of intermediaries as this may impede unnecessarily the development of the market. Platform providers should be required to carry standardised warnings about the risks of equity investing and the especially high risks associated with investing in technology start-ups.

The need for an intermediary to build reputation in the CSEF market is likely to mean that those specialising in hosting early stage technology companies will carry out significant due diligence before agreeing to host a company on their platform. In such a case the operator's human resources will need to include individuals with experience in early stage investing and the operator will build its brand and reputation around the quality of the investment opportunities it hosts. Other operators will run less highly curated platforms. There may be opportunities for intermediaries to make use of others with expertise for example, business incubators could be involved in the due diligence vetting process. Online channels of communication between investors will be an important feature to facilitate information sharing and to build the reputation of participants in the CSEF market.

There will also need to be secure online payments systems and systems to guard against fraud and money laundering.

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

Response

Issues of process should be addressed by regulation to ensure a measure of standardisation which will support market integrity and investor confidence. Basic information about the offer, the issuer and the intermediary should be provided.

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

Response

We consider these two requirements to be appropriate.

(ii) intermediary matters related to issuers: these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

Response

No view is expressed. Our interest in CSEF lies principally in the potential it may have to improve access to finance for innovative early stage Australian companies.

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

Response

To build and protect their reputation, intermediaries will seek to undertake basic enquiries about companies and key personnel. These might include: searches to establish the identity of a company including registered office, to check that financial accounts have been filed uptodate, to ascertain the existence of any charges on the company's business and assets and pending legal actions and judgments; searches against directors, officers and significant shareholders to establish, among other matters, background and the absence of bankruptcy and director disqualification orders. It will be important for investors to be able to access a verification of the identity of the issuer, and also information about the issuer to inform their decision about the investment. A due diligence vetting process for issuers would enable this. However, it is not essential that it be the intermediary that undertakes the due diligence. Other actors could provide this service, as long as the information is made available to potential investors at the time they are considering the investment, that is, on the online crowd sourcing platform. The regulatory settings should be designed to create a systems where the results of due diligence are communicated to the investors, but with the flexibility to allow the market to establish the means for delivering this outcome.

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

Response

We believe that enquiries about the business conducted by the issuers are principally matters between the issuer and the investor. We have commented on the type of information that an investor might wish to obtain and consider before making a decision to proceed with an investment (Response to Question 4 (iv)).

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

Response

Provided that the intermediary has exercised reasonable care to verify the accuracy of matters that it is required by regulation to verify (to be decided but these would be matters capable of ascertainment and verification by routine enquiry), and provided that the intermediary does not have knowledge or reason to suspect that statements made by the issuer are not true, liability for misleading statements made by the issuer should rest with the issuer as maker of the statement. The intermediary should not be held liable. For the situation to be otherwise would risk placing undue burden on the intermediary and operate as a disincentive to the establishment of a CSEF market in Australia. Intermediaries should post notice on their website where material statements made by issuers have not been able to be verified by the intermediary (or agents instructed on the intermediaries' behalf) and that investors should make their own enquiries prior to subscribing for shares. Intermediaries should not be permitted to recommend or endorse particular investment opportunities.

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

Response

Provided that the intermediary has exercised reasonable care to verify the accuracy of matters that it is required by regulation to verify (to be decided), liability for investor losses should rest with the issuer and the investor should pursue legal remedy against the issuer.

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

Response

Where any element of the intermediary's remuneration is linked to the amount of funds raised, the intermediary should be under an obligation to disclose this fact to investors. The intermediary and its officers should be prohibited from having any financial interest in the issuer, consistent with the US SEC proposals.

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

Response

Access by the issuer to funds raised should not be permitted until the issuer's fund raising target has been achieved. Intermediaries should not be permitted to hold or manage any investor funds. This allows for less stringent licensing arrangements while not compromising investor protection. Pending fundraising targets being met, investors' funds should be held by an external agent appropriately licensed for such purpose. We note the proposed US SEC rules require transmission of funds by the investor directly to an account with a qualified third party bank, which has agreed to hold the funds and to transmit them to the issuer or investors, depending on whether the offering is completed or cancelled.

(iii) intermediary matters related to investors: these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

Response

Basic identity checks should be carried out by the intermediary or an agent instructed for the purpose as a measure of protection against fraud. Intermediaries will need to comply with existing anti-money laundering regulations.

(b) what risk and other disclosures should intermediaries be required to make to investors

Response

Standard warnings should be developed which it would be obligatory for all intermediaries to carry on their online platform. These should take the form of a basic "health" warning to draw the investor's attention to the high risk of loss of capital associated with investments in companies which are in the early stages of business development. A short warning is more likely to be read and considered, compared to a long detailed warning. A short warning could then direct investors to more detailed information. In this, attention should be drawn in general terms to risks linked to technology, market, intellectual property and competing products. There should also be a recommendation to take legal and financial advice and attention should be drawn to the risks of dilution of first round shareholdings as a consequence of later funding rounds and to the illiquid nature of investments in technology startups, and that there will typically be a lack of dividends during the early development stages. Attention should also be drawn to the potential impact of preferential shareholder rights on returns to ordinary shareholders.

(c) what measures should intermediaries be required to take to ensure that any investment limits are not breached

Response

Consideration should be given to a regime of self-certification for investors. The important issue is for prospective investors to be adequately appraised of the high risk of loss of capital associated with early stage investing, the illiquid nature of the investment, the risk of dilution and the lack of dividends.

(d) what controls should be placed on intermediaries offering investment advice to investors

Response

Intermediaries should not be permitted to provide financial advice.

(e) should controls be placed on intermediaries soliciting transactions on their websites

Response

The intermediary should not be permitted to solicit transactions but be limited to hosting and publishing the investment opportunity on the website. We support safe harbour provisions proposed by the US SEC to enable intermediaries to apply criteria to limit offerings on its website to, for example, specific industries, without being deemed to be soliciting transactions or providing investment advice.

(f) ***what controls should there be on intermediaries holding or managing investor funds***

Response

Intermediaries should not be permitted to hold or manage investors' funds. See response to Question 6 (ii) (g).

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

Response

We believe that information and knowledge sharing among investors has the potential to improve the investment decision making process in the crowd funding context. Accordingly we concur in the US SEC proposal to require intermediaries to facilitate communication between investors on its online platform.

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

Response

No comments are made.

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

Response

Where any element of the intermediary's remuneration is linked to the amount of funds raised, the intermediary should be under an obligation to disclose this fact to investors. No additional comments are made save that there should be rules to provide for disclosure of remuneration arrangements to ensure transparency.

(j) what, if any, additional services should intermediaries provide to enhance investor protection

Response

No additional comments.

(iv) any other matter?

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

Response

Basic information could be provided. Beyond this, these are matters on which an investor may be expected to obtain legal advice, should additional information be desired, having regard to the cost of obtaining advice relative to the amount to be invested. As noted earlier, the intermediary should be required to recommend that prospective investors obtain legal advice before entering into a binding commitment to invest.

(ii) the difference between legal and beneficial interests in shares

Response

Similarly, beyond the provision of basic information, this is a matter on which legal advice should be obtained by the investor, where appropriate.

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

Response

Beyond the matters noted earlier as regards information and warnings the intermediary should be required to provide to the investor, these are matters about which the issuer should be required to provide full and comprehensive disclosure to the prospective investor via the intermediary's online platform. Attention should, for example, be drawn to any limitation upon crowd equity shareholders' voting rights.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) permitted types of investor: should there be any limitations on who may be a CSEF investor

Response

We would propose no limitation on who may be an investor, consistent with the US and Canadian proposals and with investor protection being provided through investment caps based on income.

(ii) threshold sophisticated investor involvement (Italy only): should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

Response

No. It is considered that such a restriction, while having some benefit in de-risking the investment for the less well informed investor, would run strongly counter to the objective of increasing access to capital. The protection for the investor should focus around caps on how much may be invested relative to net income and wealth.

(iii) maximum funds that each investor can contribute: should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

Response

There should be a cap. As noted in the discussion paper, investment caps are an important measure of investor protection. We believe the US model is to be preferred, that is, limiting the total monetary amount that an investor may invest in all CSEF issuers in one year according to that person's income or net worth. A cap where the investor is limited to what he may invest in any one intermediary on an annual basis (a part of the Canadian proposal) may be unduly restrictive as investors may wish to direct their investment through a preferred intermediary with a strong track record or due to some other attributes of that intermediary. We also believe the per annum aggregate CAD10, 000 limit under the Canadian proposal to be unduly restrictive. We prefer the investment limits under the JOBS Act which are set out in paragraph 4.4.1 of the discussion paper.

(iv) risk acknowledgement by the investor: should an investor be required to acknowledge the risks involved in CSEF

Response

This is a useful way to emphasise and draw attention to the risks of early stage investing.

(v) cooling off rights: should an investor have some right of withdrawal after accepting a CSEF offer

Response

Since CSEF is aimed at the retail investor, this consumer protection type of measure is appropriate.

(vi) subsequent withdrawal rights (Italy only): should an investor have some further withdrawal right subsequent to the offer

Response

No comments are made.

(vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF

Response

We consider there should be such restrictions to prevent the manipulation of the share price through "pump and dump" activities.

(viii) reporting: what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

Response

Issuers should be required to report to investors with audited annual financial statements

(ix) losses: what recourse should investors have in relation to losses resulting from inadequate disclosure

Response

No additional protection to the CSEF investor beyond the recourse available to other investors.

(x) remedies: what remedies should investors have in relation to losses resulting from poor management of the enterprise they invest in

Response

None beyond those already existing under the law

(xi) any other matter?

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

Response

See responses to questions 1 and 2. We believe a self-contained regulatory regime is required rather than incremental adjustments to existing provisions.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

Response

Consideration might be given to a means of tracking the performance of companies hosted on and funded through online CSEF platforms so that this data is available for investors in the future to facilitate informed decision-making. This may focus the attention of intermediaries on the quality of the companies they host.

Intermediaries might be encouraged to consider publishing their portfolio performance on their website. This would be a means of shaping market behaviour other than by prescription.

Disclosure does not necessarily need to be mandatory. Often the immediate cause of lack of information in the market is the lack of a well-recognised standard to report against. Here the first task is to establish one or encourage one to emerge. Once it has, the best performers will generally have an incentive to report against it and this will put pressure to disclose on other players, lest they be seen to have something to hide. The desired outcome of information disclosure can be achieved without compulsion.

We also draw attention to the need, in considering what appropriate policy settings might be, that consideration is given to any implications that internet enabled CSEF may have for the tax system. It is desirable that the design and administration of the tax system should not pose barriers or operate as a disincentive to participation in the CSEF market, for example, the system should not unduly raise transaction costs.

NORTON ROSE FULBRIGHT

Submission to CAMAC: Crowd sourced equity funding

1 This submission

1.1 This is a submission to the Australian Government Corporations and Markets Advisory Committee (**CAMAC**) on their *Crowd Sourced Equity Funding Discussion Paper* dated October 2013 (**Discussion Paper**).

1.2 The views expressed in this submission are those of the authors and do not represent the views of Norton Rose Fulbright.

2 Introduction

2.1 As noted in the Discussion Paper, crowd sourced equity funding (**CSEF**) is a form of capital raising, typically characterised by small financial contributions made by a large number of investors. CSEF can be used to fund a wide range of activities including, for the purposes of this submission, start-ups.

2.2 Although relatively new, CSEF has become a well-established form of capital raising for start-ups and is now regulated (or proposed to be regulated) in a number of key financial markets. In the United States, CSEF is regulated by the Jumpstart Our Business Startups Act (**JOBS Act**). It is also proposed to be regulated in New Zealand.

2.3 Many Australian start-ups struggle due to a lack of access to capital. In some cases, they resort to foreign capital, or capital provided by friends and family (which is effectively unregulated). CSEF has the potential to provide that capital.

2.4 In our view, the Australian Government should follow the lead of the United States and New Zealand and establish a framework for the regulation of CSEF in Australia.

2.5 Supporting start-ups by facilitating their access to capital will have considerable benefits for Australia. In particular, it will lead to increased economic activity and employment opportunities. It will also assist in developing an entrepreneurial and innovative culture.

2.6 Regulatory framework

2.7 Given the unique characteristics and regulatory challenges posed by crowd funding, and consistent with the approach adopted in the United States, in our view a self-contained regulatory structure should be established to regulate CSEF in Australia.

2.8 Changes should only be made to the existing framework for raising capital under the *Corporations Act 2001* (Cth) (**Corporations Act**) to the extent that the Act is inconsistent with the CSEF regulatory structure.

2.9 Any regulation of CSEF should cover each of the main participants in CSEF, ie. issuers, intermediaries, and investors.

2.10 Given the small amounts of capital involved, and the lack of sophistication of all the main participants in CSEF, any regulation should be kept to the minimum necessary. Detailed regulation will impose a cost burden on issuers and reduce the attractiveness of CSEF and the likelihood of compliance.

3 Issuers

3.1 There are three key features of issuers (and capital raisings under CSEF) relevant to any proposed regulation of CSEF:

(1) Issuers are generally small, unsophisticated enterprises.

(2) The amount sought to be raised is generally low (ie. less than $10 million).

(3) The amount sought to be raised from each individual investor is low (ie. less than $5,000) and as a result there are often hundreds, possibly thousands, of investors.

3.2 In our view, taking these considerations into account, and consistent with the approach adopted in the United States and proposed to be adopted in New Zealand, any regulation of CSEF should:

(1) Limit the amount that an issuer may raise in any 12 month period. Any such amount should be low (eg. $2 million) and should include any amounts raised under the fundraising provisions in the Corporation Act. The limit of 20 personal offerings in any 12 month period under the Corporations Act should not apply.

(2) Remove the shareholder cap of no more than 50 non-employee shareholders for issuers. The takeovers provisions of the Corporations Code should only apply if the CSEF funded company has more than, eg 500 shareholders or a certain level of revenue.

(3) Remove the sophisticated investor exception for investors in CSEF companies. In our view, CSEF should be limited to small investments only.

3.3 Issuers should be prohibited from advertising the offer except through notices directing investors to intermediaries. The content of any such notices should be limited to basic information about the issuer and its product that is available on the intermediary's website.

3.4 Funding should be kept as simple as possible. Issuers should only be able to issue debt and ordinary shares. There should be no preferred or convertible shares.

3.5 Issuers should not be able to access CSEF proceeds until a designated funds target for that CSEF company is reached, thereby ensuring that investors can cancel their contributions for a limited period.

3.6 There should also be a ban on a secondary market for two years after the designated funds target is realised. The purpose of CSEF is to raise capital, not to facilitate a market for the sale of securities in CSEF companies.

3.7 Issuers should be required to make certain basic disclosures to intermediaries, including filing a business plan and providing basic corporate information, accounts to show financial standing, a description of the ownership and the capital structure of the issuer. Issuers should also specify the target offering amount, the deadline to reach that target and provide regular updates on progress of the issuer in meeting the target amount. These disclosures should include enough information so that investors can make an informed decision.

3.8 There should be no requirement for a disclosure document as currently required under the Corporations Act for funding of the type contemplated by CSEF.

3.9 Also, in our view, certain products should not be able to be crowd funded eg weapons, drugs, cigarettes and pharmaceuticals. CSEF should also not be able to be used to fund investment companies.

4 Intermediaries

4.1 Intermediaries play a key role in CSEF, being the portal through which investors can invest in issuers. A number of intermediaries, such as Kickstarter, have recently set up an Australian presence.

4.2 In our view, all CSEF should operate through appropriately registered and licensed intermediaries.

4.3 Currently, an intermediary must register with the Australian Securities and Investments Commission (**ASIC**) and hold an Australian Financial Services Licence (**AFSL**). ASIC has stated that intermediaries may be considered as the person arranging for the issue of a financial product. In our view, these requirements should continue, subject to some minor amendments to the AFSL conditions to take into account the different disclosure requirements for intermediaries.

4.4 Intermediaries should be required to disclose the risks of CSEF when an investor registers with their website. The disclosure information should set out that crowd funded projects are speculative ventures with no guarantee of profit or that the product or idea will even be executed.

4.5 When registering with an intermediary an issuer should be required to:

(1) Undergo basic regulatory checks on directors, officers and any significant shareholders, such as checks on insolvency, banned register and conflicts of interest.

(2) Ensure that basic corporate information is available to investors and issuers.

4.6 Intermediaries must receive assurances from investors that they:

(1) Are over 18 years old.

(2) Are not from countries with trade embargos, UN sanctions or any other similar political issues.

(3) Have not exceeded the CSEF investment limits within the financial year (see below).

4.7 In order to avoid any potential conflicts intermediaries should not have any interest in issuers unless that interest is disclosed upfront.

5 Investors

5.1 In our view, it is important that investors understand the general risks of CSEF. Investors should be required to confirm they are aware of the risks of CSEF when they sign up to an intermediary.

5.2 Information should be readily available on the intermediary's website about CSEF, how it works and the reality that many start-ups will not reach their designated funds target.

5.3 There should be investor caps that limit the total amount an investor may invest in issuers for a financial year. The limit on investment in issuers should be in proportion to that person's annual income or net wealth. Under the JOBS Act the cap is the higher of $5,000 or 5% of annual income for investors that earn less than $100,000 a year and $10,000 or 10% of annual income for investors that earn more than $100,000 a year.

5.4 There should be a limit an investor can invest in any issuer in a financial year.

5.5 Also, investors should be able to cancel an investment commitment at any time prior to 48 hours before the designated funds target deadline. This period provides an opportunity for investors to reconsider their investment decision.

6 Conclusion

6.1 In our view, the Australian Government should take steps to regulate CSEF in Australia.

6.2 Consistent with the approach taken in the United States, the Australian Government should establish a self-contained statutory and compliance structure to regulate CSEF in Australia. Changes to the Corporations Act should only be made where necessary to be consistent with the CSEF regulatory framework.

6.3 Any regulation of CSEF should cover each of the main participants in CSEF, ie. issuers, intermediaries, and investors.

6.4 Given the nature of the participants, and the amount of funds proposed to be raised, any CSEF regulations should be kept to a minimum.

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SUBMISSION ON CROWD SOURCED EQUITY FUNDING DISCUSSION PAPER

As stakeholders with interests in crowd funding, Pozible Pty Ltd and Clearpoint Counsel Pty Ltd jointly submit the following responses to the Crowd Sourced Equity Funding ("**Equity Crowd Funding**") Discussion Paper released in September 2013 by the Corporations and Markets Advisory Committee.

We support the use of Equity Crowd Funding as an important tool for funding small businesses with potential to grow.

Pozible

Pozible has provided Australia's largest crowdfunding platform since 2010 in terms of funds raised and the number of projects hosted. The platform was developed to help people raise funds, realise their aspirations and make great things possible. It has been used with great success as a community-building tool for creative projects and ideas.

Crowdfunding with Pozible is a way for motivated project creators to access funding beyond 'official' channels by talking directly to switched-on consumers, fans, peers and like-minded strangers.

Pozible currently advertises projects that comply with their platform terms and conditions. People are able to support different projects by pledging a sum of money which is paid once the declared target is met. In return project creators offer contributors non-financial rewards matching the level of funds pledged.

Clearpoint Counsel

Clearpoint Counsel is a Melbourne based law firm. It is engaged to work with many small businesses and start-ups alongside listed companies and other clients.

Members of our team have used crowd funding to fund projects in the past and also have deep experience with raising money through more traditional mechanisms such stock exchanges.

Crowd funding grows business

As crowd sourced funding methods become increasingly well established internationally as an option for funding small enterprises, enabling such funding methods is in the interest of the Australian economy. This is especially true in the recent economic climate where more traditional methods of raising equity have been difficult to access.

Small business can be a vibrant source of innovation as part of a healthy economic ecosystem. Small business is also a major source of employment. Failure to introduce amendments to the current legislative regime would disadvantage Australian businesses compared to other jurisdictions that are moving to facilitate Equity Crowd Funding.

Crowdfunding in Australia

Reward based Crowdfunding ('RBCF') has experienced 400%-500% growth per year since 2010. We estimate RBCF mechanisms raised a total of $20-25 million in Australia this year and $1.4 million globally. Predictions are that funds raised bay way of CSEF will grow to far exceed funds raised through RBCF.

There are a number of key benefits of crowd funding that extend beyond simply raising funds. These include its ability to:

(i) Accelerate funding

Timeframes to raise funds and setup operations through reward based crowdfunding can be as short as 14 days. Pozible sets a maximum 60 days to run a campaign. In Australia, it can sometimes take at least 6 to 12 months to raise investment funds through business angels, and sophisticated investors. The risk of new ventures failing (especially innovative ventures) can be reduced if the timeframe and expense to raise investment is reduced i.e. Seedrs (UK CSEF platform) raised $750,000 in 2 days.

(ii) Facilitate Marketing & Awareness

With crowd funding, stakeholders/supporters not only provide funding but also a voice, access to new networks and potentially new talent. Capping the number of investors will limit the effectiveness of these additional benefits.

(iii) Encourage Security & Online Profiling

Online communities and online social networks facilitated through platforms like Pozible are quickly becoming self regulating because the public can easily raise issues or feedback. Also, with the 'all-or-nothing' approach adopted by responsible crowd funding platforms (where

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the creator must raise a desired target) - the risk of the issuer being unable to achieve the project for which funds are directed is significantly reduced.

Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate Equity Crowd Funding. If so, why, if not, why?

We submit that amendments should be made to the Corporations Act 2001 (*Cth*) ("**Corporations Act**") to accommodate Equity Crowd Funding. The current corporate fundraising framework is not designed to facilitate Equity Crowd Funding.

At present, the disclosure, licensing and compliance obligations attached to offers of shares are simply too onerous and expensive for the kind of small businesses that would rely on Equity Crowd Funding.

The aim of any law reform should be to develop a balanced regime that provides some protection to investors and encourages confident investment, while at the same time recognising what Equity Crowd Funding investors actually expect and the realities of Equity Crowd Funding which is characterised by low level investment by a large number of investors.

Question 2: Should any such provision:

(i) Take the form of some variation of the small scale offering exemption,

A modified version of the small scale offering exemption contained in section 708(1) of the Corporations Act could be employed as a starting point for accommodating Equity Crowd Funding. While increasing the number of investors permitted under the small scale offer exemption to 100 would help, it would be preferable to have as high a cap as possible on the permitted number of investors, as many responders to applications for crowd funding contribute small sums.

The limitation of the section 708 exemption to personal offers would also need to be amended for it to have application to Equity Crowd Funding.

(ii) Confine Equity Crowd Funding to sophisticated, experienced and professional investors? If so, what, if any change should be made to the test of a sophisticated investor in this context,

Limiting investment in Equity Crowd Funding to sophisticated, experienced investors restricts the scope of Equity Crowd Funding significantly. Projects that seek to raise funds through Crowdfunding

often have different objectives than those that raise substantial amounts from a small number of sophisticated investors.

Confining Equity Crowd Funding to sophisticated investors limits the social and economic utility of Equity Crowd Funding which is used as way for businesses to gauge public support for an idea or enterprise before fully investing in it and for investors to participate in a company in a small way or contribute to ideas they think are worthy or philanthropic.

(iii) Adopt some other approach (such as discussed in Section 7.3, below).

We submit that a variation of the existing small scale offer exemption should be used as a starting point to enable Equity Crowd Funding, however a stand- alone regulatory regime may be another option for accommodating the particular requirements of Equity Crowd Funding while preserving the existing regime for other forms of capital raising. Any new regime must have the effect of reducing compliance costs of for small businesses utilising Equity Crowd Funding.

Question 3: In the Equity Crowd Funding context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) Proprietary Companies

(ii) Public Companies

The existing rules around proprietary and public companies could create difficulties for crowd funding in that issuer companies will be required to comply with the public company reporting rules once the 50 shareholders limit is reached. This is an added expense which may not reflect the equity that would be raised from having additional shareholders.

We suggest consideration be given to whether the rules should be amended to allow greater numbers of shareholders before the public company requirements are triggered.

If this is not practical we consider that issuers could be required to comply with the existing reporting requirements if other costs associated with disclosure and due diligence were managed.

(iii) Managed investment schemes.

While managed investment schemes could be a useful tool the costs of setting up a registered managed investment scheme are prohibitive for a small company seeking funds.

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Question 4: What provision if any, should be made for each of the following matters as they concern Equity Crowd Funding issuers.

(i) Types of issuer

It would be preferable to have no limit to the type of issuer. Restricting the use of Equity Crowd Funding by the type of issuer creates difficulties around defining the different classes of companies eligible. Instead a limit could be placed on the amount of funds that an issuer can raise through Equity Crowd Funding.

(ii) Types of permitted securities

Investors will be able to determine through their own assessment whether a class of shares offered by an issuer fits with their expectations and investment needs. A description of the class of shares submitted in the disclosure documents and a general disclosure statement detailing the generic risks of investment and Equity Crowd Funding will help investors to make informed decisions on whether they wish to subsrcibe for any particular security.

(iii) Maximum funds that an issuer may raise

A maximum limit on funds raised could be modelled around the existing small scale personal offers exemption. In keeping with the existing exemption, issuers could be limited to raising a maximum of $2 million over a 12 month period. This was the limit implemented in the New Zealand Equity Crowd Funding regulatory regime. Alternatively the ASSOB Class Order could be used as a model by caping the amount to be raised in a 12 month period to $5 million.

(iv) Disclosure by the issuer to investors

Small, start-up businesses are unlikely to have sophisticated financial arrangements. We suggest a similar level of disclosure to the United States regime should be followed which requires issuers to submit:

- a description of their business;
- business plans with goals and fundraising targets;
- financial statements if any, certified by either officer of issuer, accountant or auditor depending on amount raised;
- names and descriptions of owners and shareholders with above 20% holding;
- intended use of proceeds including remuneration of owners/directors; and
- information on the securities – class, rights, prices, maybe anti-dilution guarantees etc and resale restrictions.

This disclosure statement would be hosted by the relevant crowd funding intermediary's website for all potential investors to access. Issuers may also wish to require investors to sign up to a shareholders' agreement to include matters such as drag along rights. If so this would need to be provided to investors.

Some argue that disclosure requirements for Equity Crowd Funding should be heavier to reflect the high risk of such investments. In general however, investors would be aware of the risks involved in small business.

A general statement detailing the risks involved in Equity Crowd Funding and in investing generally could be used to warn investors that are not financially sophisticated. This could be made available on the intermediary website.

(v) Controls on the advertising by the issuer

Public advertising is a necessary aspect of the Equity Crowd Funding concept. However advertising of Equity Crowd Funding schemes could be controlled by requiring that issuers only advertise on approved crowd funding intermediary sites which would have a proforma warning on the website as to general risks involved in Equity Crown Funding.

If some form of due diligence or quality control is required, this could perhaps be done by non-platform provider sponsor intermediaries (such as investment bankers, accountants or corporate advisers with relevant financial skills). Issuers could submit the required disclosure documents though such an intermediary before the offer can be advertised.

Existing exemptions should remain available. For example issuers should still able to make select offers to sophisticated investors under section 708 of the Corporations Act outside of and in addition to crowd funding mechanisms.

(vi) Liability of issuers

Issuers of Equity Crowd Funding securities should be subject to the same liability as other issuers under Ch 6D of the Corporations Act for misleading or deceptive statements in an offering document. The standard defence of reasonable inquiry should apply. However it may be necessary to take into account the level of business experience when assessing what is reasonable in the circumstances.

(vii) Ban on secondary market

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As mentioned in the consultation paper, the purpose of crowd sourced funding is to raise funding. However there is no reason given why the securities in Equity Crowd Funding schemes should not be permitted to be on sold at some point. This would allow an investor to realise his or her investment.

Question 5: In the Equity Crowd Funding context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

We submit that intermediaries should be approved by ASIC as crowd funding platforms rather than being required to obtain a financial services or financial market licence. Exemptions from market licencing requirements already exist in cases where the Minister is satisfied that the regulatory costs of complying with a financial market licence substantially outweigh the benefits from regulation. However requiring a ministerial decision could policiticise the process and is likely to be overly onerous.

Obtaining a financial market licence would likewise be too onerous and difficult to obtain for Equity Crowd Funding platform providers despite the flexibility of the Minister's powers on the face of the Corporations Act.

If there is a specific approval mechanism for Equity Crowd Funding intermediaries then changes to the existing licencing requirements are not needed. There is room for the use of independent sponsors to perform limited due diligence. This could be an additional service offered by some intermediaries or it could be a general requirement. The sponsors would need to be covered by appropriate Australia Financial Services licences.

Question 6: What provision, if any, should be made for each of the following matters as they concern Equity Crowd Funding intermediaries

(i) Permitted types of intermediary

(a) Should Equity Crowd Funding intermediaries be required to be registered/licensed in some manner?

Intermediaries providing crowd funding platforms should be approved by ASIC as funding portals for the purpose of Equity Crowd Funding. It is important that there is a neutral responsible body between issuers and investors. Intermediary sponsors could be used to help the company perform its documentation and gain investor interest. These

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sponsors (such as investment banks) may need to have an appropriate form of Australian financial services licence.

(b) What financial, human technology and risk management capabilities should an intermediary have to carry out its role?

We have submitted that crowd funding platforms should not be required to carry out full due diligence investigations into issuers as this would require specialised financial qualifications and extensive costs and resources. It would be more efficient and economic in the circumstances of Equity Crowd Funding to require disclosure from issuers. Requirements regarding financial, human technology and risk management capabilities should therefore be kept to a minimum, maybe proof of solvency and a requirement that the managing staff demonstrate midlevel business experience. Sponsors may require a different type of expertise.

(c) What fair, orderly and transparent processes must the intermediary be required to have for its online platform?

The New Zealand Equity Crowd Funding regulations regarding intermediary platform providers provide a useful model in requiring that intermediaries disclose the processes by which issuers and investors access the service, the processes for matching of issuers and investors to a service fairly, where applicable, the process of handling investment funds and processes and checks to avoid price manipulation.

(d) Should an intermediary be required to have an internal dispute resolution mechanism and be a member of an external dispute body, such as the Financial Services Ombudsman?

A dispute resolution service could be available to investors who have a complaint against Issuers. This could be a third party service. Platform providers are not best placed to take a dispute resolution role.

(ii) Intermediary matters related to issuers: These matters include:

(a) What, if any projects and/or issuers should intermediaries not permit to raise funds through Equity Crowd Funding?

Intermediaries providing crowd funding platforms should not be required to conduct screening or vetting. It may be appropriate to require issuing companies raising money

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to have a licenced sponsor (who might have financial or other relevant experience such as stockbrokers, accountants or corporate advisors). The sponsor could then carry our due diligence investigations. Where preliminary checks by a sponsor indicate that the issuer may be involved in fraudulent or reckless practices eg if the directors have been bankrupt or have been banned or disqualified from directing a company, then the intermediary should refuse to sponsor the issuer. Another approach, perhaps an alternative, would be to permit use of the exemption by a company that has a major sophisticated investor who is not related to the founders who has invested on the same basis as offered on the crowd funding platform.

(b) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management?

A sponsor could undertake preliminary searches on ASIC registers of the issuer's management to ensure that they are not banned or disqualified persons. Sponsors should also make sure financial statements are properly certified as appropriate in light of the amount fo funds raised (see our comments on proposed dislosure).

(c) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers?

It may be too much of a burden to require sponsors of any type to make a judgement on the viability of different issuers. The sponsor should not be liable for any losses due to business mismanagement by the issuer. The disclosure documents required by issuers should provide investors with information to make a determination of the risk and potential reward involved themselves.

(d) To what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites?

Intermediaries should not be held liable for investor losses. Issuers should be liable for misstatements. It would be too much of a burden on intermediaries to be liable for something they could have little control over and for which the issuer should have primary responsibility.

(e) To what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors?

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As above, the issuer should be liable and not the intermediary provider to the crowd funding platform.

(f) What possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how might these situations best be dealt with?

We have described the purpose of the intermediary providing the crowd funding platform as being a neutral portal.

(g) What controls should be placed on issuers having access to funds raised through a Equity Crowd Funding model?

It would be good practice for investors to pledge an amount which will only be transferred to the issuer once a predetermined target investment level is reached. In this way, the investor can be confident that their money will only be committed if the company receives the full funding it indicated was required for the particular project or scheme. The intermediary will either have pre-authorised credit card deductions arranged or hold the monies on trust until the minimum amount necessary to undertake the project for which money is being raised is intended.

(iii) Intermediary matters related to investors:

(a) What, if any screening or vetting should intermediaries conduct on investors?

Intermediaries providing crowd funding platforms should not be required to conduct screening or vetting, however Investors could be required to complete a basic questionnaire relating to the fundamentals of investing in securities and the principles of Equity Crowd Funding. Ultimately it is the responsibility of investors to inform themselves of the merits of making an investment in a crowd funding offer.

(b) What risk and other disclosures should intermediaries be required to make to investors?

Intermediaries providing crowd funding platforms should be required to place a general statement relating to the risks involved in Equity Crowd Funding on their website. This would not contain any advice on specific projects/issuers. Specific disclosures relating to

the financial circumstances of individual issuers should be the responsibility of the issuers.

(c) What measures if any should intermediaries be required to ensure that any investment limits are not breached?

Intermediaries could obtain an agreement from the issuer stating that they will comply with any ceiling on funds raised. Intermediaries providing the crowd funding platform could design software that prevents further subscription after the ceiling is reached.

(d) What controls should be placed on intermediaries offering investment advice to investors?

Intermediaries should be prevented from offering advice to investors unless they hold an Australian Financial Services licence that permits this.

(e) Should controls be placed on intermediaries soliciting transactions on their websites?

Intermediaries providing a crowd funding portal should be able to advertise their website as a crowd funding platform.

(f) What controls should there be on intermediaries holding or managing investor funds?

There will likely be a need for intermediaries providing crowd funding portals to be able to hold funds until the minimum required investment is obtained.

We recommend that investors pledge a certain amount which is either pre-authorised from a credit card or held on trust and transferred to the issuer once a set target is met. If funds are held on trust then intermediaries may be required to complete a basic course on trustee responsibilities.

(g) What facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other?

As suggested in the consultation paper, it may be beneficial for issuers and investors to communicate through discussion forums to obtain more information and the responses would be available on the Crowd Funding website to all users. Intermediaries should not be required to monitor such discussion forums and provision of such forums should not be a mandatory part of providing a crowd funding platform.

(h) What disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary.

An intermediary could be required to provide this information on their website.

(i) What disclosure should be made about the commission and other fees that intermediaries may collect from funds raised.

A simple statement of what fees are taken by the intermediary should be sufficient. This should be disclosed on the website or in the disclosure statement for sponsors.

(j) What, if any additional services should intermediaries provide to enhance investor protection.

Sponsors could take a role working with the company to ensure some level of quality. This would be different from the portal provider intermediary.

Question 7: In the Equity Crowd Funding context, what provision if any, should be made for investors to be made aware of:

(i) The differences between share and debt securities

(ii) The difference between legal and beneficial interests in shares

(iii) Any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

The disclosure statement content which we have recommended should explain these matters to the extent relevant.

Question 8: What provision, if any, should be made for each of the following matters as they concern Equity Crowd Funding investors:

(i) Permitted types of investor

As discussed above, investors could be asked to demonstrate a basic understanding of investing in securities by passing an online test.

(ii) Threshold sophisticated investor involvement (Italy only)

Requiring threshold sophisticated involvement as the only way to access crowd funding seems like an unnecessarily difficult criterion for small start-up enterprises who may not have proceeded fair enough with their project/idea to attract sophisticated investors. Instead there could be a system where funds are only transferred from investors to issuers once a certain trigger funds target has been pledged.

(iii) Maximum funds that each investor can contribute

Regulating the amount a person can invest with Equity Crowd Funding issuers presents difficulties in compliance. If a limit was to be imposed, the most practical and effective measure would be to limit the amount an investor can invest in one issuer over the period of 12 months. Otherwise there would have to be a centralised intermediary system that was able to monitor the number of issuers an investor had invested in and the amount invested. A cap based on a person's income is too difficult for the issuer to verify.

(iv) Risk acknowledgement by the investor

An investor could be required to acknowledge the risks involved in Equity Crowd Funding.

(v) Cooling off rights

An investor should have a standard cooling off period of 10 working days in which he or she can require money to be returned. Investors would be made aware of this right at the time of investment.

(vi) Subsequent withdrawal rights (Italy only)

To extend withdrawal rights beyond a short cooling off period would unnecessarily create uncertainty for issuers. Especially if investors are aiming to achieve a certain target before funds are able to be transferred.

(vii) Resale restrictions

The purpose of crowd sourced funding is to raise funds. However there is no reason why the securities subscribed for should not be allowed to be on-sold at some point. The existing 12 month onsale timing provision could be used to regulate this.

(viii) Ongoing Reporting

Issuers could be required to disclose to investors annually through the intermediary platform or on its own website. Documents required could include financial statements (if a public company), and

comments by the managing director on the company's performance relative to the stated objectives and plans. If the company is a public company the existing reporting requirements will be sufficient.

(ix) Losses

The current legislation provides sufficient recourse for losses related to inadequate disclosure.

(x) Remedies for losses resulting from poor management

Directors are personally liable to the company for breaches of director duties. However business choices made in good faith and which were open to a reasonable person taking reasonable care, should not give rise to a right to recourse by shareholders.

Question 9: Should any accommodation for Equity Crowd Funding in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime?

As discussed above, we submit that incremental adjustments to the existing provisions would potentially be the simplest way to facilitate Equity Crowd Funding. In particular we suggest that the existing small scale offers exemption be expanded to allow for higher numbers of investors. If a stand-alone regime is implemented it would be important that the regime is informed by the principles of the existing regulatory regime.

Question 10: What, if any, other matters which come within the scope of this review might be considered.

N/A

Closing Remarks

We would be happy to meet with you to discuss our views if that could assist.

Yours faithfully,

Alan Crabbe
Director
Pozible Pty Ltd

Rick Chen
Director
Pozible Pty Ltd

Toby Norgate
Director
Clearpoint Counsel Pty Ltd

Joel Cranshaw
Director
Clearpoint Counsel Pty Ltd

Dear John,

Re: Crowd sourced equity funding discussion paper

We welcome the opportunity to make our submission in relation to the crowd sourced equity funding ("**CSEF**") review process currently being undertaken by the Corporations and Markets Advisory Committee ("**CAMAC**"). By way of background, Pennam Partners is a Melbourne-based investment and corporate advisory house with, inter-alia, domestic and cross border mandates assisting firms in different business lifecycles (including with fundraising matter). Pennam Partners is/has been involved in the crowdfunding field. We are currently working with an established offshore CSEF platform intermediary to assess crowdfunding viability in different jurisdictions; we have previously undertaken an Australian survey in relation to crowdfunding; and we maintain a watching brief on crowdfunding developments offshore (for instance Italy).

The review process in Australia is timely given same has been/is being conducted in various offshore jurisdictions. Australia, through the CAMAC review, should be commended for giving serious consideration to a CSEF regime given the likely positive impact a CSEF regime would have on the financing landscape for Australian start-ups and for Australian innovation. As you may be aware, there is comparatively a limited pool of capital allocated to the venture capital asset class in Australia by institutional investors; this can be substantiated by the limited number of Australian-based venture capital funds. As a result, many Australian start-ups fail to source funding locally with a substantial start-up cohort looking at offshore markets to raise funds, which sometimes leads to the start-ups relocating to that offshore market. Secondly, venture capital funds do not generally make investment less than $3 million in an investee firm; this creates a gap at the smaller end of the venture capital funding spectrum. In addition, it is common knowledge that start-ups do not have the appropriate financial profile to seek bank funding given they are generally at pre-revenue stage, are likely to be asset-poor and cannot provide the adequate collateral; venture debt is currently not available in Australia. This means there are reasons other than a flawed business model that impede start-ups from raising the necessary funding they require. The inability to raise capital for a start-up business does not necessarily translate in that start-up being riskier compared to a start-up that managed to snare funding from a venture capital fund or companies that are listed on the Australian Securities Exchange (for instance mining exploration and biotechnology companies).

Many industries, including the financial industry, are being disrupted with the advent of sophisticated online technologies and social media. Disintermediation is starting to occur in the financial industry, which is providing companies with direct access to sources of capital while at the same time providing retail investors access to investment opportunities. For instance peer-to-peer lending is providing retail investors with the opportunity to participate in debt funding opportunities and earning higher interest rate compared to a bank/term deposit. Financial disintermediation is growing at an accelerated rate with the expectation that USD 5.1 bn[1] will be raised through crowdfunding platforms in 2013. However, there is an urgent need to review current regulatory regimes in place (including Australia) to ensure: 1) the regulatory regime caters for both intermediated and disintermediated funding mechanisms; 2) disintermediation does not produce higher and unnecessary investment risk due to a lack of adequate safeguards (e.g. appropriate disclosures and due diligence required); and 3) the compliance cost for the participants in a disintermediated marketplace is not excessive to achieve and maintain a properly regulated marketplace.

A: We have set-out below our views on the matters listed for consideration in the CSEF discussion paper.

1. Option 1: no regulatory change

[1] 2013 CF: The crowdfunding industry report

We are of the view that Option 1 should be discarded. Historically, Australia has a strong corporate regulatory regime with investors' protection being one of the foremost drivers behind such regime. With that in mind, we believe that appropriate regulatory changes can be drafted to accommodate CSEF in the financing landscape. In addition, Australia tends to be proactive with its legal and regulatory regime to keep pace with its counterparts and adjust such regime to address global event(s). For instance, section 254T of the Corporations Law was amended from a profitability test to a net assets test to deal with the aftermath of the global financial crisis.

2. Option 2: liberalising the small scale personal offers exemption from the fundraising provisions

Option 2 is the most preferred option and would allow for an expeditious tailoring of the regulatory regime to accommodate CSEF. We recommend the following:

- The number of investors that can participate per issuance should be increased but such increase should cater for proprietary companies. Proprietary companies will face undue burden if the investor threshold is raised to over 50 investors given they will have to convert to an unlisted public company prior to launching the CSEF campaign and at that particular stage they will not know whether they are going to exceed the 50 non-employee shareholders threshold. On that basis, we propose the following:

    - For a proprietary company undertaking a CSEF campaign, the total investors post the CSEF capital raising should be capped at 50 non-employee shareholders. This means the amount of investors that can participate in a CSEF raise will vary on a case by case basis and will depend on the existing non-employee shareholders a proprietary company has at the time of starting the CSEF campaign; and

    - In the case of a public company, the total investors that can participate should be capped at 100 investors. This gives some flexibility and allows a proprietary company to convert to an unlisted public company if they think they should be raising from a bigger pool of investors but also provides them with the opportunity to use CSEF for subsequent capital raising if they have already raised funding via CSEF in the form of a proprietary company;

- As it is currently the case with the 20/12/2 offer, sophisticated, professional and foreign investors should not be included in the investor threshold cap for a CSEF offer. That is, participation by sophisticated, professional and/or foreign investors should not deplete the cap but would be in addition to the investor threshold cap;

- The investment size per CSEF offer should be increased to $3 million. This will truly provide start-ups with an alternative fundraising conduit and may even create pressure for (foreign) venture capital funds looking into Australian inbound investments to revise their minimum investment outlay to compete for deal flows. Whilst the aim of CSEF is to raise funding from a large pool of investors with each contributing small amount of money, practically it is highly likely that sophisticated and/or professional investors will participate in a CSEF offer and will make comparatively significant investments. This should be taken into consideration when determining whether to increase the CSEF investment offer size;

- Consideration should be given to codifying ASIC Class Order 02/273 into the Corporations Act to provide certainty for CSEF intermediaries;

- CSEF intermediaries should explicitly be excluded from the requirement to hold an Australian Market Licence ("**AML**") to operate a CSEF platform. If there is a need to hold an AML to operate a CSEF platform, this will place undue pecuniary and compliance burden onto the CSEF intermediaries. This will invariably translate into higher cost for the CSEF intermediaries, which will ultimately be passed on to the issuers.

  However, to ensure CSEF intermediaries have the appropriate expertise, resources and can be held accountable, CSEF intermediaries should hold an Australian Financial Services Licence ("**AFSL**").

Operating via an AFSL will limit the amount of CSEF intermediaries and will, in theory, maintain an adequate level of competency; and

- It would be worthwhile to liaise with the Australian Investments and Securities Commission ("**ASIC**") in relation to the 20/12/2 offer (if the CAMAC has not already done so). ASIC can provide insights about the 20/12/2 offer, fraudulent offers registered and the amount of complaints. This should provide a fair idea on whether the 20/12/2 offer is the most appropriate platform to use for implementing a CSEF regime in Australia.

3. Option 3: Confining CSEF exemptions to offers to sophisticated, experienced or professional investors

We fail to see the merit in Option 3. Offers to sophisticated, experienced or professional investors already benefit from various carve-outs in relation to solicitation and provision of disclosure document, and confining CSEF offers to this group of investors will severely restrain the operation of a CSEF platform.

We opine that the test for sophisticated investors is adequate and none of the thresholds of the test should be lowered. Any modification will potentially have broader impact i.e. not only on CSEF related matters but also for other kind of investments.

4. Options 4 and 5

As aforementioned, any 'cherry picking' approaches should use the 20/12/2 offer regime as the starting point and build upon that regime to implement a CSEF regime. If a separate and new regime is considered to be the most appropriate option, then the CAMAC should consider the following:

- The CSEF regime should be limited to unlisted public companies;

- This will ensure a heightened oversight mechanism of the issuer with at least 3 directors sitting on the board and shareholders can benefit from additional protection under the Corporations Act;

- At the risk of stating the obvious, a CSEF issuer can use only one CSEF intermediary to raise funding during a CSEF campaign;

- Irrespective of whether a company is a public company or a proprietary company, if it is a CSEF issuer it will, mandatorily or willingly, be subject to comprehensive ongoing disclosure and auditing (or a process akin to auditing). This means the additional cost from an ongoing information disclosure and auditing/review process perspectives for using a public company will be minimal;

- To make the process cost-effective, a new disclosure document regime should be devised. A prospectus-lite regime should be developed and consideration should be given to offer information statement and how this can be tailored for smaller public capital raisings;

- Consideration should be given to the accounting reporting requirements and the requirements under the Australian Accounting Standards. The Australian Accounting Standard Board can be of assistance in clarifying whether CSEF issuers would be subject to reduced accounting disclosure requirements; and

- Consideration should be given to whether CSEF should be limited to start-ups only. The CAMAC should consider the outcomes of the employee share schemes and start-up companies consultation and whether recommendation has been made to define the term 'start-up'. The other alternative is to make sure that CSEF issuers do not carry on 'ineligible activities'. The term 'ineligible activities' can mirror the ones in the venture capital limited partnership and the early stage venture capital limited partnership regimes.

B: We have also addressed some of the queries that the CAMAC has raised in the discussion paper:

- **Q3 (iii):** It is our view that a CSEF model operating under a managed investment scheme will commercially not be feasible in Australia. We are aware of back to back arrangements undertaken overseas (such as Solar Mosaic, Funders Club and Angel List). Such arrangements would fall either under the managed investment scheme regime or the debenture regime in Australia. However, the requirement for a responsible entity or a debenture trustee (and the regulatory onus placed on these parties) to operate such arrangement will significantly impede the use of CSEF in Australia. From our experience, these arrangements are costly and as opposed to a company, the costs are recurring year in and year out.

- **Q4 (i):** Refer to the above.

- **Q4 (ii):** If a proprietary company is the issuer, then the CSEF issuer should have on issue only one class of securities for all of its shareholders. A public company should be able to have different classes of securities.

- **Q4 (iii):** There should be a ceiling of $3 million and that ceiling should not take into consideration sophisticated, professional and foreign investors but would include the small scale personal offers. Arguably, the small scale personal offers should be broadened to cater for CSEF offer and effectively making it one and only regime.

- **Q4 (iv):** Issuers should provide periodic reporting to investors in the form of year-end financial reporting together with continuous disclosure for material events. The continuous disclosure should be done electronically and can be done via a third party or through the CSEF platform.

- **Q4 (v):** Advertising should predominantly be done through the CSEF platform (and to its subscribers) with the issuer only able to communicate with its existing network only (similar to the 20/12/2 offer) outside of the CSEF platform.

- **Q4 (vi):** The existing laws (including defence) are adequate.

- **Q4 (vii):** Unless the CSEF intermediary is operating via an AML, electronic on-selling of existing securities or operating a secondary market should be banned. However, the CSEF intermediary should be able to operate a securities 'match-making' service to match buyers and sellers of companies that listed on that particular CSEF platform.

- **Q5:** CSEF intermediaries should operate via an AFSL and should be excluded from the requirement to hold an AML. Given funds will be held on trust (potentially by a third party), the financial capacity of the CSEF intermediary should not be of the upmost importance.

- **Q6 (i):** It is important to place some barriers to entry for CSEF intermediaries ensuring that CSEF does not get flooded with 'fly-by-night' intermediaries. However, undue burden should not be placed on CSEF intermediaries to make CSEF an unviable operation.

- **Q6 (ii):**

  a) This would depend on whether CSEF is limited to 'start-ups' only (term yet to be defined) or limited to companies not carrying on 'ineligible activities' (term yet to be defined);

  b) The due diligence undertaken by intermediaries should be limited to preliminary due diligence. The CSEF platform is not a market and therefore should not be carrying ongoing surveillance on past CSEF issuers unless they are providing a platform for continuous information disclosure to investors. A

process akin to Know Your Customer process should be designed and implemented by CSEF intermediaries, which would include at a minimum review of ASIC company extract, credit report, personal checks on directors, getting issuer to provide legal sign-off to ensure offer document is legally compliant and accountant sign-off for financial information included, and solvency statement by the directors of the issuer;

c) This onus should fall on investors;

d) To the extent that CSEF intermediaries have used their best endeavours to carry out due diligence on information provided, CSEF intermediaries should not be liable for investor losses resulting from misleading statements published on their websites;

e) To the extent that CSEF intermediaries have used their best endeavours to carry out due diligence on issuers, CSEF intermediaries should not be liable for fraudulent activities;

f) A CSEF intermediary should not have any financial interest in a CSEF issuer. All fees (including application fee and capital raising fee) should be disclosed in the offer document; and

g) Irrespective of whether it is an 'all or nothing' or 'keeping it all' CSEF campaign, issuers should only get access to the funds when the CSEF campaign period has ended and subsequent to the proposed cooling off period being over.

- **Q6 (iii):**

a) CSEF intermediaries should get evidence from subscribers of the CSEF platform about their investor status i.e. if they are sophisticated, professional or foreign investors. Otherwise, the investor will be considered as a retail investor (i.e. not sophisticated, not professional and not foreign investors);

b) Similar risk and disclosures contained in ASIC Class Order 02/273;

c) Any amount in excess of the (yet to be determined) investment threshold per CSEF issuance should be returned to the investors. This can be achieved given the funds will be placed on trust. We are of the view that there should be no investment threshold per investor but rather this should only be per CSEF issuer;

d) CSEF intermediaries should not provide any investment advice and this should be prominently displayed on the CSEF platform. In addition, CSEF intermediary should not participate in discussions on the CSEF platform except as a facilitator and moderator;

e) No;

f) CSEF intermediaries should not control or manage investor funds. It is recommended that a third party be used to operate the trust account;

g) As part of a CSEF campaign, a Q&A facility should be provided for the issuer and the potential investors. The Q&A facility can be accessed by all subscribers of the CSEF platform and the subscribers will have the option of corresponding privately or publicly with the issuer;

h) Complaint procedures and liability insurance should be disclosed in the financial services guide (on the proviso the CSEF intermediaries need to hold an AFSL). The financial services guide will be provided at the time of subscribing to the CSEF platform and also will be made available on the CSEF platform itself;

i) Disclosure on commission and other fees should be made in the offer document; and

j) CSEF intermediaries can operate an ongoing online disclosure facility where previous CSEF issuers can upload material and/or periodic disclosures for investors to have access to.

- **Q7 (iii):** Where a CSEF issuer is allowed to issue equity under different classes of shares, the CSEF issuer should disclose the rationale for the adoption different classes of shares and the implications of subscribing to the different classes of shares. Our view is that if a proprietary company is allowed to raise capital using CSEF, then the proprietary company should have one class of shares only.

- **Q8 (i):** No limitation should apply.

- **Q8 (ii):** No minimum threshold for sophisticated investor participation should apply. However, we note practically it is likely that there would be sophisticated investor that would participate in some of the CSEF issuances.

- **Q8 (iii):** No cap per investor should apply. Issuer linked caps and investor linked caps will be hard to monitor and police in practice.

- **Q8 (iv):** Yes, at the time of making an investment in a CSEF issuer.

- **Q8 (v):** Yes.

- **Q8 (vi):** No.

- **Q8 (vii):** No, resale restrictions should apply to founders and directors only.

- **Q8 (viii):** Financial reporting, material disclosures and solvency statement should be made by CSEF issuers.

- **Q8 (ix):** This would depend on which party contributed to the inadequate disclosure (for instance directors, lawyer and/or accountant).

- **Q8 (x):** This is part of the investment risk and there are existing remedies that may or may not be available (for instance directors' duties).

- **Q9:** Initially, this should be in the form of incremental adjustments to the existing provisions as aforementioned. This should allow for an expeditious implementation of a CSEF regime in Australia.

- **Q10:** Privacy policy (e.g. data security) and AASB-related matters should be considered concurrently but this would be outside of CAMAC's terms of reference.

If you want to discuss the contents herein or have any query, please contact me on 03 8635 1987 or via email on yanese@pennampartners.com. I look forward to continuing this discussion.

Yours sincerely

Yanese Chellapen
Director
Pennam Partners

[ELECTRONIC SUBMISSION]

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Dear Sir

Submission in relation to CAMAC's Discussion Paper on Crowd Sourced Equity Funding (September 2013)

I refer to the Corporations and Markets Advisory Committee (**CAMAC**)'s discussion paper on crowd sourced equity funding (**CSEF**) dated September 2013 (**Discussion Paper**).

Introduction

1. "Crowd sourced funding" has received extensive media coverage as a new, fashionable, cheap and easy method of raising funds for various causes and projects. However CSEFs should not be mistaken with other forms of crowd sourced funding such as, crowd sourced donation funding.

2. A recently publicised example of a crowd sourced funding platform which is not CSEF is kickstarter.com which featured in an article in The Australian Financial Review on 16 October 2013. The primary participants in Kickstarter are: the entity looking for funding who pitches their project on the Kickstarter platform (**Project Operator**); the person who invests into various projects (**Investor**); and Kickstarter which manages the platform and interaction between the Investor and the Project Operator. The Project Operator may provide the Investor with a (non-financial product) gift if their project is successful - no equity is issued or transferred to the investor.

3. The main participants in a CSEF are: the issuer of the equities or promoter of the scheme requiring funds (**Issuer**); the CSEF platform provider/operator (**Intermediary**); and the potential Investors.

4. The Discussion Paper identifies various approaches in relation to the Issuers, Intermediaries and Investors that have been or are being considered in various jurisdictions to protect the integrity of equity markets and retail Investors[1] by imposing various restrictions and obligations the main participants in CSEFs.

My Submissions

5. While Australia does not have specific CSEF regulation, the current Australian financial products and fundraising regulatory framework (**Australian Framework**) contains restraints which apply to activities such as CSEF which are similar to the restraints which the United States of America, Canada, Italy the United Kingdom and/or New Zealand are implementing or propose to implement in their respective jurisdictions.

[1] The test for whether an Investor is deemed a retail Investor varies from country to country. In Australia, broadly speaking, a **retail Investor** is an Investor who is not a **wholesale Investor**, that is, an Investor: (a) in relation to equity offers, where the minimum investment of $500,000; (b) whose investment is in relation to a business that has 20 or more employees or if it is in manufacturing 100 or more employees; (c) is certified by an accountant has having net assets of at least $2.5 million or gross income for each of the last 2 financial years of at least $250,000; (d) is a professional Investor (eg. has an AFS licence, is regulated by the Australian Prudential Regulation Authority, has or controls at least $10 million worth of assets; is a trustee of a superannuation fund with at least $10million of assets or is a listed entity); or (e) is a sophisticated Investor (ie. there are reasonable grounds to believe that the Investor has relevant experience in, knowledge and understanding of offers and investments of the kind contemplated and the Investor has provided the Issuer a certificate prior to the issue of equity of the same).

6. Investor restraints:

(a) The Australian Framework includes a cap on the value of investment per Issuer per year by way of its exemption from:

(i) managed investment scheme[2] (**MIS**) registration; and

(ii) the requirement to issue prescribed regulated disclosure documents, (such as prospectuses and product disclosure statements) for public offers of equity to retail Investors (**Current Regulated Disclosure**),

where the offer is a Small Scale Offer (this is, in summary, an offer to raise no more than $2 million and from no more than 20 retail Investors in any 12 month period). This limits the quantity of Investors which may be affected by a failed or fraudulent CSEF activity to $2 million and 20 retail Investors.

(b) The Discussion Paper suggests that the Small Scale Offer exemption may need to be reviewed and modified as a method of dealing with CSEF.

(i) The existence and implementation of the Small Scale Offer exception since 2001 suggests that the Australian financial industry and Parliament alike have agreed that public offers of equity to a limited number of retail Investors should be allowed without:

(A) regulated disclosure documents; or

(B) the Issuer being a public company or registered MIS (and therefore not subject to the reporting and other obligations imposed on public companies or registered MISs).

(ii) Furthermore, proprietary companies (which may, depending on its size, not be subject to the reporting and other obligations imposed on public company or registered MISs) are allowed to raise funds through the (non-public) issue of equity to up to 50 non-employee shareholders.

(iii) Given the above, increasing the cap on Investors through a Small Scale Offer from 20 retail Investors to, say, 50 retail Investors (together with other Investor protection measures and a reduction of red tape and compliance costs to Intermediaries) would be in line with the principles embodied in the Australian Framework and a step in the right direction for capital markets.

(c) The Australian Framework also includes a cap on the value of investment in all Issuers by Investors based on the Investor's wealth in the form of the exemption from Current Regulated Disclosure for offers to wholesale Investors.

(i) This wholesale Investor exemption is intended to ensure that those who may invest alternate funding arrangements such as CSEF (outside of Current Regulated Disclosure) have the experience, skill and/or wealth to engage advisors to properly assess their investments and/or sufficient wealth to be able to bear potential losses.

(ii) However satisfying the wholesale Investor test (eg earning more than $250,000 per annum in each of the last two financial years or agreeing to invest a minimum of $500,000 in any one Issuer) is a poor indicator of the individual's understanding or investment skills. It is my view that a knowledge based test (in particular regarding risk) would be a better

[2] A 'managed investment scheme' (**MIS**) is defined in the Corporations Act as a scheme whereby people contribute to acquire interest in (actual, prospective or contingent) benefits produced by the scheme, the contributions are pooled to produce benefits for the people and the members of the scheme do not have day to day control of the operation of the scheme or a time-sharing scheme. The Corporations Act also provides limited exceptions to this definition. Under the Act, unless certain conditions are satisfied, a MIS must be registered.

indicator of an Investor's ability to assess CSEF investment offers and a more egalitarian approach to who is given access to potential investments.

(iii) I suggest the following as additional or supplementary requirements for exemption from the Current Regulated Disclosure:

(A) Investors in CSEF must pass a CSEF investment risk knowledge test (as in the USA and Canada) in addition to satisfying the order conditions of the Small Scale Offer exemption; or

(B) as an entirely new exemption category from Current Regulated Disclosure, the Investor must pass (every 24 months that the Investor invests through the CSEF platform):

(I) a comprehensive online CSEF general knowledge test (generated by the Intermediary and audited by the Australian Securities Investment Commission (**ASIC**)) in order to be granted access to CSEF offers; and

(II) a CSEF offer specific online test based on the investment facts and other terms of the relevant CSEF offer generated by the Intermediary from input by the Issuer; and

(C) Investors must hold the CSEF equity for a minimum period to discourage speculative investment.

7. Issuer restraints:

(a) Under the Australian Framework if an Issuer offers to more than 20 retail Investors (that is offers to wholesale Investors and those not exempt under the Small Scale Offers exemption) the Issuer:

(i) must be a registered MIS or public company and thereby regulated and monitored by ASIC as such.

(ii) must provide detailed prescribed disclosure documents to potential Investors which sets out important information and relevant information in relation to offer.

Furthermore, the Issuer, as a public company or a registered MIS, would be required to prepare and lodge audited financial reports annually with ASIC.

(b) Under the Australian Framework regardless of what facility or technology is employed to raise equity:

(i) an Issuer will be liable for any misstatements or fraud it was responsible for;

(ii) Investors will be entitled to pursue remedy for damages against the Issuer in relation to such misstatements or fraud; and

(iii) ASIC my take action against the Issuer and/or its directors for any breaches of the Corporations Act (eg fraud, negligence of the directors or breach of other obligations, such as reporting obligations, under the *Corporations Act* 2001 (Cth)).

(c) Given the public nature of CSEF offers, the Issuer should also be required to disclose online:

(i) in a short form disclosure statement (similar to the simple managed investment scheme's 8 page Short Form Product Disclosure Statement),

prescribed information about: its finances; its business plan; its equity structure; the target and deadline to achieve the financials; its ownership structure; and its management at the time of listing on the CSEF platform;

(ii) any changes to occurrence to any circumstances salient to the information contained the Information Memorandum; and

(iii) updates and annual reports on the matters contained in the Information Memorandum.

8. Intermediary restraints:

(a) Under the Australian Framework any financial product market operator, regardless of the facility in which the market is operated or to whom the market is targeted to, will require licensing in Australia.

(b) Given the broad definitions under the Corporations Act with respect to the Australian Market Licence (**AML**), an Intermediary will need to apply for and hold an AML to operate the CSEF. There is no need to create a new registration or authorisation regime for Intermediaries as ASIC may impose CSEF specific conditions n the AML licensees who intend to operate CSEF.

(c) Given the rigorous pre-requisites to be issued with an AML, there is no need to restrict Intermediaries of CSEFs to financial institutions as required in Italy.

9. The UK's approach of CSEF funds being held by a custodian and released to the Issuer only if the target has been reached (within the deadline) should be followed in Australia.

Conclusion

10. In order for Australian entities to benefit from CSEF as a low cost alternate funding method for start up businesses in Australia:

(a) the existing effective crowd cap of 20 retail Investors should be expanded by a knowledge based test exemption together with or standing alone from an expanded Small Scale Offer exemption;

(b) Intermediaries should still be required to be licensed as market operators but the process, prerequisites and licence conditions should be made quicker, cheaper and more relaxed so as to lower barriers to listing on the Intermediary's platform and funding for the Issuer; and

(c) certain CSEF industry specific safeguards should be put in place to protect Investors (such as, short form disclosure requirements for Issuers and the requirement on Investors to hold CSEF investments for at least one year).

11. My above suggestions attempts to balance retail Investor protections against the encouragement of small/medium businesses and the CSEF industry. These suggestions should, to the extent possible, be incorporated in:

(a) the existing provisions of the Corporations Act and existing regulations and exemptions; and/or

(b) new class orders,

as this would likely be cheaper and more easily understood by the existing financial and private equity industry and stakeholders.

12. However even if no change is made to the existing Australian Framework, non-equity based crowd funding may still be utilised as a method of raising funds for innovation and

new business start ups (like Kickstarter.com) and traditional methods is likely to continue to dominate as the preferred method of raising larger funds.

13. For example, non-equity based crowd funding would allow Issuers to obtain funds from a wider crowd (it would not be limited by any restriction on numbers of shareholders or investors under equity fund raising provisions of the Corporations Act). Crowd sourced debt funding (as opposed to equity) would provide the Investors with priority to the proceeds of the business before distribution to equity holders and avoid any impediment or delays in the business operations that may otherwise arise from a diverse and diluted equity holding.

14. Given the:

    (a) high risk nature of retail Investors investing in new start up business without a prospectus, product disclosure statement or audited financials, and

    (b) more intrusive nature of raising funds through issuing equity,

    it may be more suitable for such business projects to raise funds through non-financial product means until they grow to a sufficient commercial standing that it can raise funds the more traditional way (i.e., through banks, private equity, angel Investors or through the existing regulated public offers regime).

If you have any queries about this personal submission please do not hesitate to contact me.

Yours faithfully,

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Crowd sourced equity funding

ASX is pleased to make a submission to the Committee's inquiry into crowd sourced equity funding (CSEF).

A range of studies over the years have concluded that many small and early stage start-up companies in Australia struggle to access the capital needed to enable them to develop and commercialise their ideas. This is a significant impediment to innovation industries in Australia.

Many of these companies are at a stage of development where they find it difficult to access bank financing and tap capital markets for debt and equity finance. While the venture capital sector (including angel investors) often fills this financing gap in other countries, this aspect of Australia's capital markets is less well developed.

This 'market failure' has prompted the Government to consider and implement a range of tax and other incentives to promote these industries. The results of those policy interventions have been mixed.

Encouraging new avenues for funding these innovative industries, which often have relatively modest capital needs, offers the prospect of facilitating a range of emerging technologies. If this initial funding yields positive results then the companies that gain traction in the market may also eventually graduate to public markets as their need to raise more substantial sums of capital increases.

Crowd sourced funding is still an emerging funding mechanism which, as the Committee's paper noted, has focused to date on raising small amounts of capital motivated more by philanthropic rationales than by prospective financial gains. As these funding mechanisms mature and move more into equity type investments, the role of the prospect of financial returns in driving the supply of funds from investors will increase. It is not clear how many potential issuers may be attracted to using crowd sourced finance.

The ability of CSEF to play a role in providing capital for early stage start-up companies and innovative industries in Australia will be driven by a combination of the:

- size and nature of the potential investor pool for making investments through such portals; and
- regulatory requirements for capital raising.

ASX acknowledges that the capital raising provisions of the Corporations Act were designed for more substantive capital raising activities and that the compliance costs associated with those requirements may be prohibitive for very small capital raisings through crowd funding portals. The Corporations Act provisions have a proper focus on providing an appropriate level of investor protection when issuers are seeking to raise capital given the risk associated with those investments. Striking a balance between investor protection concerns and encouraging a capital raising regime that can facilitate new, innovative funding mechanisms is an appropriate matter for the Government/ASIC to consider.

In the immediate future, developing a new self-contained statutory and compliance structure for such funding would not seem justified. However, in the longer term and as this form of capital raising becomes more widely

used globally and locally, it will be important for Australia to put in place the appropriate statutory and compliance regime.

ASX also does not believe that offers under any CSEF arrangement should be restricted only to 'sophisticated' investors as this would appear to reduce the potential benefits that might be achieved by tapping non-traditional investors who may be attracted both to the types of issuers seeking to raise capital.

ASX is of the view that there is merit in considering measures that would provide relief for this type of fundraising activity – so long as such relief is effectively targeted and not allowed to undermine the broader fund raising provisions but reflects the nature of CSEF, that is, a large number of very small individual investments.

The paper notes that in other jurisdictions, where a policy decision has been made to support such targeted assistance, this has usually been accompanied by specific funding limitations to ring-fence the regulatory relief. For example, by limiting the total amount that a company could raise annually through such means.

This appears to be a sensible approach and one that could be adopted in Australia, requiring only relatively limited modifications to existing Corporations Act arrangements.

The option raised in the paper of liberalising the small scale personal offer exemption would appear to be an effective policy response. That is, increasing the number of investors may facilitate the sort of CSEF envisaged without undermining the general capital raising rules.

However, more careful consideration would need to be given to what may constitute a reasonable maximum funding limit that could be raised by an issuer under this relief. ASX notes that the existing maximum amount ($2 million) allowed under the small scale exemption is not out of line with the approach taken in other jurisdictions that have specifically examined CSEF. That is, the US JOBS Act limits the proposed relief to an annual $US1m and recent NZ legislation limits it to $NZ2m.

It is also important that CSEF is subject to disclosure obligations which appropriately balance the needs of issuers and provide for informed investment decisions by investors. To help facilitate CSEF becoming a viable form of capital raising, it will be important to ensure the that the disclosure obligations are no unduly burdensome and do not discourage participation from issuers.

The intermediaries that provide the platform between the issuers and the investors should be subject to an appropriate licensing arrangement to provide some minimum standard of protection to those issuers and investors participating in the marketplace. For example, it makes sense that there should also be some more generic disclosure of the risks of such funding mechanisms provided by the operator of the web portal.

The question of whether the licensing of an intermediary should be under an Australian Market Licence or an Australian Financial Services Licence, or even the creation of a new licence category (eg the US approach of a specialised licenced 'Funding Portal') is difficult to answer without knowledge of the precise nature of the services the operator is providing. The role the operators play in the intermediation of investors and issuers should determine what type of license they have and the regulatory obligations the operator should meet.

There are a number of overseas jurisdictions, where CSEF arrangements are more advanced, and where regulators are also looking closely at many of the questions raised in the CAMAC discussion paper. Australia should seek to learn from their experiences.

ASX would be happy to meet with CAMAC to discuss in more detail our perspectives on capital raising issues confronting companies in the micro-cap market segment of the market and particularly those in the early stage start-up stage and innovative industries.

If you would like to discuss our submission or arrange a meeting please contact: Gary Hobourn, Senior Economic Analyst, Regulatory and Public Policy (02 9227 0930 or gary.hobourn@asx.com.au)

Yours sincerely

Diane Lewis
Senior Manager, Regulatory and Public Policy

CROWD-SOURCED EQUITY FUNDING

CONSULTATION SUBMISSION NOVEMBER 2013

EMMA TOMKINSON

I make this submission both as an investor and as someone who has been involved in developing impact/social investment markets. I have previously worked on impact investment policy and product development with State Government in Australia (NSW) and the UK Government. The emerging global impact investment market is receiving significant attention worldwide. Impact investment includes crowd-sourced equity funding (CSEF) for organisations or projects to achieve social, cultural and/or environmental benefit. DEEWR published a report on impact investing called *IMPACT - Australia* in 2013, saying "the distinguishing feature of impact investing is the intention to achieve both a positive social, cultural and/or environmental benefit *and* some measure of financial return" (p. 2).

I personally invest in both impact and commercial investments, but would like it to be easier for me to invest a greater proportion of my portfolio in a larger number of impact investments. CSEF would allow me to use an efficient platform to invest small amounts in a diverse range of innovative social and environmental projects and organisations. I am currently unable to do this in Australia. Impact investment did not exist at the time of drafting current corporations legislation, so the legislation creates unintended barriers to these new forms of investment. These barriers must be examined and only kept in place if they are proportionate and necessary.

The recent growth in crowd funding is not only a response to the tightening of credit requirements since the global financial crisis (as suggested on page 10 of the discussion document), it is also part of a movement of democratising processes that have been traditionally controlled by intermediaries or middlemen and which have enabled concerned individuals to participate in a small way in impact investment. To some extent this trend has been fuelled by the internet and smartphone technology, but it is also a reaction to the failure of traditional financial and economic systems to foster innovation and thus meet the evolving needs of individuals and communities.

There is much in the discussion document about safeguarding investors from the risks of investment. It must also be recognised that there are benefits to investors in high-risk products that should be more widely accessible, particularly to those who wish to invest significantly smaller amounts. CSEF allows small investments to be aggregated, encouraging diverse portfolios and participation by a wider range of investors. I would like the CSEF review to result in regulatory changes that widen the retail investor base for impact investment. This would provide a larger community of support for innovation and foster both financial and social inclusion.

I restrict my response to those questions I can answer with confidence based on my experiences.

QUESTION 1 IN PRINCIPLE, SHOULD ANY PROVISION BE MADE IN THE CORPORATIONS LEGISLATION TO ACCOMMODATE OR FACILITATE CSEF. IF SO, WHY, IF NOT, WHY?

Yes, provision should be made in the corporations legislation to accommodate and facilitate CSEF.

Current corporations legislation creates barriers for CSEF that mean equity and debt cannot be raised by many small, innovative organisations that could benefit from this type of finance.

Crowd-sourced equity funding makes investment accessible to a wider range of investors and investees. It enables investment in innovative, high-risk projects and organisations by reducing the financial and impact risk by involving a much larger number of investors. Traditional finance products often manage risk by

requiring a 'track record' of similar activity, making it very difficult for innovative projects and organisations to get funded. Additionally, the regulatory burden for an organisation to offer financial products to retail investors is prohibitively high.

There is understandable reluctance and legislation against making complex investment products open to individual, retail investors. But the safeguards are not always logical:

- Anyone can give as much as they like to any charity (or in fact any person or organisation) that will accept their donation. There is no requirement for charities to check the annual income of the person donating or their understanding of the programs they are donating to. And yet if there is even the slightest suggestion that givers of funds may get this money back, it becomes an investment and they are immediately subject to heavy regulatory barriers.

- To safeguard investors from making an investment mistake, we often confine offers to sophisticated, experienced or professional investors and put a minimum investment threshold in place. So an investor is not allowed to risk $100, but they are allowed to risk $100,000. A maximum amount for high-risk investments would make more sense than a minimum, when deciding where regulations can be lifted or lightened.

- Commercial investors find Social Impact Bonds "a difficult investment because it is a small, illiquid product with no credit rating" (Australian Financial Review, 5 October 2013). They understand the way a certain number of products in the market work and to them a SIB is new and different. But to the average person on the street, all investments are to some extent a minefield. Most people will never read all the fine print, but will learn new products and systems as they go. Very few who enter into a mortgage understand all the terms and conditions – a fact exploited and revealed in the sub-prime mortgage collapse of 2008. CSEF which features a cap on the amount invested for instance would allow more investors to engage with more projects. In my experience, retail investors often find products like SIBs less alien and confronting than finance professionals.

QUESTION 2 SHOULD ANY SUCH PROVISION:

(I) TAKE THE FORM OF SOME VARIATION OF THE SMALL SCALE OFFERING EXEMPTION AND/OR

(II) CONFINE CSEF TO SOPHISTICATED, EXPERIENCED AND PROFESSIONAL INVESTORS? IF SO, WHAT, IF ANY, CHANGE SHOULD BE MADE TO THE TEST OF A SOPHISTICATED INVESTOR IN THIS CONTEXT, OR

(III) ADOPT SOME OTHER APPROACH (SUCH AS DISCUSSED IN SECTION 7.3, BELOW).

Depending on the changes made, option 2 (liberalising the small scale personal offers exemption from the fundraising provisions), option 4 (making targeted amendments to the existing regulatory structure for CSEF open to all investors) and option 5 (creating a self-contained statutory and compliance structure for CSEF open to all investors) in the discussion paper could result in the same set of CSEF regulations.

The desirable result would be that organisations could raise equity and debt through CSEF platforms in line with regulations that were proportionate to the offer and investment size. The current regulatory barrier is too high and thus prohibitive.

(i) A variation to the small scale offering exemption should entail (a) lifting the ban on advertising, (b) removing the shareholder cap and (c) delimiting the number of investors that may invest annually. (b) and (c) will decrease the risk apportioned to any one investor/shareholder by increasing the number of investors. To manage risk, these changes could be accompanied by

limiting the amount which an investor could invest in any one CSEF in a 12 month period thus limiting the potential individual loss.

(ii) Confining CSEF to sophisticated, experienced and professional investors limits the ability of retail investors to participate in investments that could be highly beneficial to them and their communities. This is not acceptable.

(iii) Some other approach may be appropriate, but that would be determined by its detail and effect on the ground. The intention of many policy reforms is lost through implementation, so there is a risk that a more restrictive or inappropriate system is designed.

QUESTION 8 WHAT PROVISION, IF ANY, SHOULD BE MADE FOR EACH OF THE FOLLOWING MATTERS AS THEY CONCERN CSEF INVESTORS:

(I) **PERMITTED TYPES OF INVESTOR:** SHOULD THERE BE ANY LIMITATIONS ON WHO MAY BE A CSEF INVESTOR

(II) **THRESHOLD SOPHISTICATED INVESTOR INVOLVEMENT (ITALY ONLY):** SHOULD THERE BE A REQUIREMENT THAT SOPHISTICATED INVESTORS HOLD AT LEAST A CERTAIN THRESHOLD INTEREST IN AN ENTERPRISE BEFORE IT CAN MAKE CSEF OFFERS TO OTHER INVESTORS

(III) **MAXIMUM FUNDS THAT EACH INVESTOR CAN CONTRIBUTE:** SHOULD THERE BE SOME FORM OF CAP ON THE FUNDS THAT AN INVESTOR CAN INVEST. IN THIS CONTEXT, THERE ARE A NUMBER OF POSSIBLE APPROACHES UNDER *ISSUER LINKED CAPS* AND UNDER *INVESTOR LINKED CAPS*

(IV) **RISK ACKNOWLEDGEMENT BY THE INVESTOR:** SHOULD AN INVESTOR BE REQUIRED TO ACKNOWLEDGE THE RISKS INVOLVED IN CSEF

(V) **COOLING OFF RIGHTS:** SHOULD AN INVESTOR HAVE SOME RIGHT OF WITHDRAWAL AFTER ACCEPTING A CSEF OFFER

(VI) **SUBSEQUENT WITHDRAWAL RIGHTS (ITALY ONLY):** SHOULD AN INVESTOR HAVE SOME FURTHER WITHDRAWAL RIGHT SUBSEQUENT TO THE OFFER

(i) No. It's not a good crowd if someone's not allowed to join it.

(ii) No. Sophisticated investors are not necessarily suitable investors for all CSEF offers. The essence of a CSEF is that it appeals to the non-sophisticated investor.

(iii) Perhaps this could be used as a trade-off for some other requirement or to encourage disclosure, while allowing very new organisations to participate e.g. if financial statements are not available, then the organisation can only raise a maximum of $1000 from each investor.

(iv) Yes, the investor should acknowledge that they accept the risk as long as it wasn't a deterrent – ticking the box to acknowledge something like this from Abundance Generation could be suitable: "As with any investment product there are risks. Part or all of your original invested capital may be at risk and any return on your investment depends on the success of the project invested in."

(v) One week would be appropriate.

(vi) No – this creates instability for the organisation raising funds.

Submission to

Corporations and Markets Advisory Committee

On

Crowd Sourced Equity Funding

Gerard Shea

2013

About Me

NAME: Gerard SHEA
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EDUCATION:

Graduate Diploma of Legal Practice - Australian National University - exp 2014
Bachelor of Laws - Southern Cross University - exp 2013
Diploma of Financial Services (Financial Planning) - Tribeca Learning - 2005
Diploma of Financial Planning - IAFP/Deakin University - 1990

I also have partial qualifications in Accounting and Information Technology.

RELEVANT EMPLOYMENT:

I have four years experience as a Purchasing Officer with the Department of Defence, five years as an Investigator with the Australian Securities Commission (now ASIC), nine years working with the Health Insurance Commission and eight years within the financial services industry with exposure to financial planning and compliance. I have been a Justice of the Peace for 23 years.

OTHER MATTERS:

I have a strong personal interest in peer-to-peer and crowdsourced funding.

I am currently a director of P2P Financial Services Pty Ltd through which was established with the objective of developing and offering P2P/CSEF facilities. This company is currently dormant and has not yet traded.

Background

Throughout this submission the internet and the world wide web will be collectively referred to as "the internet". Similarly, unless otherwise specifically referenced, Peer to Peer (or P2P) funding and Crowdsourced funding will be collectively referred to as "CSEF" although it is acknowledged that CSEF is more commonly used for equity funding and P2P for debt financing.

The *raison d'être* of CSEF is to facilitate the provision of finance to and from sources that would otherwise not be engaged in the financial system. It serves to complement existing conventional financial services, leveraging off the ability of the internet to overcome the two biggest impediments faced by traditional markets - the 'tyranny of distance' and the 'coincidence of wants'.

CSEF has also arisen due to dissatisfaction with traditional financial intermediaries and a perception that modern technology is rendering the role of the traditional intermediary obsolete. This was envisioned as far back as 1997, "…an emerging view that technological developments and financial innovation have stripped banks of their pivotal position in the financial system.[1]"

The fundamental principles underlying CSEF are simplicity, utility and equity/fairness. Any facilitation and/or regulation of CSEF must bear these principles in mind.

[1] Warren P Hogan and Ian G Sharpe, 'Prudential Regulation of the Financial System: A Functional Approach' (1997) 4 *Agenda* 15.

As CSEF is still in its infancy any regulatory scheme needs to be tailored accordingly. Once CSEF proves its viability within the financial system a more complex and extensive regime of regulation may be implemented.

Any regulatory scheme needs to avoid stifling CSEF or prematurely incurring an unnecessary level of expense for CSEF participants or regulatory agencies.

Questions and Answers

1. In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

In principle, yes. The use of CSEF is intimately linked with the growth of the internet. The internet is already facilitating conventional financial services functions through the provision of online banking and the ability to make purchases online. This level of involvement can only increase over time, in both it's current and any evolved form. It would be irresponsible to ignore the growing impact the internet will have on the provision of financial services in the near and distant future especially if Australia is to remain globally competitive in the provision and utilisation of financial services.

2. Should any such provision:
   (i) take the form of some variation of the small scale offering exemption and/or
   (ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or
   (iii) adopt some other approach?

Any regulatory scheme should manifest as a variation to the existing small scale offering exemptions as this would serve to minimise necessary legislative enactments and also bring CSEF within the general fold of fundraising provisions. This would have the collateral advantage of giving credibility to the CSEF industry which may deter infiltration by less savoury participants.

Confining CSEF to sophisticated or professional investors would defeat the fundamental purpose of CSEF in both a practical and ideological sense.

3. In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:
   (i) proprietary companies
   (ii) public companies
   (iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Proprietary companies should be permitted to participate in CSEF. It is unlikely that public companies would need to utilise CSEF, due primarily to scale, but if they were to be permitted to participate such participation should be restricted to raising funds for a specific need or project and not general fundraising. This would be in accordance with the general philosophy and structure of CSEF. In considering economic efficiency, it is also likely that permitting larger entities to utilise CSEF would drain the limited amount of funds available, making them less accessible to those entities that could benefit most from them.

The use of Managed Investment Schemes ("MIS") adds an additional level of complexity that is not really attuned with the philosophy and/or practicality of CSEF. A dual level of disclosure would be required by an MIS relating to both the operations of the MIS and the underlying companies within the fund/s it managed. If MIS's are permitted to participate in CSEF it may be best limit the MIS to

holding the securities of one underlying entity as an MIS holding a diverse portfolio of securities may best be regulated under the existing MIS regime.

4. What provision, if any, should be made for each of the following matters as they concern CSEF issuers:
   (i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')
   (ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF
   (iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption
   (iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors
   (v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer
   (vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply
   (vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities
   (viii) **any other matter?**

The philosophy and methodology of CSEF would best serve the needs of small proprietary companies or small businesses. As per the US JOBS Act, investment companies should not be permitted to directly participate in CSEF, however they should be permitted to participate in any official or pseudo secondary markets of CSEF securities (discussed elsewhere).

The approach adopted by Italy, whilst commendable in principle, may prove to be difficult to administer given that much legal debate could be engendered on the definition of 'innovative start-up'. Such a term would best be left to the individual investor to define.

In order to maintain simplicity in the operation of any CSEF service and to reduce the intellectual burden on investors, issuers should only be permitted to offer a single class of security - preferably an ordinary share for companies or a single class of unit for an MIS. Issuers wishing to offer diverse or complex financial instruments should utilise more sophisticated marketplaces in the interest of both themselves and potential investors.

From both a legal and operational perspective, there is no fundamental difference between the existing small scale offer provisions and the use of CSEF. Both seek to raise funds directly from investors without the issue of any formal disclosure documentation. It would be appropriate therefore to include any amount raised in the existing small scale offering ceiling.

The 'Crowd' element of CSEF places a focus on obtaining funds from a large number of investors, usually with a commensurately smaller individual *per capita* contribution. In order to achieve this, the existing 20 investor limit for small scale offerings would be manifestly inadequate. Separate provision should be made to allow a greater number of investors if CSEF is utilised, whilst retaining the 20 investor ceiling for any non-CSEF investors. This has two collateral advantages. First, it spreads the risk across a greater number of investors. Secondly, by using a CSEF intermediary a base level of disclosure and scrutiny is present. This could generally provide more protection to investors than what is available under direct approach to individuals, through the aforementioned disclosure and scrutiny but also through the ability of CSEF participants to provide commentary and exchange information on CSEF websites regarding potential investments.

It should also be possible for issuers to engage in 'hybrid' fundraising whereby equity can be raised simultaneously with other non-equity funds, such as donated money, providing the relevant ceilings are not breached for the equity component.

Any disclosure requirements should be significantly less onerous than existing Product Disclosure Statement ("PDS") requirements. They should fall within an amended small offer exemptions regime. If only a single class of shares and/or units are offered, as suggested elsewhere herein, only generic information relating to the nature of the security need be disclosed. Combined with information relating to the purpose of the fundraising and some background on the issuer this may suffice. Known or perceived risks to the project and projected income/returns may also prove useful where these can be ascertained with a degree of accuracy.

Advertising should only take the form of the information displayed on the CSEF website or on a central register held by an independent body specifically to list CSEF projects that has links back to the CSEF website.

Investors obtaining securities via CSEF should have no greater or lesser advantages than any other investor. This would require a limit on how shares held in proprietary companies could be disposed of. Having said that, given the greater number of participants likely to have smaller holdings of securities, it is in the interests of economic efficiency to facilitate disposal. This may best be achieved via a CSEF provider acting as intermediary for the exchange of securities originally offered through that same CSEF provider or via a requirement that issuers offer the ability to exchange securities using their in-house share registry. It would also be theoretically possible for an issuer to utilise a CSEF intermediary to securitise existing issues (primarily for P2P loans) or offer their own securities in exchange for other issued securities. Whilst this effectively creates an investment company, the aforementioned single share/unit class restriction would retain the CSEF nature of such an undertaking whilst facilitating liquidity in CSEF markets.

5. In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

CSEF intermediaries can take two forms. First they can act as a pure intermediary by merely listing securities and facilitating the matching of issuer and investor. Secondly, they can be actively involved in the transaction. This distinction is more pronounced in the P2P lending markets where some intermediaries act as pseudo banks by holding and consolidating investor funds and dispensing them to the relevant issuers - the 'pooling and divisibility' function of the financial system[2]. This active participation adds an additional level of risk for investors, particularly of a professional indemnity nature. Intermediaries should be discouraged from actively participating in transactions and maintain their role primarily as an exchange, akin to the ASX.

Any licencing regime should serve to act primarily as a formal registration system. Intermediaries not actively involved in transactions should be registered and listed on a central registry held by ASIC. To qualify for listing such intermediaries would need to include certain content on their websites (discussed elsewhere). Intermediaries who do take an active part in CSEF transactions should require a higher level of licencing akin to those required by other 'dealers' in financial services and products.

6. What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:
   (i) **permitted types of intermediary:**
      (a) should CSEF intermediaries be required to be registered/licensed in some manner
      (b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

[2] Hogan and Sharpe, above n 1, 21.

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

As previously mentioned intermediaries should be registered rather than licenced (this refers only to those not actively participating in transactions). Registration allows for sanctions to be imposed via de-registration. There should be no statutory requirements vis-à-vis financial/human/technology resources as these will manifest themselves on the relevant CSEF exchange and any failures will soon result in the demise of underperforming intermediaries, which should have minimal impact on investors and issuers if the intermediary has not played an active role in any transactions.

The principal risk management functions that an intermediary can undertake are to screen investors and issuers prior to allowing participation. The exact form such screening takes would best be left to the individual intermediaries but should be explained on their respective websites.

(ii) **intermediary matters related to issuers:** these matters include:
(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites
(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors
(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with
(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

CSEF should be available to raise funds for any project except those that have an illegal purpose. Some projects, e.g. mining operations, will be excluded from raising funds via CSEF purely due to the relevant ceiling imposed on fundraising.

Due to the start-up nature of most issuers using CSEF, there is little that due diligence by an intermediary could offer as an added level of protection to investors. It would be inappropriate and administratively difficult for both the participants and regulator to impose statutory due diligence requirements on intermediaries. In addition, the assumption of due-diligence requirements by intermediaries exposes them to potential litigation for any errors and/or omissions which are inevitable given the aforementioned start-up nature of most issuers and the limited resources available to intermediaries. Any due diligence undertaken would need to be optional and voluntary. Notwithstanding the aforementioned considerations, it is preferable for CSEF intermediaries to act as pure intermediaries and this minimises both the need and obligation for undertaking due diligence checks whilst not absolving the intermediary from requiring certain levels of disclosure by issuers. This is akin to the role of the ASX which holds itself out to be "…a regulated entity with some supervisory functions…[3]".

[3] Australian Securities Exchange, 'ASX's Role in Australia's Financial Regulatory Framework' (2008) *ASX Position Paper* 3.

Full disclosure by issuers would be the most effective way to address this issue. An important check that would be required is proof of identity for both issuers and investors. Online services often do not require such proof and this should not be permitted in the CSEF industry.

Intermediaries who act as pure intermediaries should not be held responsible for any errors/omissions/misleading statements made by issuers unless the accuracy and/or authenticity of those statements can be readily verified. This should not prevent intermediaries from establishing their own fidelity-type funds to compensate for losses on a voluntary basis. The same can be said for liability for fraudulent activities undertaken on an intermediary's website.

Self-dealing should be discouraged on CSEF platforms but if this is unavoidable it should be clearly disclosed in a prominent location and/or the relevant issuer listing clearly flagged to bring the attention of investors to a potential conflict of interest.

Funding models relating to remuneration should be fully disclosed.

Intermediaries should be discouraged from holding investor funds. If such a service is to be offered it would be best if they were held by an independent trustee. Such trustees could be entities registered as such by an appropriate body.

(iii) **intermediary matters related to investors:** these matters include:
   (a) what, if any, screening or vetting should intermediaries conduct on investors
   (b) what risk and other disclosures should intermediaries be required to make to investors
   (c) what measures should intermediaries be required to make to ensure that any investment limits are not breached
   (d) what controls should be placed on intermediaries offering investment advice to investors
   (e) should controls be placed on intermediaries soliciting transactions on their websites
   (f) what controls should there be on intermediaries holding or managing investor funds
   (g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other
   (h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary
   (i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised
   (j) what, if any, additional services should intermediaries provide to enhance investor protection

(iv) **any other matter?**

Given that CSEF, both philosophically and mechanically, is intended to be used primarily by lay individuals it is imperative that participants have at least a basic understanding of the nature of the transactions they are entering and the implications thereof. This would best be achieved through some sort of educational function. One option would be an online quiz on the intermediary's website that needs to be completed before an investor can utilise the site. Another option would be to have an external entity offer an educational service that provides certification that can be used to access intermediary websites.

Intermediaries should only be required to disclose generic risks to investors as they may not be qualified to offer detailed risk analysis and doing so could render them subject to legal liability issues. Offering comprehensive risk assessments may also constitute offering investment advice which should not be permitted by intermediaries.

Assuming that it is expedient to impose a limit on investors, intermediaries could prevent breaches of any statutory or voluntary investment limits by having a central registry that maintains running totals of amounts invested by individual investors. This could be accessed automatically by individual

intermediaries before processing any application by an investor. If a transaction would breach the relevant limit it would not be permitted to proceed and the investor notified accordingly.

Issuers should be required to include contact details in their listings on intermediary websites. There should be no requirement to have any 'bulletin board' or 'forum' facility on the websites for this purpose as it could constitute breaches of privacy and/or confidentiality and act to deter open communication between investors and issuers. However, intermediaries should offer such facilities for communication between investors and/or the public as this would facilitate the dissemination of information among investors that may not otherwise be available.

Pure intermediaries should only be responsible for addressing issues directly related to the listing of projects by issuers on their websites and the behaviour of issuers and investors on those websites. To facilitate the handling of more complex and serious complaints, intermediaries should be required to pass on such complaints to the relevant authorities and include links and/or contact details for such bodies on their websites. These should be placed in an obvious location such as a separate webpage clearly titled 'complaints'. Intermediaries who actively participate in transactions would need to address any complaints that arise from those activities and the permutations thereof are too numerous to address herein.

As previously outlined, disclosure of fees and commissions should be total.

Assuming it would be financially viable, it may be appropriate to restrict intermediaries to listing either projects or equity raisings but not both. This would serve to clearly differentiate between the two in the minds of the investor/donor. If it would not prove financially viable, then the two categories of issuer listings should be clearly identified and listed separately so that they do not appear together in any list on the intermediary's website.

7. In the CSEF context, what provision, if any, should be made for investors to be made aware of:
   (i) the differences between share and debt securities
   (ii) the difference between legal and beneficial interests in shares
   (iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

These matters can best be addressed through the use of the aforementioned online quiz and/or external education certification. If only one class of share (preferably ordinary) and/or unit is permitted to be offered the problems associated with differentiation between share and unit classes does not arise. Whilst this may limit the ability of an issuer to tailor their fundraising accordingly, they must be aware that CSEF operates in a financially unsophisticated environment.

8. What provision, if any, should be made for each of the following matters as they concern CSEF investors:
   (i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor
   (ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors
   (iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*
   (iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF
   (v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer
   (vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF
(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment
(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure
(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in
(xi) **any other matter?**

There should be no real limits on who can be a CSEF investor, subject to normal contract law provisions. As previously mentioned, it may be beneficial to require some sort of basic educational foundation prior to permitting an investor to transact on an intermediary website. This should be consistent for both professional and 'amateur' investors. Whilst professional or sophisticated investors may resent the need to 'prove themselves' in this manner, this is countered by their obvious advantage in having sufficient knowledge to easily complete the educational assessment. In addition, the educational content will address the peer-to-peer and crowdsource nature of the facility which is not addressed in traditional investment education.

No sophisticated investor threshold requirements should be implemented as this runs counterintuitive to the philosophy of CSEF. It also opens up potential avenues for the exertion of bias and control over issuers that may be detrimental to investors in general.

There is no compelling ethical or moral reason to implement investor or issuer linked caps. Investors should be free to invest as they see fit. However, from an operational perspective it may be prudent to limit individual investors to a cap on the total amount of investment they may make in a given period and/or hold at any point in time. This also adheres to the 'crowd' aspect of CSEF which aims to gather small amounts from a larger body of investors. This would be self-regulatory if a statutory obligation was imposed requiring issuers and/or intermediaries to evenly distribute securities to those who have applied. This is best summed up in a table as follows:

Project: $20,000 to be raised by issuing 20,000 shares @ $1 each.		
Investor:	**Equity Sought:**	**Equity Issued:**
A	$5,000	$5,000
B	$1,000	$1,000
C	$10,000	$5,000
D	$5,000	$5,000
E	$4,000	$4,000
Total:	$20,000	$20,000

No individual investor would be able to invest a inordinately large amount of money into a single venture and any investment would be subject to the potential cross-checking against any central registry in operation as previously outlined.

9. Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

A minimalist approach should be adopted with CSEF fitted into the existing regime.

10. What, if any, other matters which come within the scope of this review might be considered?

No further issues to raise.

ClearSky
SOLAR INVESTMENTS

Background to this submission

ClearSky Solar Investments Ltd is a not for profit social enterprise that has been established to provide a mechanism to allow members of the community to invest in commercial solar PV installations.

The capital cost of the installation is met by raising capital from community investors. The end-user then pays for the electricity the panels produce for a defined number of years, after which ownership of the panels is transferred to the end user. Over the term of the investment investors get their capital paid back and a profit component. Typically the IRR is 8% or more.

ClearSky is an intermediary/issuer as defined in the discussion paper. We set up trusts with up to 20 investors to raise capital for projects of up to $200,000 in value. Registered users (who must confirm their commitment to the growth of renewable energy in Australia before getting accepted) are given access to investment opportunities on our website

In establishing ClearSky, which is a CSEF, we have had to operate within the Corporations Act as it currently stands and this has highlighted to us where changes should be made. These suggested changes, which we have incorporated into the framework of questions in the CAMAC discussion paper constitute this submission.

Which Option do we prefer?

Our preference is for Option 4 – making amendments, targeted for CSEF, to the existing regulatory structure to reduce the entrance barriers (the need for a FSL and an expensive-to-produce prospectus) specifically when the CSEF involves a not-for-profit organisation that is seeking to raise funds from individuals who are committed to a cause the not-for-profit is promoting.

There is a much diminished need to protect investors where 'a good cause' is involved. The border line between philanthropy and investment is not clear cut in these circumstances. The biggest concern of investors may not be the risk of losing their money, but having the social benefit that they were seeking to promote not eventuate. Just as philanthropists take personal responsibility for doing due diligence on any of the charities they support one could expect that investors in social enterprises would do the same.

We consider first the liberalisation that is needed to section 708 of the Corporations Act which sets out the characteristics of offers that do not need disclosure

The two issues that we need to be considered are

1. What conditions would the social enterprise CSEF capital raising program need to meet in order to qualify for the liberalised exemptions
2. What the liberalisation would involve

We would argue that the following conditions for the liberalisation of the Section 708 exemption would open up opportunities for raising capital for projects with a positive social benefit without 'opening the flood gates' or exposing finance-naive to excessive risks

To qualify for the exemption

- the social enterprise intermediary/issuer should be a registered on ACNC
- Less than $2 million was being raised
- At any one time 80% of the equity would be in the hands of no more than 20 investors (this would address the point made in the discussion paper that too many investors reduces vigilance)
- There were less than 100 investors in total
- The capital was being raised for a project with a social benefit that was aligned to the intermediary/issuer's mission
- The offer would be accessible only to individuals who had confirmed their commitment to the mission of the intermediary/issuer, by registering on a website set up for this purpose.

The liberalisation we would recommend for intermediary/issuers that met the above conditions would be

- No restriction on adverting to the public at large the existence or the website where one could register and get access to offers
- No restriction is advertising, in general terms, the type of offers that were available to registered users once they had registered on the website.

Furthermore there should be no restriction how many trusts that complied with the above conditions that a social enterprise intermediary/issuer could have on their books.

It would clearly be in the interests of intermediary/issuers to have a disclosure document for each investment. There is no need to regulate the content or have a formal registration of the document however. A government issued check list of the items that should be covered would help investors do their own due diligence.

What follows is our answers to specific questions

Question 3: In the case proprietary companies such as trusts set up by social enterprises meeting the conditions outlined above, it should be permitted to advertise to the public the fact the offers can be found on a website that they are able to sign on to. It should also be permissible to advertise the general characteristics of these offers.

Question 4 (i) Social enterprises should be included

Question 4 (ii) Units in trusts should be included

Question 4 (iii) No ceiling on the aggregate of funds raised by the intermediary/issuer, although individual offers should each have a ceiling of $2 million

Question 4 (iv) Checklists of what should be included in the disclosure for intermediary/issuers and what investors should look for should be provided by the appropriate authority but self-regulation should be used

Question 4 (v) See answer to Q3

Question 4(vii) A unit holder in a trust should be able to sell their units to an existing unit holder.

Question 5 Social enterprises meeting the conditions outlined above should not be required to have a licence but on-line training courses should be made available.

Question 6(i)(a) Social enterprise intermediary/issuers should be registered with the ACNC

Question 6(i)(b) It should be the responsibility of the social enterprise to demonstrate that it has the necessary capability in response to an audit, but there should be up front assessment and registration process

Question 6(i)(c) The appropriate authority should provide a model which intermediary/issuers can use to bench mark their own performance, but no regulation

Question 6(i)(d) Not if the intermediary is a social enterprise

Question 6(ii) Provision needs to be made for the case where the intermediary is a social enterprise which has set up proprietary company issuers.

Question 6(iii)(a) No investor screening should be required when the intermediary/issuer is a social enterprise

Question 6(iii)(d) See answers to Question 3 above. There should be no restrictions to social enterprises encouraging members of the public to register on their website. It should be permissible to advertise in general terms what the social benefit of the offers are and what the benefit is to investors.

Question 6 (iii)(i) see answer to Question 4(iv) above. Full disclosure should strongly encouraged but not mandated

Question 8 (i) Individuals only

Question 8 (iii) An upper limit of $200,000 would not cause us any problem if it was thought necessary to have an upper limit.

Question 8(iv) We would have no objection if the application form for units had the risks listed with a space for the investor to sign in acknowledgement

Finally we would recommend that CAMAC consults with the Centre for Social Innovation and Research at UNSW before making its final recommednations

Bizzbuild would like to take the opportunity to thank CAMAC for providing an opportunity to comment upon its Crowd Sourced Equity Funding discussion paper.

Bizzbuild is writing this paper from the intermediary viewpoint. Based in Australia we are currently setting up a crowdfunding platform in the US. We are also in the process of obtaining a financial services license to operate as intermediary in the UK and ideally we would want a similar platform in Australia and therefore welcome the review.

The Australian Corporations Legislation should make provision for Crowd Sourced Equity Funding.

The primary duty of an entrepreneur is to raise capital for the business. Cash flow is the most important aspect to keep a business moving and growing and therefore an entrepreneur must keep cash flowing continuously into the business for it to survive. Unfortunately access to capital is one of the major business challenges any entrepreneur face. Sources of finance include family, friends, credit cards, mortgages and unsecured loans, to name a few.

Small businesses meet their funding needs using internal equity funding and existing debt facilities. Eighty per cent of small business loan applications are accepted while only a small fraction of businesses who seek venture capital funding are successful. Small businesses pay more, on average, for debt than both households and larger businesses. This is because smaller businesses are typically viewed as having more volatile revenue streams, make greater use of riskier forms of loan collateral, and make more use of unsecured debt products. The higher cost of small business debt facilities leads many smaller businesses to use household debt products to fund their business. Smaller businesses also make use of alternative sources of debt such as equipment and vehicle leasing. Other forms of finance for small businesses include debtor finance and debt funding from trade suppliers.

The traditional way of borrowing from a bank or other financial institution. Whether the business is in its startup stage or a small established business, borrowing in this way has numerous challenges including providing financial statements, forecasts etc. This is not only a costly process but could possibly not be enough to justify the amount of cash needed to establish their business. Banks also require security over an asset and very rarely lend to start up businesses. Many of the applications a bank receives will not be approved, simply because the risk the bank is required to carry is too high, or because it believes the applicant cannot support the risk either. Banks are regulated by the Australian Prudential Regulation

Authority (APRA) which requires banks to make prudentially responsible lending decisions – the more risk the bank takes, the more capital it has to hold against that lending. Banks also quantify risk according to their own lending portfolio. A bank may decline to loan to a viable business based on the fact they are overexposed in the sector the business is in.

The other way of raising funds is through offering securities to the general public. Currently in Australia to raise funds from the general public the business must be trading as a public company or private company and there are strenuous rules on these company structures and how they offer their securities to the general public.

Crowdfunding (alternately crowd financing, equity crowdfunding, crowd-sourced fundraising) is the collective effort of individuals who network and pool their money, usually via the Internet, to support efforts initiated by other people or organizations. This method of raising funds has been adopted by the US, UK and a few other countries. The rules implemented in the US encourage funding in small businesses as it relieves a lot of the strenuous regulations.

Because of the strict regulations on raising funds in Australia and the ease of raising funds in the US some small business owners are willing to relocate to the US. See Forge is only one example of this - SEE Forge is an award winning cloud based and mobile reporting platform for field workers to take their existing paperwork (safety, audits, maintenance, inspections, time sheets etc.) onto any mobile device. They make it remarkably easy for field workers to collect, report and manage operational and hazard information to increase productivity, lower costs and minimize risk. Their business has extremely great potential but the inability to successfully raise funds in Australia is forcing them to move abroad. We are of the opinion that the regulations in Australia discourage small businesses and therefore a lot of extraordinary business ideas will never come to life or be taken abroad which results in a valuable loss to the Australian economy.

Even the strongest supporters of crowdfunding acknowledge that it carries substantial risks. Small business investing is inherently risky and, the fact is, the majority of new business establishments fail. Moreover, small business investments tend to be highly illiquid, as most securities offerings may be too small for an active secondary trading market to develop. As a result, crowdfunding investors must be prepared to hold and bear the risk of their investments indefinitely. This risk is in no way other than the risk of investing on the stock market. To date there is no proof of fraudulent crowdfunding and thus the fraud risk should not be a determining factor not to allow and regulate crowdfunding in Australia.

Crowdfunding as an internet phenomenon is still a relatively new concept but it is believed to be the preferred method of funding in this tough economic climate. The benefit of crowdfunding is not only the ease of raising funds from multiple interested parties but it also has numerous other benefits such as avoiding interest and extra cost involved in a loan and it can, in itself, be a very powerful marketing tool to create awareness and public connection. Supporters of crowdfunding believe that it may offer a potential solution to the small business funding problem. Observers point to the success of existing crowdfunding services around the world, which raised almost $2.7 billion in 2012, an increase of more than 80% from the prior year.

Ideally a new Chapter should be added to the Australian Corporations Act to regulate Crowd funding in a similar way that the JOBS Act in the US regulate crowdfunding. The US regulate it as follow:

For Startups & Small Businesses

- They can generally solicit and advertise publicly.
- Only accredited investors can actually invest in generally solicited companies.
- File a form with the SEC before they begin soliciting, letting them know they will.
- Disclose details about their general solicitation to the SEC within 15 days from first solicitation.
- Strict verifications done by companies are required to confirm that each investor is accredited.
- The penalty for not adequately meeting and following general solicitation requirements with the SEC is being banned from fundraising for a full year.

For Investors

- Only accredited investors can invest in companies who generally solicit.
- Qualifying as accredited means having $1 million in net worth, or making over $200,000 a year for the past 3 years.
- Investors will need to prove accredited investors status, which can be done through written confirmation by a CPA, attorney, investment advisor, or Broker-Dealer, or income-related IRS forms.
-

We suggest that Australia regulate crowfunding in a similar way to stay competitive internationally.

Regards,

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CFO

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Submission to CAMAC review of crowd sourced equity funding (CSEF)

Authors: Kylie Hammond and Roger Buckeridge

Credentials:

Kylie Hammond is founder and CEO of Board Portfolio www.boardportfolio.com and is authorised under ASIC Class Order 02/273 to deliver Business Introduction or Matching Services. Board Portfolio is accredited as a sponsor to ASSOB for capital raising services. Like ASSOB, Board Portfolio operates under section 708 of the Corporations Act (Cth.) 2001. This provides for (in certain circumstances) an issue of securities being made to certain types of investors without a disclosure statement and regulated promotion securities offers.

Roger Buckeridge is co-founder and director of Allen & Buckeridge Asset Management Limited (A&BAM), holder of AFS Licence #238128, for which he is the responsible officer and an authorised representative. A&BAM has operated as responsible entity for both registered and unregistered managed investment schemes since 2000 which have invested >$200 million in equity of early-stage technology-based businesses in Australia.

Structure of Submission:

After a summary and our principal comments and recommendations, we provide responses to the ten questions set out in section 7 of the Updated Discussion Paper of October 2013 (the "DP").

Summary

We agree with CAMAC's analysis of the differing positions of issuers, intermediaries and investors and we believe that CSEF has a high potential to stimulate business capital formation and create high value jobs in the Australian economy through:

- A simplified, less expensive but strongly regulated issuance regime
- Aggregation of many tens of thousands of pre-qualified Australian and overseas investors who are disposed to examine Australian equity and debt financing opportunities in small and medium size growing companies
- Development of Australian-based online platforms to intermediate cost effectively between such investors and offerors that have been vetted or qualified in some consistent and factual way.
- Platform economics that attract quality issuers to it because of timeliness and lower fee structures than private placements and major stock exchange listings.
- Platforms that assist potential offerors to acquire human resources that will bring them to an investment grade that will be acceptable to investors and warrant listing on the platform.

We support what ASSOB has achieved in this regard during the last several years, evolving a platform that requires high standards of disclosure and compliance from issuers without themselves providing investment advice. Board Portfolio collaborates closely with ASSOB to assist in upgrading of offeror boards and executive ranks so that they are of an acceptable standard to list on the ASSOB platform and attract investor interest. See www.assob.com.au/executive-equity.asp

Licensing of Intermediaries

In regard to platform operators, we submit that an online CSEF portal or platform should not be making a recommendation or statement of opinion. They are facilitators and not advisors. Thus portals or platforms should not themselves be required to hold an Australian Financial Services Licence. However this view is not supported by current ASIC guidance on CSEF (12-196MR ASIC guidance on crowd funding, 14 August 2012), which states:

> "In the circumstances that crowd funding involves an offer that meets the definition of a financial product, the owner of Australian-based websites that facilitate this crowd funding may be legally considered as the person making an offer to arrange for the issue that financial product. In these circumstances, a person must meet certain requirements under the Corporations Act:
>
> - Hold or obtain an AFS licence with the appropriate licence authorisations or be an authorised representative of an AFS licence holder; and
> - If offering to arrange for issue of a financial product to retail investors or inviting them to apply for a financial product, give a Product Disclosure Statement (PDS) for the offer to the client."

Earlier, ASIC has said that:

> "'Financial product advice' is defined broadly in s766B of the *Corporations Act 2001*. Generally, financial product advice is a recommendation or statement of opinion (or a report or either) that:
>
> - Is intended to influence a person or persons in making a decision in relation to a financial product or class of products (including superannuation products); or
> - Could reasonably be regarded as being intended to have such an influence.
>
> When assessing whether a communication falls within this definition, we will consider the overall impression and the particular circumstances of a communication. *The giving of just factual information is not however regulated as advice.* Thus it will be a question of fact for each service provider as to the extent to which the information being provided by the service provider is intended to influence a person in making a decision in relation to a financial product. The answer to the question will revolve around the way in which the service provider engages with the people to whom information is provided about the securities that may be offered. An introduction service might also consider the extent to which Reg. 7.6.01(e) and (ea) may apply. These two exclusions operate to exempt from licensing people who refer a person to a financial services licensee. "

We are more comfortable with this earlier position, from the perspective of a platform or portal operator, who would prefer to operate the engine room and not be responsible for the content.

Section 3.3.1 of the DP suggests that an Australian Market Licence (AML) may be required for a CSEF portal/platform. We think that a CSEF portal is far from being a stock exchange like the ASX or Chi-X. The balance sheet resources required for an AML are almost certainly beyond the capacity of candidates to operate as CSEF intermediaries.

However some regulation of intermediaries is likely to build confidence and provide integrity and guard against fraud and scams. It is in the interest of the intermediary to self-police in this regard, as has been the experience of crowd funded rewards platforms, like Kickstarter and Pozible, which have developed algorithms to alert them to frauds and scams.

The DP suggests that a licensed CSEF platform should perform initial background and/or viability checks on issuers before including them on their website, as well as ongoing checks on issuers already on their website. The licences could also regulate how each intermediary website is to operate and how funds provided by investors are to be held prior to their being passed to the issuer. An intermediary must be an organisation of substance and be sufficiently capitalised and resourced to carry out its role.

We think that the market will demand that an intermediary carry out these functions and that an AML-like regime is not required.

Managed Investment Schemes

In Section 3.2.4 of the DP, managed investment scheme (MIS) structures are considered. A&BAM and its associates have raised and managed such schemes in Australia since 1997. CSEF schemes would likely need to be registered schemes and in our opinion and experience would need to be at least $50 million in committed funds for the management expense and compliance costs to be supportable. However, many individual investors do not wish to be in a large "blind pool" structure.

An approach, as the DP suggests, where a scheme could be structured so that investors can elect which from a number of projects they want to support, has considerable merit. They would then acquire a specific class of interests in the scheme for each project or enterprise chosen. Again, all equity acquired would be held by the RE, on trust for the investors who are scheme members.

We would envisage a CSEF platform having a member (or indeed many members) that holds an appropriate AFSL, which would offer such schemes to investors, who may also be individually accredited members of the platform. Some would be happy to be aggregated in this way, so long as they get to pick the investments that they wish to take a position in. In particular this might work for issuers who wish to retain proprietary company status and not convert to an unlisted public company until they have become more robust and proven in their business models. It is also likely to suit investors who do not wish to be individually accredited under existing sophisticated investor rules.

We think that the existing regulatory regime for licensing, disclosure and compliance for responsible entities of MIS is robust and appropriate to CSEF MIS, as described in Section 3.2.4 of the DP.

CSEF of proprietary companies

Section 3.2.4 also suggests:

> "A benefit of CSEF under a managed investment scheme arrangement to an issuer is that an issuer incorporated as a proprietary company could receive investor funds, but without the shareholder cap problem that would arise if investors themselves could acquire equity in the company in their own name. Also, as the scheme (not the proprietary company) would be making offers to investors of interests in the scheme, the prohibition on proprietary companies making public offers of their own securities would not apply."

Whilst this statement is true on the facts, in our experience using MIS structures is highly unlikely to satisfy the demand for small scale capital raisings in Australia. The Australian market experience is that the existing small scale personal offers s708 exemption, whereby an proprietary company issuer may make a personal equity investment offer to investors, provided that no more than $2 million is raised in any 12 month period from no more than 20 investors, but with no public solicitation, is too

restrictive. Not enough investors are available under these rules to fund proprietary companies in Australia.

We believe sufficient investors can be attracted to CSEF by selective changes to the law. We advocate an expansion of s708 rules to accommodate up to 100 investors in raisings of up to $5,000,000 in any 12 month period. This would require lifting of the shareholder cap for proprietary companies to at least 100 persons not including existing shareholders, directors, advisers and employees. Recognising that a proprietary company is generally prohibited from engaging in any public offer of its equity or other securities, under s113(3), there would need to be an exemption for offers made via a regulated or approved platform or portal, with processes and compliance rules such as have been developed by ASSOB, for example.

We recognise that ASIC Class Order 02/273 *Business Introduction and Matching Services* permits up to $5,000,000 to be raised in some circumstances, with the restrictions on advertising a small-scale offer also being relaxed. However the ceiling of 20 investors in any 12 month period needs to be substantially lifted to accommodate those investors who may meet tests for a sophisticated investor but wish to diversify their SME investment portfolio by making many investments in the $25,000 to $50,000 range. Many of BP's members are likely to fit this description.

Options for CSEF regulation

Section 7 of the DP sets out five options for consideration of what, if any, regulatory response might be made in Australia to CSEF:

- **Option 1**: no regulatory change
- **Option 2**: liberalising the small scale personal offers exemption from the fundraising provisions
- **Option 3**: confining CSEF exemptions to offers to a limited group of persons, such as sophisticated, experienced or professional investors
- **Option 4:** making targeted amendments to the existing regulatory structure for CSEF open to all investors
- **Option 5**: creating a self-contained statutory and compliance structure for CSEF open to all investors.

We favour Option 4, which includes Option 2 liberalisation.

Our comments to the specific questions set out on section 7.3 follow:

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF? If so, why, if not, why?

Response: Yes, for the reasons set out above regarding unmet SME demand for equity and unsecured debt funding

Question 2 Should any such provision:

(i) Take the form of some variation of the small scale offering exemption?

Response: Yes, to 100 investors per 12 months per company for up to $5,000,000 per 12 months per offeror. and/or

(ii) Confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context?

Response: No. the current tests are too stringent for CSEF platforms. The approach should be similar to that emerging in the USA, where pre-qualification by platforms or by aggregators of investors through membership organisations like angel groups, can guard against over-commitment by retail investors.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) Proprietary companies

(ii) Public companies

(iii) Managed investment schemes. Should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Response: See above comments on MIS and lifting of the shareholder cap for proprietary companies who raise funds through an accredited CSEF platform**.**

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **Types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

Response: no case has been made for exclusion of classes of investors. CSEF is all about liberalising access for investors to offerors

(ii) **Types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF?

Response: all equity and equity-like instruments such as ordinary shares, preferred shares and convertible notes; and debt-like instruments such as debentures and secured interests in income streams. These are all proven instruments used by the venture capital investor community.

(iii) **Maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption?

Response: see comments above. We think that the ceiling should be flexible but for an initial trial period $5,000,000 per issuer per 12 month period should be okay. The SEC's proposal for a $1,000,000 cap in the US context has been universally panned by the VC and CSEF community. This ceiling should apply to CSEF offers irrespective of whether the issuer is a proprietary or unlisted public company.

(iv) **Disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors?

Response: an information memorandum or OIS similar to those currently permitted under the ASIC Class Order 02/273.

(v) **Controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer?

Response: none other than existing consumer protection against false and misleading statements

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

Response: See our comments above about intermediaries and MIS Res

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **Permitted types of intermediary** (also relevant to Question 5):

(a) Should CSEF intermediaries be required to be registered/licensed in some manner?

(b) What financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

(c) What fair, orderly and transparent processes must the intermediary be required to have for its online platform

(d) Should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman?

Response: See our above comments regarding an AML regime. We recognise that considerable thought must be given to this subject and welcome the opportunity to further consult with ASIC based upon our experiences in this market.

(ii) **Intermediary matters related to issuers:** these matters include:

(a) What, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF?

(b) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management?

(c) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers?

(d) To what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites?

(e) To what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors?

(f) What possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with?

(g) What controls should be placed on issuers having access to funds raised through a CSEF portal

Response: There are many matters to be worked through on these topics. We think that many have been appropriately dealt with by ASSOB as it accumulated experience of many transactions during the last 5 years. Regarding intermediary liability (points d and e), a platform operator, similar to an Internet Service Provider, cannot be held liable for the acts of others who use their platform. It is in their interest to monitor and curate, as best they can, the integrity of offers made using their platform in order to build and retain investor trust. Question (f) is often raised. The CSEF platform must have a transparent fee structure that allows it to invest and build its business, whilst not having a financial bias towards one issuer versus another. It will be advisory businesses that bring issuers to the platform which earn fees based upon success of the fund-raising.

(iii) **Intermediary matters related to investors:** these matters include:

(a) What, if any, screening or vetting should intermediaries conduct on investors?

(b) What risk and other disclosures should intermediaries be required to make to investors?

(c) What measures should intermediaries be required to make to ensure that any investment limits are not breached?

(d) What controls should be placed on intermediaries offering investment advice to investors?

(e) Should controls be placed on intermediaries soliciting transactions on their websites?

(f) What controls should there be on intermediaries holding or managing investor funds?

(g) What facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other?

(h) What disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary?

(i) What disclosure should be made about the commission and other fees that intermediaries may collect from funds raised?

(j) What, if any, additional services should intermediaries provide to enhance investor protection?

Response: We support the processes that ASSOB has developed in most of these matters. As we have said above, intermediaries should not provide investment advice to investors. They do have a key role in marketing offers once listed on their platform. All types of media and public solicitation must be permitted or the CSEF concept fails.

Investor funds should be held by a trustee or custodian independent of the platform operator, just as happens for registered and many unregistered MIS.

Complaints regarding performance by the intermediary of its legally permitted functions should be made under existing ACCC regulations.

(iv) **Any other matter?**

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) The differences between share and debt securities?

(ii) The difference between legal and beneficial interests in shares?

(iv) Any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

Response: All offer memorandums or OIS prepared by issuers should address these matters. The intermediary would require these statements as part of its rules for listing on its platform but would not prepare them itself. This is a duty of the issuer. Generally the duty of the issuer is one of disclosure and the investor or the RE representing an MIS must satisfy himself that these matters are properly and fully explained.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **Permitted types of investor:** should there be any limitations on who may be a CSEF investor?

(ii) **Threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors?

(iii) **Maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**?** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*.

(iv) **Risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF?

(v) **Cancellation rights:** should an investor have some right of withdrawal after accepting a CSEF offer?

(vi) **Subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer?

(vii) **Resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF?

(viii) **Reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment?

(ix) **Losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure?

(x) **Remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in?

(xi) **Any other matter?**

Response: Our view on points (i) through (vii) and (ix) and (x) is no or none. These are restrictions designed for failure of the CSEF policy objectives: removal of constraints on willing buyers and willing sellers of equity securities finding one another and entering into a transaction; and hence the creation of growth companies that in turn create value-adding jobs and contribute to national productivity. The market realities of risk and reward that pertain to all equity investing cannot be ameliorated by regulation, nor should they be. Regarding reporting, point (viii), it is the primary

responsibility of the issuer or the RE of a MIS to report to investors regarding the progress of their investment. Some intermediaries, and ASSOB is one such, require a company to be a public company to be listed, as that affords investors the legal protections of audits and continuous disclosure. We do advocate however that CSEF platforms accept proprietary companies, particularly in their early stages, which may need advisers recommended by the intermediary to assist them in satisfying disclosure and financial statements that will be mandatory as they transition to public company status.

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

Response: We advocate incremental adjustments. CSEF has a valuable role to play as companies start-up and grow and graduate to full stock exchange listing or become established profitable and self-financing enterprises. However the regulatory and consumer protection laws applying to all retail investors and to fraudulent activity should be applicable to financing transactions along this whole spectrum.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

Response: We look forward to further consultation with CAMAC in 2014.

Supplementary comment to submission to CAMAC's CSEF review

Authors: Kylie Hammond and Roger Buckeridge

29 November 2013

We wish to provide some recent experience in raising equity capital in Australia under the current small scale offerings regime.

There is a view expressed by some that today's raisings under the ASIC Class Order 02/273 and s708 regime are achieved mainly from "friends and family" and that investors unknown to the issuer are rarely attracted to subscribe to these offerings. Our experience is that this is not so and does not need to be the case.

What is required is a platform that is credible to its members and properly prepares offerings before they are allowed to use the platform. Its members will be individuals who are pre-qualified as being interested in taking small equity positions in early stage companies as part of a diversified portfolio approach to managing their own assets.

Many investor members registered with the platform will be interested in the opportunity to actively take an interest in the companies in which they invest, either directly or via a MIS (as described in our primary submission). This could include becoming non-executive directors or advisers to the boards and management of the investee enterprise, or it could involve having some process of regular access to the management and some information rights. We think that this type of investor is an ideal fit for young enterprises whose founders and directors may have very little practical experience in building successful businesses.

By way of example, we have recently (since July 2013) collaborated in privately raising over $500,000 in three months as the first step in a $2.8 million raising for a young company that is unprofitable and is recording less than $1 million revenue per annum. We assembled a group of strangers quickly, none of whom knew the company or each other. The process is still under way and we expect to finalise the raise within the next 6 months, on schedule. We will be happy to provide detailed commentary if and when we have an opportunity to meet with CAMAC in 2014.

In summary, our point here is that a successful CSEF intermediary will need to have a world-class capability to market to both investors and issuers, so that a broader investor cohort than friends and family is matched with each issuer. We know already from practical experience how to build the investor community, for solid issuer opportunities that are not necessarily associated with the celebrities, rewards or philanthropic goals that often are the feature of successful donation and rewards-based crowd-funded projects.

White Paper

Equity Crowd Funding in Australia

November 2013

Author:

Andy Tompkins

Important Notice:

Information included in this paper is intended to be for guidance only and is not intended to be relied upon by potential issuers of securities or potential investors. We recommend professional advice is sought should you wish to raise funds in terms of the current legislation in Australia.

Contents

Glossary

AAAI	Australian Association of Angel Investors
ABS	Australian Bureau of Statistics
AFSL	Australian Financial Services License
ASSOB	Australian Small Scale Offerings Board
ASIC	Australian Securities and Investments Commission
AVCAL	Australian Private Equity & Venture Capital Association
CAMAC	the Australian Corporations and Markets Advisory Committee
CSEF	Crowd Sourced Equity Funding
PE	Private Equity
RBA	Reserve Bank of Australia
The Act	Corporations Act, 2001
VC	Venture Capital

1. Executive Summary

Small business is the back-bone of the Australian economy, and it has the ability, given the right conditions, to have a significant positive impact on the Australian economy.

Small business (0 to 19 employees) accounts for almost 50% of private sector industry employment and there were over 2.1 million actively trading businesses in Australia in 2011, the vast majority of which were small businesses and at any one time there are over half a million Australians involved in early stage entrepreneurial activity.

The problem that many of these small businesses and entrepreneurs face is a lack of access to capital to grow and develop their businesses. As a result less than 60% of small businesses manage to survive for any degree of time.

Many start-ups do not even try to source outside funding, possibly due to a perceived lack of available options.

Equity Crowd Funding is a means for small business to access capital by engaging with the crowd via social media to raise money in exchange for equity in the underlying business.

Currently equity crowd funding is illegal in Australia. A number of other jurisdictions around the world are considering or have passed new laws regulating equity crowd funding and Australia, via CAMAC, has taken the first steps in seeking feedback from the public in terms of how any equity crowd funding legislation should be structured.

There are a number of avenues currently available for small business in Australia to raise equity capital including:

- Angel Investors
- Venture Capital & Private Equity
- Prospectus or disclosure document
- Family & friends via personal offers

The reality is though that many of these avenues either have a low chance of success or come at significant cost and a significant investment in time.

At present the fund raising laws in Australia are bent towards investor protection and that is obviously an important characteristic that should not be fundamentally changed, but there needs to be a balance between investor protection and giving small business the ability to access capital in a cost effective and timely manner, i.e. equity crowd funding.

There seems to be a wide acceptance that the fund raising laws in Australia (and around the world) which in most cases have been in place for decades need to be amended to suit the current climate that we find ourselves in.

Our blueprint for a credible and viable equity crowd funding industry in Australia supports the amendment of the existing personal offers exemption included in the Corporations Act

Some of the key principles which we believe should be adopted and which are more fully detailed in section 9 include:

For Investors

- Limits on investment – we believe equity crowd funding should be open to all residents and there should be an investment limit of $5,000 pa. For Self-Managed Super Funds we suggest a limit of $10,000.
- Self-regulation and reporting – we recommend self-regulation of the investment limits by the investor via the ATO
- Tax relief –we recommend specific tax relief for investors in the form of a tax deduction on any equity crowd funding investment
- Accreditation – we would support an accreditation process whereby prior to investing an investor would be required to attend and pass a risk awareness workshop.
- Limit on potential investors – we suggest a limit on the number of potential investors of 400 (i.e. a maximum fund raising of $2 million per issuer)
- Legal interest in shares –we support the investor having full legal interest in the shares and not indirect beneficial interest via a managed investment scheme.
- Tag Along rights – we suggest that Tag-Along clauses are compulsory. This would force anybody making an offer for the shares of a controlling shareholder to make the same offer to all minority shareholders.
- Cooling off period –we suggest a cooling off period of 14 days

For Issuers

- Accreditation of directors – we believe that all directors of an issuer should be accredited (via formal training)
- New issues only – any issue of securities via an equity crowd funding process should be for the issue of new shares only
- Provisional Public Company – we suggest the creation of a new form of company called a Provisional Public Company which gives the issuer the flexibility to have multiple shareholders but not the related public company governance requirements. The intention would also be for an issuer to evolve into a full public company once certain criteria were met. Other potential attributes include:
    - A maximum of 400 shareholders
    - Only one type of share available
    - A limited disclosure document for fund raising purposes
    - No audit requirements unless turnover exceeds a certain pre-determined amount (we suggest $2 million)
- Solicitation & advertising – Issuers should have the ability to directly solicit investment from accredited investors

For Intermediaries

- Registration of intermediary – we recommend that all intermediaries be registered with ASIC but no requirement for an AFSL or being registered as a Responsible Entity
- Risk awareness – the intermediary should ensure that the investor is fully aware of the potential risks of investing in a small business start-up

- Investment advice – the intermediary should not be allowed to offer investment advice to any investor or issuer
- Solicitation – the intermediary should not be able to solicit investment, the role of the intermediary should simply be to facilitate the introduction of accredited investors with issuers
- Due diligence – The intermediary should be responsible for basic due diligence on the issuer
- Project eligibility – the intermediary should take reasonable care to ensure that any issuer listed on their platform does not Infringe any intellectual property rights amongst other things
- Access to accredited investors – The intermediary should ensure that only accredited investors have access to the investment opportunities on the platform

We welcome any feedback on this document, please send any questions and/or comments to “whitepaper@ipledg.com”

2. Background

Small business is the back-bone of the Australian economy, and it has the ability, given the right conditions, to have a significant positive impact on the Australian economy.

Unfortunately in recent years these conditions have deteriorated due to the global financial crisis which has put a lot of pressure on these small businesses, especially from a financing perspective as the main stream banks have tightened their credit policies making it very difficult for these small businesses to access capital to grow their business.

To highlight the impact of small business on the Australian economy reference is made to the Australian Small Business, Key Statistics & Analysis – December 2012, published by the Australian Government, Department of Industry, Innovation, Science, Research & Tertiary Education.

Some of the key findings of this report were as follows:

- In Australia, small business (defined as actively trading businesses with between 0 and 19 employees) make a significant contribution to the Australian economy, accounting for slightly less than one-half of private sector industry employment and contributing approximately one third of private sector industry value added in 2010–11.
- There were 2 132 412 actively trading businesses in Australia as at June 2011
- In 2010–11, micro businesses, other small businesses and medium businesses experienced barriers to innovation shown by 65.8 per cent, 58.8 per cent and 63.1 per cent respectively

Additional evidence from the Australian study of Entrepreneurial Emergence suggests that:

- Over half a million Australians are involved in early stage entrepreneurial activity at any point in time.
- Australian start-ups compare well with their American counterparts on indicators of quality.
- In terms of quality, Australian founders are less likely to be motivated by necessity or lack of alternatives, more likely to be growth oriented, more likely to emphasise research and development, and more likely to be based on young and/or sophisticated technologies

On the contrary, the Global Entrepreneurship Monitor (GEM) suggests that

- Australia has high rates—second only to the US among “innovation-driven economies”
- Australia has the highest proportion of start-ups motivated by “improvement-driven opportunity”.

In terms of finance only one source, personal savings, is used by more than 50 per cent of all start-ups.

Despite frequent references to the '3 Fs'—friends, family and fools—most firms do not rely on such sources. Apart from credit card debt, even a major source such as bank funding is used only by a minority.

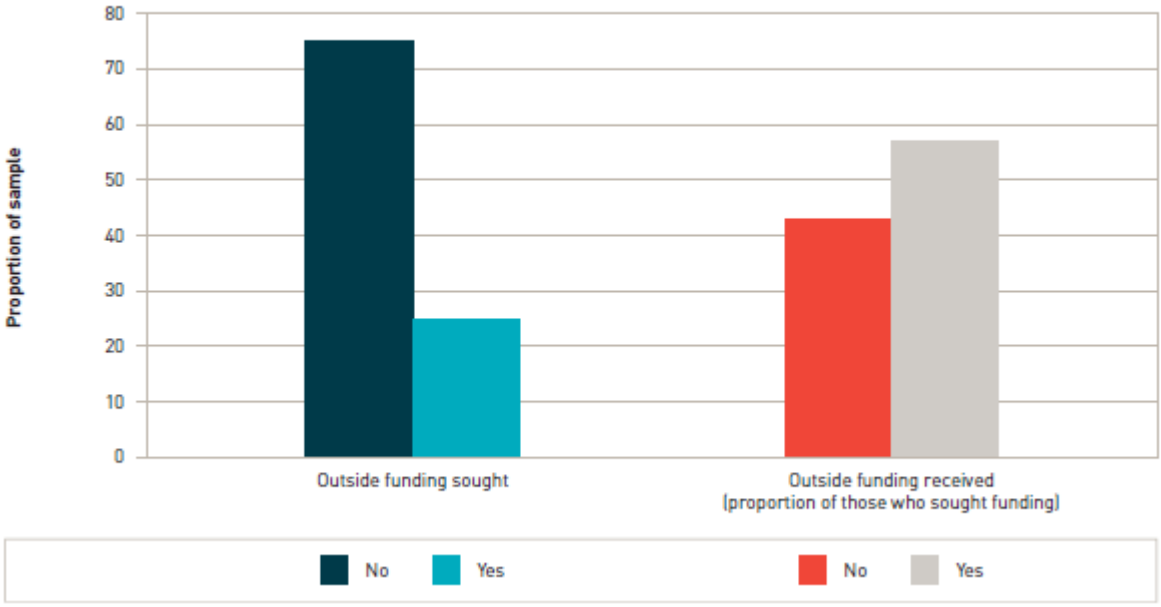
In a random sample, funding by business angels and venture capital firms is close to non-existent. This is quite different from the picture of "typical" start-ups from the business press or business school textbooks.

Table 2: Per cent of nascent and young firms using different sources of funding

Source	Not used		Minor source		Major source	
	NF	YF	NF	YF	NF	YF
Personal savings	13	25	15	24	72	51
Personal credit card	55	53	25	28	21	19
Money from another business that the founders' also own	85	96	6	2	9	2
Government grants	93	94	5	5	2	1
Delayed payment terms from suppliers	87	78	8	13	5	9
Advance payment from customers	86	78	9	14	5	8
Loans from family members	86	91	9	6	5	2
Loans from friends, employers or colleagues	95	96	4	3	1	1
Founders' personal secured-bank loans	83	84	4	6	12	11
Founders' other personal loans, overdraft or other credit facilities from a bank	85	84	9	9	6	6
Secured bank loans to the business itself	92	91	3	4	5	6
Other loans, overdraft or other credit facilities from a bank to the business itself	94	92	5	6	1	2
Loans from any other organisation to the business itself	96	94	3	3	1	2
Equity from family members	95	91	4	6	1	2
Equity from friends, employers or colleagues	98	99	1	1	1	0
Equity from other private investors ('business angels')	98	99	1	1	1	0
Equity from Venture Capital firms or any other organisations	100	100	(one case each among NF and YF, respectively)			

Note: NF – Nascent firm; YF – Young firm. Entries in per cent. Entries may not sum to 100 due to rounding.
"Major" was defined as representing at least 20 per cent of total funding needs.

Figure 6: Seeking and receiving external funding (nascent firms only)

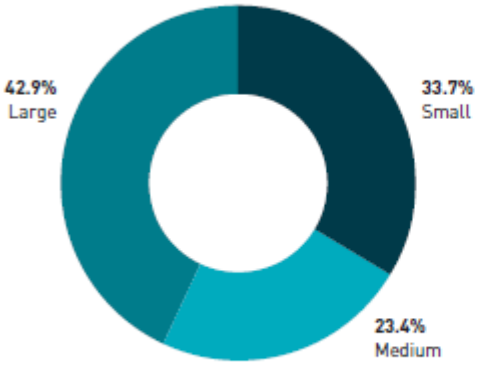


The graphs above indicate that many start-ups do not even try to source outside funding, possibly due to a perceived lack of options available or perhaps not wanting to rescind control of their firm.

a) Australian Bureau of Statistics

According to the ABS Small businesses make a significant contribution to the Australian economy, accounting for nearly one-half of private sector industry employment and contributing approximately one third of private sector industry value added in 2010–11.

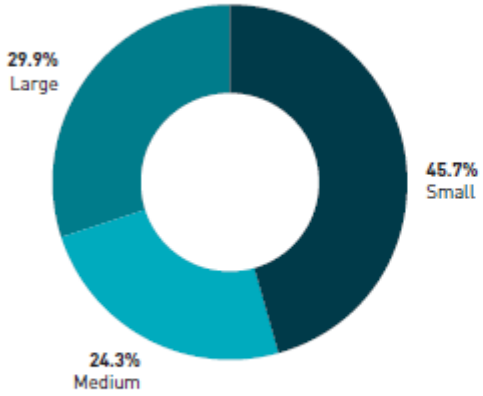
Figure 9: Contribution to private sector industry value added by business size, 2010–11



Data source: ABS Cat. No. 8155.0 and DIISRTE calculations.

Text description: see Appendix C.

Figure 11: Share of private sector employment by business size, at end June 2011

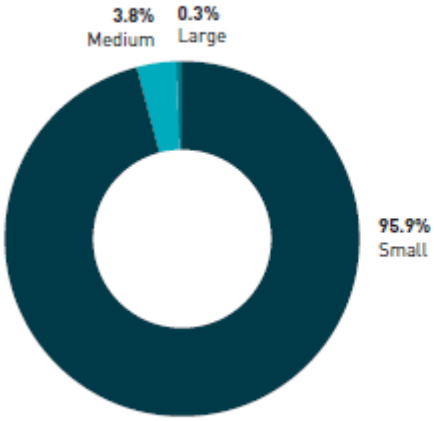


Data source: ABS Cat. No. 8155.0 and DIISRTE calculations.

Text description: see Appendix C.

The figure below shows that of the 2,1 million actively trading businesses in June 2011, almost 96 per cent were small businesses (over 2 million), 3.8 per cent were medium businesses and less than 1 per cent were large businesses.

Figure 16: Distribution of total business numbers by business size, June 2011



Data source: ABS Cat. No. 8165.0 and DIISRTE calculations.

The Australian Taxation Office (ATO) estimates that there were around 3 million micro entities in Australia at the start of the 2012–13 financial year, up from around 2.8 million micro entities at the start of the 2011–12 financial year. Micro entities are defined as having a turnover of equal to or more than $1 and less than $2 million in a financial year.

In relation to business finance, businesses were asked whether they had sought any debt and/or equity finance during 2010–11. The proportion of businesses seeking finance increased with each successive employment size range: from 15 per cent for firms employing 0–4 persons, to 37 per cent of firms employing more than 200 persons.

Both micro businesses (40 per cent) and other small businesses (45 per cent) reported short-term cash flow or liquidity as the most common reason for seeking finance. The

second most common response from micro and other small businesses was to ensure survival of business at 35 and 37 per cent respectively.

Table 14 below shows the aggregate survival rates for the Australian economy as a whole and depicts the proportion of businesses that were operating in June 2007 and continued operating to June 2011. As can be seen from this table, the survival rate for small businesses is lower than for medium and large businesses

Table 14: Business "survival" rates by employment size between June 2007 to June 2011

	Number of businesses operating in June 2007	Number of businesses that continued to operate to June 2011	"Survival" rate (%)
Small (0–19)	1 985 822	1 185 997	59.7
Medium (20–199)	82 071	62 243	75.8
Large (200+)	5 900	4 386	74.3
Total	**2 073 793**	**1 252 626**	**60.4**

Data source: ABS Cat. No. 8165.0 and DIISRTE calculations.

b) Bank lending for small business

Small businesses access many sources of finance to assist their business. Sources of finance include family, friends, credit cards, mortgages and unsecured loans, to name a few.

The Reserve Bank of Australia hosted a small business finance roundtable in May 2012, to gain better understanding of how small businesses are financed. The roundtable, besides making other observations, noted that:

- Small businesses meet their funding needs using internal equity funding and existing debt facilities.
- Eighty per cent of small business loan applications are accepted while only a small fraction of businesses who seek venture capital funding are successful.
- Small businesses pay more, on average, for debt than both households and larger businesses. This is because smaller businesses are typically viewed as having more volatile revenue streams, make greater use of riskier forms of loan collateral, and make more use of unsecured debt products.
- The higher cost of small business debt facilities leads many smaller businesses to use household debt products to fund their business.
- Smaller businesses also make use of alternative sources of debt such as equipment and vehicle leasing.
- Other forms of finance for small businesses include debtor finance and debt funding from trade suppliers.

The RBA also reported that:

'The strong links between small businesses and households also accords with the finding that while small businesses tend to have less debt than large businesses, households that own small businesses tend to have higher debt than other households. The personal nature of small businesses is often reflected in their financing arrangements, with financing evolving with the business. Initially, financing is predominantly tied to the owners' personal situation. As the business develops, financing becomes more closely linked to the performance of the business.

c) Trends in small business access to finance

In its Submission to the Inquiry into Access for Small and Medium Business to Finance, the Reserve Bank of Australia, on 7 February 2011, reported that:

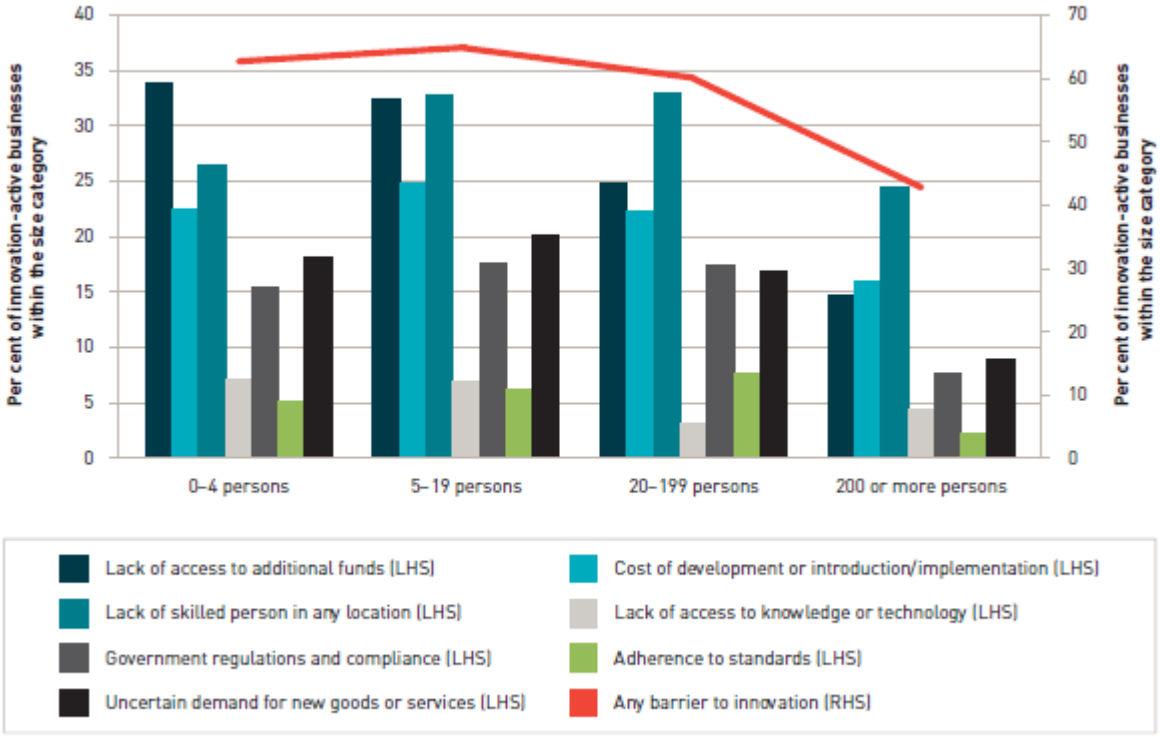
- Lending to small businesses has increased slightly over 2009 and 2010, after growing steadily over the decade prior. The slowdown reflects both reduced demand from businesses and a general tightening in banks' lending standards. Small businesses in most industries have been able to access funding throughout the financial crisis, albeit on less favourable terms than previously.'
- 'Higher funding costs and a reassessment of risk have resulted in an increase in the spread between the rates that lenders charge on business loans and the cash rate.'
- 'Competition in the small business lending market eased following the onset of the financial crisis, but there are some early signs that competitive pressures are again beginning to intensify in some segments of the business lending market. This should continue as the economy continues to strengthen.'

The CPA Australia Asia-Pacific Small Business Survey 2011 found that only 30 per cent of businesses surveyed had a business loan at the time of the survey. According to the survey, 30 per cent of businesses needed additional funds in the year to October 2011, with the main reasons for requiring additional funding being to cover increasing expenses and business survival (41% each).

The survey also revealed that in 2011, a much higher percentage of business owners sought additional finance for business survival, purchasing assets and covering tax payments compared with the year before. On the other hand, the percentage of businesses seeking additional finance for business growth remained almost unchanged from 2010. This may reflect a shift in small business bank financing priorities from growth to survival. Of those businesses which reported requiring additional funding, 55 per cent obtained all or part

About a third of business seeking finance reported difficulty in accessing additional funding, with difficulty in finding a financier willing to provide funding to the business' industry reported as the main reason.

Figure 33: Barriers to innovation, 2010–11[48]



Data source: ABS Cat. No. 8158.0, Data Cube 6, Table 1

3. Current Australian Environment for Equity raising

Equity fund raising in Australia can currently be secured from a number of avenues namely:

- Offers to the Public
- ASSOB
- Angel Investors
- Venture Capital & Private Equity

a) Offers to the Public

The Australian Corporations Act, 2001 (the Act) sets out the rules and procedures required to raise funds from the public via the issue of shares.

The relevant rules are contained in Chapter 6D of the Act and essentially state that a person cannot make an offer of securities (i.e. shares) to an investor until a disclosure document has been lodged with ASIC.

Some offers, as defined in s708 of the Act, can be classified as exempt and require no disclosure, such as:

- Personal offers (offers of less than $2m and no more than 20 investors in a 12 month period)
- Offers to sophisticated investors (defined as someone with net assets of >$2.5m or gross income for the last 2 years of at least $250k)
- Offers to professional investors (e.g. listed entities with assets of at least $10m)

Where none of these exemptions apply a proprietary company (i.e. a private company) is prohibited from raising any funds from investors in Australia. Where offers are received from outside Australia these rules do not apply but local rules (from where the offer is made) may be applicable.

Given the above, the opportunity for small private companies to raise funds from the public is very limited unless you know some wealthy and/or sophisticated investors. Certainly equity crowd funding (i.e. raising small amounts of investment from lots of people) would not be allowed unless the rules of Chapter 6D were followed.

Irrespective of whether an offer is exempt or not, the conduct of someone raising funds from the public could still be subject to other sections of the Act or common law, i.e. you cannot make false or misleading statements or engage in misleading or deceptive conduct.

For this reason most offers to the public (exempt or not) are contained in an information memorandum, the aim of which is to minimise risk for the issuer in case they are accused of misleading or deceptive behaviour. Although this is not a formal document required by the Act it is common practice and typically requires input from professional accountants and lawyers which can turn into fees of tens of thousands of dollars.

For non-exempt offers to the public a prospectus is required to be prepared and lodged with ASIC. This is a formal document containing pre-determined information and again typically involves input from accountants and lawyers.

For offers of less than $5m an offer information statement can be used which is a less onerous document in terms of content but again typically requires input from accountants and lawyers.

What we can conclude from the above is that the current legislation enables the raising of funds from the public but the cost of compliance and complexity and risk involved is high making it almost impossible for private companies to access the public for investment with the legislation in its current form.

The key is to find an alternative solution which balances investor protection (via various disclosure and/or statements from the directors) with minimising the cost of compliance in terms of preparation of documentation.

b) ASSOB

ASSOB operates under ASIC Class Order 02/273 which provides an exemption from the fundraising provisions of the Corporations Act for persons involved in making or calling attention to offers of securities through a business introduction service.

According to their website ASSOB is Australia's largest and most successful business introduction and matching platform for showcasing investment opportunities in high growth, unlisted Australian companies.

A wide range of businesses, from seed and start-up stage to award-winning and government granted companies, as well as more established growth and expanding companies have joined ASSOB seeking access to growth capital and a convenient forum to connect with potential investors and other stakeholders.

To join ASSOB, companies are not required to have a minimum company size, particular financial track record, proven profit trading history or shareholder spread.

ASSOB have raised ~$135m to date, but the class order limits investors to 20 accredited investors per annum and a maximum funding amount of $5m.

It costs a company $4,500 to list on the platform plus $400 per month to retain the listing, sponsor fees for investor documentation average $3,000 plus, with typical fees of $8,000 upwards.

There are also other fees to consider such as

- Trust account & Share register establishment fee of $1,250,

- Transaction fees of 2.5%
- Success fees of 8% of capital raised

Although ASSOB, operating under its class order, certainly makes it easier and cheaper for smaller companies to access capital it certainly requires improvement to enable smaller companies to access the capital markets more cheaply and to engage a wider cross section of the population.

c) Angel Investors

According to Wikipedia an Angel Investor is an affluent individual who provides capital for a business start-up, usually in exchange for ownership equity. According to the Australian Association of Angel Investors (AAAI, www.aaai.net.au):

- Australian Angel investors invested $1 billion in emerging businesses.
- These businesses generated 5,000 jobs.
- More than 50% of Angel investments were in seed and start-up companies.
- The most popular sectors for Angel investment were Life Sciences, Clean Technologies, Web Software and IT.
- Angel investors spend around 48 hours per month on Angel investment activities. Up to 20 hours is spent advising entrepreneurs seeking investment.
- There are now 12 Angel Groups across Australia. In 2006 there were only three.
- The average size of an Angel Capital investment in a round is between $350,000 – $400,000 in Australia.

From the above Angel Investing would certainly seem to be a viable source of capital for many businesses but consideration needs to be taken of the chances of success under Angel funding and also the consequences of bringing in an Angel investor.

The following data was gathered from Southern California's Tech Coast Angels (sourced via www.billpayne.com), showing that only 1 in 72 entrepreneurs (1.4%) who applied for funding were successful, broken down as follows:

- Pre-Screening: 1 in 4 deals proceeds to Screening
- Screening: 1 in 3 deals proceeds to Due diligence
- Due diligence: 1 in 3 deals proceeds to an Investment Meeting
- Investment Meeting: 1 in 2 deals raising money
- Overall: 1 in 72 companies who apply for funding are successful

So this would infer that the chances of finding and securing a deal with an Angel Investor are pretty slim. This makes sense when you consider that an Angel Investor is potentially investing a few hundred thousand dollars in a number of investments, 80% of which may not work, therefore they have to be strict in their investment screening process to try and earn a return on their investments.

Angel Investors apply a screening method to all of their potential investors and there is no reason why a similar process should not be used in the equity crowd funding process to enable potential investors to form a view of the company.

Typically this screening process would involve looking at the following issues:

- What is the value proposition for the business and for the investors
- How are you going to scale revenues and business value as fast as possible
- Ensure your business has a unique competitive position – something that indicates why you will succeed over anyone else
- Identify an exit strategy, e.g. trade sale or IPO
- Knowing how much money you are going to need to deliver the returns to investors

The management team is also one of the most important pieces of the puzzle for Angel Investors, the following information is extracted directly from the AAAI website:

"Angel Investors recognise that the founder and management team are the critical factors in delivering on outcomes in any business. There is a continual debate about whether to "bet on the horse or the jockey". For Angels it is about both. There must be a significant and unique value proposition that will give you a distinct competitive advantage. However the best technology in the world cannot be guaranteed to succeed without the passion and drive of the founder and the management team. Someone has to live that business and drive it forward. The investors will need to have confidence that founders and management can deliver on that and that they are prepared to develop a strong relationship based on trust. One key factor is whether the team is mentorable. If a founder is not prepared to listen and learn from experience, it is not likely to be a comfortable relationship and investors may walk away."

When it comes to equity crowd funding mentoring is not an option, it is assumed that the existing management team has the required skills, experience and drive to deliver on results. As a result there needs to be a consistent way to measure this to enable potential investors to gauge these management traits. Many of these can be assessed by discussions or investor presentations, interviews with management, background checks etc.

In conclusion although Angel Investing has an important role to play in finding and developing new businesses it also has a number of drawbacks, mainly in relation to your chances of securing investment.

d) Private Equity & Venture Capital

In Australia Private Equity & venture Capital is essentially an avenue for companies to secure funding for expansion capital rather than start-up capital.

According to the Australian Private Equity & Venture Capital Association (AVCAL - www.avcal.com.au) there are approximately 300 private equity & venture capital firms in Australia.

Over the last 10 years over $1.5bn has been invested in 250 companies. Considering there are over 1 million businesses in Australia, many thousands of which are looking for capital, this is not a high hit rate and indicates that the private equity and venture capital industry in Australia is more focused on companies that already have some substance to them with a track record of growth requiring expansion capital to take them to the next level.

As a result this form of funding is not really viable for small private companies looking to raise seed capital although it does have its place on the funding ladder.

4. US Overview

The US JOBS Act ("the Act") was signed into law on 5 April 2012, with an initial expectation that it would be implemented by the SEC on 1 January 2013.

The primary provisions of the Act were aimed at:

- Increasing the number of shareholders a company may have before being required to register its common stock with the SEC and become a public reporting company. Currently these requirements are applied when company assets reach $10 million and it has 500 shareholders. This would be altered so that the threshold is reached only if the company has 500 "unaccredited" shareholders, or 2,000 total shareholders, including both accredited and unaccredited.
- Provide a new exemption (subject to a number of conditions) from the requirement to register public offerings with the SEC. This exemption would allow use of the internet "funding portals" registered with the government. Currently the use of such portals in private placements is extremely limited. Included in these conditions is a yearly limit on the amount each person may invest in offerings of this type (linked to net worth or yearly income). The limits are $2,000 or 5% (whichever is greater) for people earning (or worth) up to $100,000, and $100,000 or 10% (whichever is less) for people earning (or worth) $100,000 or more. The aim of this exemption is to allow a form of crowd funding. The Act also allows for reviews of financial statements for offerings between $100,000 and $500,000, and audits of financial statements for offerings greater than $500,000 (with a maximum offering of $1million).
- Relieve emerging growth companies from certain regulatory and disclosure requirements (most notably the obligations imposed by Section 404 of the Sarbanes-Oxley Act and related rules and regulations) in the registration statement they originally file when they go public, and for a certain period after that.
- Lift the ban on "general solicitation" and advertising in specific kinds of private placements of securities, i.e. allowing the use of social media to promote offerings to the public.
- Raise the limit for offerings from $5 million to $50 million, which allows for larger fundraising efforts under this simplified regulation.

There are obviously concerns regarding the perceived lack of investment protection for investors, thereby exposing small and inexperienced investors to the prospect of fraud.

5. UK Overview

Crowd funding sites and peer-to-peer lenders in the UK have developed to help fill a gap left by reduced bank lending due to tougher capital rules and greater regulatory scrutiny.

The British government has pledged to lend £85 million through non-bank lenders, including peer-to-peer sites, as part of its efforts to help drive economic recovery by boosting funding for small businesses.

The Financial Conduct Authority has authorised (as an exemption from the United Kingdom prospectus provisions) some intermediaries to conduct crowd funding to investors who self-certify that they come within prescribed tests of being high net worth or sophisticated investors.

Given the restrictions around investors and their perceived sophistication when it comes to investing this has reduced the amount of regulation for issuers and intermediaries compared to other countries which are considering full equity crowd funding legislation.

Intermediaries are not obliged to conduct in-depth due diligence investigations on an issuer and only basic checks are performed.

The focus on the UK is therefore on informing potential sophisticated investors of the inherent risks involved in equity investment, i.e. limiting investment opportunities to high net worth individuals, which many perceive as unfair and not true “crowd” funding.

According to Reuters, the Financial Services Authority is currently working on additional rules for equity crowd funding and proposals could include caps on the amount an individual is allowed to invest as a percentage of their net worth, or a higher minimum investment level intended to deter those who can't afford to lose money currently rumoured to be £1,000.

a) Tax incentives

The other aspect of UK legislation which should not be overlooked is the tax incentives available for investors.

On 6 April 2012, the Seed Enterprise Investment Scheme (SEIS) was launched, with the goal to "stimulate entrepreneurship and kick start the economy."

Investments which qualify under SEIS allow significant tax incentives for investors purchasing equity the rationale being that investment in companies that are not listed on a stock exchange often carries a high risk and hence the tax relief is intended to offer some compensation for that risk.

6. Italy Overview

The Italian Government recently issued a decree legalising equity based crowd funding, with CONSOB (equivalent of SEC and ASIC) given the task of implementing the legislation. The aim of the crowd funding legislation is to help entrepreneurs get access to capital but appears to be focussed on high-tech innovative start-ups.

Criteria for eligibility includes:

- the company purpose should expressly include "development and commercialisation of high-tech value products or services"
- at least 51% of the company must be natural persons (not legal entities)
- no distribution of profits
- no more than 48 months in operation
- total value of yearly output should not exceed 5 million Euros (from the second year)

Interestingly the decree includes specific request to protect un-accredited investors. To that effect, professional investors and/or VCs will need to invest at least 5% in a start-up before equity is opened up to the crowd, and CONSOB will need to create protective measures for non-professional investors in the event that controlling shareholders yield their shares to a third party after the offer".

This is similar to a "Tag Along" clause, i.e. whereby a minority shareholder can tag along with any offer a majority shareholder receives for their shares. This could be an effective way of managing minority shareholder risk under equity crowd funding.

CONSOB are in the process of defining the specific legislation which is expected in the next couple of months.

7. New Zealand Overview

The Financial Markets Conduct Bill was announced in September 2013 and allows for online equity capital raising. This is effectively a re-write of Securities law in New Zealand and not specifically implemented to cater for equity crowd funding.

An intermediary will need to be registered with the Financial Markets Authority to be licensed as a 'prescribed intermediary service'.

Issuers wishing to utilise the services of a registered intermediary will be exempt from the normal requirements to register a product disclosure document.

There is a N$2 million limit on the amount each issuer can raise in any 12 month period which needs to be aggregated with any other amounts raised under the existing small scale personal offers 20/12 exception.

There are no limitations on who may invest through CSEF.

Draft regulations to support the Act will be released for consultation later in 2013 with the legislative provisions due to come into operation in April 2014.

8. CAMAC's Discussion Paper

On 10 September 2013, the Australian Corporations and Markets Advisory Committee (CAMAC) released its 'Crowd Sourced Equity Funding (CSEF) discussion paper' which sets out CAMAC's initial findings in relation to its independent review of the regulation of CSEF funding in Australia.

The CAMAC paper considers whether the current fundraising and licensing requirements should be adjusted to suit CSEF, or alternatively whether a specific set of rules and regulations for CSEF should be implemented.

CAMAC has identified a number of possible ways forward for CSEF in Australia, including:

- No change in existing regulations
- Liberalise the small scale personal offers exemption
- Limit CSEF exemptions to offers to sophisticated, experienced or professional investors
- Make specific changes to existing regulations for CSEF offers open to all investors
- Create a specific, self-contained statutory and compliance structure for CSEF open to all investors.

a) Small scale personal offers exemption

As detailed in section 3 (a), proprietary companies are prohibited from raising funds from a large number of investors unless they fall within the small scale personal offers exemption of the Corporations Act.

One possible amendment considered by CAMAC is an increase in the number of investors from the current limit of 20 as well as an adjustment to the total funds that each issuer can raise per year.

The current limit of 20 investors could barely be considered “crowd” funding and so for the regulation to meet the finance needs of small business this increase would have to be substantial.

This would, however, not get around the issue of the limit of 50 shareholders in a proprietary company and as a result additional changes may be required to amend shareholder caps for proprietary companies and additionally the level of regulation for proprietary companies versus public companies, e.g. audit requirements.

Public companies can also be exempted from the need to prepare a full prospectus if they fall within the exemptions of section 708 of the Corporations Act. Another option is raising funds via an offer information statement, which, although not a prospectus, is still a disclosure document required to be lodged with ASIC with audited account requirements and a cap of $10 million.

The Corporations Act also restricts advertising of public offers and again this is something that needs to be addressed by any new regulation as at the core of crowd funding is the ability to use social media such as Facebook to communicate and engage with the crowd and to solicit investment.

b) Sophisticated Investors

Currently a sophisticated investor is someone with $2.5m in net assets or gross income of at least $250,000. CAMAC considers whether CSEF issues should be limited to these sophisticated investors and also whether there should be a separate determination of a sophisticated investor in a CSEF context.

Should any new CSEF legislation be limited to the privileged few who are already independently wealthy or should the "crowd" decide which opportunities they want to back? At the end of the day it's the "crowd" that decide whether a product or service is successful by consuming or using it so why shouldn't the "crowd" have the ability to invest in what they perceive to be the next best thing since sliced bread.

Nobody should be able to lose their life savings on a single investment and so we would support caps on investment in CSEF issues but we believe everybody has the right to participate if they wish.

Perhaps the definition of sophistication is also misplaced, just because someone has wealth doesn't necessarily make them sophisticated and the opposite is also true. Perhaps a better gauge of investment sophistication should be a test that anyone wanting to invest via CSEF must pass before being accredited? At a minimum this test could raise the awareness of the key investment risks for individuals and at least get them asking the right questions of the issuer.

c) Managed Investment Schemes

Another alternative to direct shareholding via CSEF is for individuals to hold an economic interest via a Managed Investment Scheme, essentially money is pooled by members of the scheme and invested in underlying securities.

These schemes are also regulated by the Corporations Act and require:

- registration with ASIC if there are more than 20 members
- a responsible entity to hold an Australian Financial Services License allowing it to operate a scheme
- the responsible entity to issue a product disclosure statement

CAMAC's paper considers whether the regulation regarding Managed Investment Schemes could be adjusted to meet the requirements of CSEF.

The problem with these schemes is the cost of compliance for the intermediary, the requirement for a responsible entity and AFSL requires significant cost which undermines the purpose of equity crowd funding which is for small business to raise money from the crowd in a timely and cost effective manner.

d) Licensing

The CAMAC paper also addresses whether the current licensing requirements should be adjusted to allow intermediaries to operate. There could be specific requirements introduced to determine:

- How the level of risk disclosure is to be communicated to investors,
- The extent of background checks required to be made by the intermediary on the issuer
- The extent of due diligence required by the intermediary on the issuer, and
- How funds should be processed and distributed to the issuer

Submissions to CAMAC are due by 30 November 2013 and feedback is expected in the first quarter of 2014.

At the end of the day any CSEF laws need to balance quick access to low cost funding for small business with investor protection and ensuring a credible and viable population of intermediaries.

9. Recommendation

The rules for equity crowd funding in Australia are already in existence (almost) in the form of the personal offer exemption. As a result we believe that the most pragmatic approach to implementing equity crowd funding in Australia is to amend the existing legislation to expeditiously allow equity crowd funding.

Equity crowd funding is a relatively new concept and will evolve over time but trying to create new legislation for something that we don't fully understand yet will result in legislation that may not address the issue of access to capital for small business. It will also be a very time consuming process to draft new legislation rather than amending existing.

We believe the following principles and guidelines should be adopted in any amendments to the legislation.

a) Investors

- Limits on investment – we believe equity crowd funding should be open to all residents irrespective of whether they meet the existing "Sophistication" criteria. There should be reasonable limits on how much an individual can invest via equity crowd funding to ensure that nobody is at risk of losing a material portion of their wealth in one investment. We suggest that this limit should be a flat $5,000 maximum. For Self-Managed Super Funds we suggest a limit of $10,000.
- Self-regulation and reporting – In order to manage these limits there needs to be some kind of regulation and reporting requirements. This would be too onerous for an intermediary to manage and as a result the most practical approach is for individuals to self-regulate possibly using the ATO and annual tax returns process.
- Tax relief – to encourage equity crowd funding for small business we recommend specific tax relief for investors, this will also force individuals to report their investments via the ATO and hence self-regulate. Tax relief should take the form of a tax deduction for up to $5,000 invested via an eligible equity crowd funding project.
- Accreditation – It is important for investors to be fully aware of the risks of investing. We do not believe that wealth or income is a good gauge of sophistication. As a result we would support an accreditation process whereby prior to investing an investor would be required to attend and pass a risk awareness workshop.
- Limit on potential investors – we suggest a limit on the number of potential investors of 400 for a specific opportunity, at an investment limit of $5,000 each this equates to a maximum investment of $2 million in the issuer which we believe is sufficient. Given the limit of 50 shareholders in a proprietary company this may require specific laws regarding the type of company that can be established for equity crowd funding, i.e. a hybrid structure (Provisional Public – refer below) giving the flexibility of a public company but the compliance regime for proprietary companies.
- Legal interest in shares – we do not support the use of managed investment schemes to invest in start-ups or small business mainly due to the onerous registration requirements and ongoing AFSL and Responsible Entity requirements. As

a result we support the investor having full legal interest in the shares and not indirect beneficial interest via a managed investment scheme.

- Tag Along rights – to protect the interests of investors whilst the business is in Provisional Public status (refer below) we suggest that Tag-Along clauses are compulsory. This would force anybody making an offer for the shares of a controlling shareholder to make the same offer to all minority shareholders. This would ensure that individual investors are not left "holding the can" after the controlling shareholder has sold out.
- Cooling off period – the investor should have a reasonable time post the investment decision to change their mind, we suggest this cooling off period should be 14 days, long enough for an investor to fully consider the opportunity and associated risks but not too long so as to delay the issuer unreasonably.

b) Issuers

- Accreditation of directors – we believe that all directors of an issuer should be accredited (via formal training) to ensure they understand their fiduciary and other duties towards their shareholders.
- New issues only – any issue of securities via an equity crowd funding process should be for the issue of new shares only, i.e. not the sale of existing shares from existing shareholders
- Provisional Public Company – we suggest the creation of a new form of company called a Provisional Public Company specifically for use in equity crowd funding. The intention being that this type of company structure gives the issuer the flexibility to have multiple shareholders but not the related public company governance requirements. The intention would also be for an issuer to eventually evolve into a full public company once certain criteria in terms of revenue, profitability or total assets was met. In this way investors will have a potential exit strategy as the company grows and converts to a full public company. Other potential attributes of a Provisional Public Company include:
    - A maximum of 400 shareholders
    - Only one type of share available, i.e. all shareholders have the same voting rights and rights to dividends (this will avoid investor confusion and potentially misleading behaviour from the issuer)
    - A limited disclosure document for fund raising purposes which should include:
        - Description of business and business plan
        - Current financial statements (income statement and balance sheet)
        - Director and Officer details, skills, experience and remuneration details
        - How much funding is required and use of proceeds
        - Deadline to reach minimum subscription
        - Price of the shares supported by a valuation including details of how valuation was reached
        - Related party transactions

        - Future fund raising rounds expected and potential dilution of shareholding
    - No audit requirements unless turnover exceeds a certain pre-determined amount (we suggest $2 million) or unless a certain minimum % of shareholders request an audit. For issuers with turnover greater than $0.5 million but less than $2 million we suggest a formal review but not an audit and for turnover less than $0.5 million we suggest no audit or review requirements.
- Tag along clauses – as mentioned above under "investors" we believe that a tag along clause should be a standard mechanism for any equity crowd funding issue. This will ensure a majority shareholder cannot sell out leaving minorities with no exit strategy.
- Solicitation & advertising – Issuers should have the ability to directly solicit investment from accredited investors (i.e. those that have completed their equity crowd funding risk workshop) via all forms of media.

c) Intermediaries

- Registration of intermediary – we recommend that all intermediaries be registered with ASIC but that should be the extent of any regulation, i.e. no requirement for an AFSL or being registered as a Responsible Entity. Anything further than simple registration would be onerous and costly for the intermediary and such costs would ultimately be passed on to the issuer which would defeat the purpose of crowd funding being a low cost option for small business.
- Risk awareness – the intermediary should ensure that the investor is fully aware of the potential risks of investing in a small business start-up. Prior to approving any investment the investor should be forced to positively acknowledge that they are aware of the potential investment risks.
- Investment advice – the intermediary should not be allowed to offer investment advice to any investor or issuer
- Solicitation – the intermediary should not be able to solicit investment, the role of the intermediary should simply be to facilitate the introduction of accredited investors with issuers, ensuring the necessary laws and regulations are followed.
- Due diligence – The intermediary should be responsible for basic due diligence on the issuer including director background checks and IP and/or key asset ownership, full details of the due diligence findings should also be disclosed.
- Project eligibility – the intermediary should take reasonable care to ensure that any issuer listed on their platform does not:
    - Infringe any intellectual property rights
    - Breach any applicable laws
    - Be defamatory
    - Be obscene or offensive
- Access to accredited investors – The intermediary should ensure that only accredited investors (refer above) have access to the investment opportunities on the platform.
- Cooling off periods – the intermediary should ensure that any investor has a reasonable time to "cool-off" after making an investment decision.

10.Contact details

If you have any questions or suggestions on equity crowd funding and specifically this white paper then please feel free to send us an email to whitepaper@ipledg.com

social business australia

Submission to the Review of "Crowd Sourced Equity Funding"(CSEF)

Social Business Australia (SBA) would like to provide the following submission to the above review. Social Business Australia is a development agency involved in the start-up of cooperative and community owned businesses and supports the development of "community share offers" which can enable community buyouts of key facilities, businesses and services important to local communities and the start-up of community owned enterprises.

This submission has been discussed with the Social Enterprise, Entrepreneurship and Innovation Alliance (SEEI), a body which is in formation to assist the development of social enterprise in Australia. SBA is a member of this body. Those organisations which are members of the SEEI which have expressed support for this approach include Social Traders (see: http://www.socialtraders.com.au/), The Desert Peoples Centre (http://desertpeoplescentre.org.au/) and Employee Ownership Australia Ltd (www.employeeownership.com.au). As well, the new Business Council for Cooperatives and Mutuals (BCCM - www.bccm.coop) has expressed support.

The writer is not a lawyer but has long term involvement in community ownership activity in Australia and some experience with the kind of projects described below.

On the policy development side of "community share offers", I would recommend the UK report "Community Investment – Using the Industrial and Provident Societies Legislation" (published by Cooperatives UK in 2008). This report contains a wealth of information and case studies on the process of "community investment" through the cooperative form of incorporation and can be seen at: http://australia2012.coop/downloads/Community-Investment.pdf.

The key point to note is that in the UK, 60 million pounds has been raised in the past three years through "community share offers" for investment in a range of community businesses as part of "community investment" programs of various sorts.

1. The Benefits of CSEF to Social Enterprise Development

Social enterprises are defined as "businesses that operate for a social purpose". They do this by trading in the marketplace, by investing any profits into their social mission and by being owned by either "not-for-profit" organisations, cooperatives or community owned companies.

Social enterprises financed through "community investment" are widespread overseas and – though small in number in Australia – are gaining much attention here. Social enterprises that could have benefitted from "crowd sourced equity funding" platforms in Australia in the past

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are those that have been involved in community buyouts or in starting up community owned businesses, especially those involved in renewable energy.

Community renewable energy enterprises are quite well developed in Australia with some 60 projects either started-up or in the planning stage. I understand that a submission will be made to the CSEF review by groups representing this area of interest. Community renewable energy projects are incorporated in a number of ways, including cooperatives and community trusts.

Key development agencies operating in the community energy area that I am aware of are "Embark" (see: : http://www.embark.com.au/display/WebsiteContent/Home and "The Community Power Agency" (see: http://www.cpagency.org.au/index.php). Community owned investment funds are also under development in this area in Australia.

The best known community renewable energy project in operation in Australia is Hepburn Community Wind Farm Cooperative Ltd (see: http://hepburnwind.com.au/). This project raised $10 million for its wind farm through a "community share offer". While most of the funds were raised locally, this offer did face Corporate law restrictions placed on it by ASIC in relation to the fundraising approach taken, when the project sought to raise funds from outside its "membership area". These restrictions could have been overcome if it was able to utilise a CSEF platform enabling "exempt" small scale investments to be made through a "direct public offer" to a wide range of community supporters – "exempt" in the same way as under the "light touch" regulatory regimes that operate for such schemes in some other countries.

In terms of CSEF technology platforms, there appear to be several of these operating in other countries specifically for starting up community owned renewable energy projects in wind, solar, hydro, wave and other technologies. Others operate for a range of community businesses and community buyouts. One such example of the latter - a functioning CSEF platform which would be of interest to the Review - is that called "Microgenius" in the UK. You can see the projects on this platform at: http://www.microgenius.org.uk/ .

This platform is part of the excellent "Community Shares" program operated by "Cooperatives UK" and is one of the most successful areas of social enterprise development. To view the projects that are developing in that program, see http://communityshares.org.uk/ .

As an example of a "community share offer" that has appeared in the press in the past couple of days, you can see this one at: http://www.theguardian.com/social-enterprise-partner-zone-the-co-operative/money-flows-in-whalley-community-hydro .

SBA is working with other groups such as the BCCM to develop an "action research" program that could provide more impetus to the broader development of "community share offers" in Australia and - for the reasons to be outlined below - CSEF will be able facilitate these developments by enabling "ease of access" to equity finance from community investors.

Overall, for social enterprise, CSEF will:

(i) Open up the benefits of social enterprise to a wider range of smaller investors who are not currently able to access opportunities through restricted "local investment" projects.
(ii) Open up equity financing for innovative social enterprises that have no track record.

2. Examples of past "Community Share Offers" in Australia

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Other than Hepburn Wind mentioned above, there are several community business examples in this country that can be used as case studies. A couple that are not cooperatives that I am aware of are related below and are narrated from my understanding and research of each case, including discussions with those who have been involved. The numbers are approximate only:

1. Yackandandah Community Development Company – an unlisted public company formed to enable the 500 "shareholders" from the township to buyout the local service station to preserve this vital facility for community use (with the average shareholding being around $1000). Luckily, Yackandandah CDO was able to receive the services of KPMG who did all the legal work on a "pro-bono" basis at a considerable cost saving to the community involved.

2. Eco Forest Ltd – an unlisted public company "green business" which sought to raise a couple of million though "public subscription" (ie: 1000 supporters purchasing $2000 worth of shares each). The project was deemed by ASIC to be non-compliant and the fundraising was stopped until a re-worked prospectus was produced. In the end, time ran out and the project did not raise what it required within the12 month limit on fundraising/disclosure documents, leaving ithe project under capitalised - and though it got started, it ran out of funds before it could generate enough income from the tree farm and associated "eco" businesses to break even, and so it went into liquidation.

3. The Difference Between "Crowd Funding" and "Crowd Sourced Equity Funding"

In the cases above of course, we are not talking about small scale "donations" to charitable projects or social ventures as crowd funding operates here now, but larger scale "capital fundraisings" in the realm of say the $1 million limit now applying under the JOBS Act in the US. If a "JOBS Act" type regulatory regime had have been operating in Australia, it could have assisted projects like those mentioned above in the past.

There appears to be no legal impediment to "crowd funding" in Australia – the simple process of "soliciting" donations, ie: free money which people are prepared to "give" to charitable projects and social ventures. The ASIC "Guidance on Crowdfunding" is the key source document here (see: http://www.asic.gov.au/asic/asic.nsf/byheadline/12-196MR+ASIC+guidance+on+crowd+funding).

"Crowd sourced equity" on the other hand is as it says - lots of people investing small amounts in the "equity" component of a business (always involving some form of "securities" as they are defined in Corporations law, eg: shares or the like). "Soliciting" for such investments in "securities" is covered by Section 708 of Corporations law. Currently, the Corporations Act requires a prospectus for all capital raisings via "public offers", the cost of which acts as a significant barrier to capital raising for small business (because it almost certainly will involve lawyers in each case).

4. The Cost of Compliance with Corporations Law in the Case of "Community Share Offers"

The problem with s708 is that it is structured with large investors/sophisticated market players in mind. The cost and complexity of disclosure aimed at protecting these investors' interests

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(through the production of prospectuses/offer information statements and the like) is considerable and acts as an impediment to seeking lower income "community investors" making small scale equity placements.

In the writer's view, complying with this legal regime could cost as much if you are seeking 200 people to invest $1000 each in the "shares" of a social business as it will if you are seeking 200 people to invest $100,000 each in the equity base of a business "start-up". Hence, the small scale "community business" is being discriminated against and the JOBS Act in the US I understand was targetted at "freeing up" this area to enable "communities" to be able to invest to a limited scale fairly much cost and red tape free in local small businesses – and to create new jobs in the process.

The "red tape free" aspect does not deny however that the important area of "risk" must be addressed in the implementation of a regulatory regime for CSEF. Consideration of such a regime for CSEF will need to balance the "risk" of the small scale "community investor" not being adequately informed and protected from potential "scams" – or as Michael Shuman, architect of the US JOBS (Jump Start Our Business Start-ups) Act puts it "ensuring that granny won't be persuaded to invest in a swamp in Florida" - with the ongoing encouragement that needs to be given to mobilising "community capital" for social enterprises and local small businesses.

Our preferred option to do this – and the best outcome from the review - would be to create a "dedicated regulatory regime" along the lines of the JOBS Act in the US rather than to attempt to tinker with the existing disclosure/fundraising provisions in the Australian "Corporations Act".

With this preferred option in mind, I can provide the following answers in relation to the questions asked in the review's "Discussion Paper".

Question 1.

As stated above, the social enterprise sector would recommend that the Government create a "dedicated regulatory regime" along the lines proposed in the JOBS Act in the US rather than attempt to amend existing disclosure/fundraising regimes under the Corporations law in Australia. This provision would benefit the "community share offer" as outlined above in the best possible way and enable maximium 'social impact' to be derived from the implementation of such schemes. "Community share offers" need to be highlighted for their social purpose, their uniqueness and for their role in building social capital and community well-being – issues that are not considered under Corporations law to be an important consideration in the regulation of "fundraising".

Question 2.

All provisions under CSEF should enable and encourage "community share offers" free of the cost and complexity issues that they currently face. Community shares by their nature are targetted at "local investors" or "supporters of the cause" whose interest may not be about "maximising return on investment", but ensuring that a "social good" is returned for the usually long-term, small scale equity holding they will have in the community business. Sophisticated and professional investors would be unlikely to be interested in this area of investing. To define a "community share offer" may require specific limits in terms of size of offering and maximum shareholding etc. Suggestions will be made below on these limits.

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Question 3

"Community share offers" may be made for investments in community businesses incorporated as proprietary companies or public companies. Community share offers should not be restricted to one form of incorporation or another. However, the likelihood is that the "cooperative" legal structure will be prominent in this area because of what it offers in terms of shared ownership and democratic community control. The cooperative form offers reduced risk because of the way it is regulated under the State Coop Acts for fundraising within the "member relationship" using "member shares". The CSEF Review needs to consider the submission being made to it by Robyn Donnelly, former legal adviser to the NSW Registry of Cooperatives about these matters. Prominent in this submission is that any amendments made to facilitate CSEF under Corporations law must not disadvantage cooperatives incorporated under State Cooperative laws. There will be a need to ensure parallel developments are introduced into Cooperatives Acts around the nation if any CSEF related exemptions are made at the Federal level to Corporations law.

Question 4.

Any restrictions on type of issuer, type of security, disclosure, advertising or liability of issuer should not serve to disadvantage the "community share offer" described above. If a ceiling is to be considered in terms of the maximum amount that can be raised through a "community share offer", our view would be something in line with the JOBS Act would be acceptable - but no less than a ceiling of $1 million per "community share offer" .

Question 5.

There are "intermediaries" operating as business advisors and development agencies in the area of social enterprise. It is likely that if they were to become involved in faciltitating "community share offers" they would need to comply with Financial Services regulations. This may involve employing a specialist with the necessary financial services license to assist the "offer". The situation with operators of the technology platforms involved (should they be different to the intermediaries) is unclear and will need to be clarified. Otherwise, in our view the community organisation making the "offer" will need to comply with whatever regulations are endorsed for "community share offers" in terms of the minimum disclosure documents required, any investor limits arising under CSEF and any disclaimers required putting the onus on the "community investor" to to seek appropriate advice on the offer. Suggestions are made in this regard below.

Question 6.

(i) Intermediaries - no provisions should be implemented which will discriminate against what are "not-for-profit" intermediaries already operating in the social enterprise development area from assisting and promoting a "community share offer". Special provisions should be crafted to ensure that 'community share offers' are enabled and assisted by social enterprise friendly organisations in any approach to defining "permitted types of intermediaries". In the case of on-line platforms operating in the community sector, special provisions may need to be investigated to define and install processes and standards that will need to managed in terms of disclosure and promotion of "community share offers". SBA and others operating in the social enterprise area would be pleased to assist with the work required here.

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(ii) Issuers - most issuers will be community businesses of various sorts and of various legal forms. There should be no restrictions on 'community share offers' other than perhaps a minimum "community benefits test". "Community share offers" will need minumum dislosure documents to be produced on the soundness of the proposed business - perhaps a standard "Business Information Statement" for community share offers could be designed. Comfort regarding due dilgence maybe provided if one of the NFP social enterprise intermediary agencies is involved as a "nominated advisor". Community share offers are usually kept "honest" through the operation of neighbourhood scrutiny and "knowledge networks" – there is nothing like your neighbours looking over your shoulder to reduce the potential for fraud in a "community share offer" .

(ii) Investor types - there should be no restrictions placed on "type of investor" that would preclude ordinary men and women in the local community becoming involved in a community owned business through a 'community share offer', given adequate written information being made available on the offer, along with the support of reputable local community agencies. Any "fees/commissions" involved in a "community share offer" are likely to be minimal and aimed at covering costs. Platforms established to facilitate "community share offers" will need to address outstanding issues through the development of appropriate guidelines on disclosure, investment limits, the provision of formal advice to investors, soliciting investors, fees, complaints, communications and feedback systems, the management of investor funds and any other "investor protections" that may be required. SBA and others involved in the development of social enrterprise would be pleased to assist with the development of these guidelines.

Question 7.

It is unlikely that a "community share offer" would get so complicated as to require such provisions as outlined in the question. 'Community share offers' are known for their "simplicity". Where different classes of investors might be involved, this will need to be discussed in the community concerned as to the reasons why, or otherwise disclosed in a plain english "community share offer" information statement.

Question 8.

In the case of community share offers, there should be no restriction on types of investors permitted to invest – from pensioner to local bank manager, all should be permitted. There may need to be an upper limit per investor, perhaps the $2000 per investor proposed in the JOBS Act should be considered. In relation to the need for a "market" for the community shares, in the case of a cooperative, this would be under the rules applying in the State Coops Acts (ie: shares are withdrawable but not transferable outside of the coop). In the case of companies, simple "windows" will need to be opened for people to divest themselves of their shares, which may be restricted to transfer to other community members. Reporting processes – annual and otherwise - would need to be in accordance with accepted reporting standards. It needs to be acknowledged that most investors in a "community share offer" are likely to be involved for matters of the "heart" – because they support the cause or the known community benefit involved. The return on investment hardly rates and most "community investors" are likley to be "buy and hold", offering the long term 'patient' capital that is so vital to the success of these forms of social enterprise. The evidence from 'community share offers' overseas is that most people involved wish any "dividends" to be re-invested in the community business.

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Question 9.

The social enterprise sector would be advocating for a "self contained regulatory regime for CSEF" along the lines that were originally intended for the JOBS Act in the US. Accommodating CSEF within the existing regulatory regime of the Corporations Act is unlikely to offer the ease and simplicity – and low cost - that will be required to enable CSEF to operate to its "social impact" potential – or for "community share offers" to serve the likely demand and growth of social enterprise in Australia. At the moment, likely cost and complexity – combined with lack of awareness - serves as a major inhibitor to the growth in "community share offers" in this country.

Question 10.

There are no other matters that need to be addressed in our view.

In Summary

Facilitating "community share offers" through CSEF require consideration of the following solutions:

1. Crowd sourced equity platforms may need to ensure that the "investment proposal" has been placed on a "CSEF Public Register" before it can be placed on a CSEF technology platform as an "offer". This will put the project into the public domain and allow some "scrutiny" and open analysis. ASIC already offers a similar"Public Register".

2. To produce greater comfort about the veracity of "offers" made under CSEF, perhaps a system similar to that operating with the "Alternative Investment Market" in the UK could be put in place – that every project needs to have a "Nominated Advisor", a local lawyer or accountant who could act as a "referee" on the proposers of the project and verify its contents (but not its financials) - but who would not act as either a "sponsor" of the project or a "guarantor" of its success.

3. Limits on "community share offer" fundraisings could be applied as per the JOBS Act, by:

(i) How much is being raised – maximum amount (eg: $1 million per project), and
(ii) How much can be invested per individual - maximum amount per investor/individual (eg: $2000 before Corps Act cuts in - section 708 primarily)

4. Place other limits/restrictions on CSEF that could favour social investment, such as:

(i) Type of project – must be aiming for disclosed "social impact" (eg: jobs created etc). Some platforms specialise already in particular "community benefit" fund raisings (eg: community energy)
(ii) Restriction to "area" eg: local neigbourhood, LGA etc (some platforms in the US are restricted by law to State boundaries). This would encourage "community ownership" of the project and open it up to neighbourhood scrutiny, with the network of knowledge operating to keep the project "honest".
(iii) Development of a new "short form" of disclosure such as a "Community Information Statement", which migh include a "community business plan".

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(iv) Open up offers to "public feedback" (similar to eBay)

Conclusion

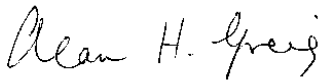
The implementation of a JOBS Act type legislative program for social enterprise in Australia would be dramatically increased "scale" in social and community enterprise developments, as has occurred with "local financing" approaches in the US and the UK.

Michael Shuman – the architect of the JOBS Act in the US – has highlighed the potential for this approach in Australia in correspindence with this writer. Michael has also visited Australia on several occasions in recent years. For example, you can see his excellent "local investment" presentation to the "Transition Towns" Conference in Sydney in September, 2012 – see "Building Resilient Local Economies through Local Investment" at: http://www.youtube.com/watch?v=xkAw4jv8hUY . He has also presented to the Sustainable Economic Growth for Regional Australia (SEGRA) Conference in Coffs Harbour in October this year.

Michael Shuman would be happy to advise the Review of CSEF if called upon to do so.

We welcome your consideration of this submission.

Yours sincerely



Alan Greig

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Submission to the Corporations and Markets Advisory Committee

Crowd Sourced Equity Funding

Discussion Paper

Submission by Dr Marina Nehme
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Introduction

This submission addresses the release of the CAMAC Discussion Paper on *Crowd Sourced Equity Funding* (September 2013). The aim of this submission is to provide an informed debate on the critical issues raised by the discussion paper.

If any of the responses require further explanations, please contact Dr Marina Nehme at the University of Western Sydney, School of Law at m.nehme@uws.edu.au.

General Observations:

The observations made in this submission can be summarised in the following manner:

- Deregulation of crowd sourced equity funding (CSEF) is not desired;
- Provisions clarifying the rules that would apply to crowdfunding should be introduced in the legislation;
- Australian crowdfunding platforms should have a financial market licence; and
- Under the current regime, investors do not need further education about investments when investing in CSEF. The only additional information that may need to be provided is the additional risk that is involved in participating in crowdfunding.

Question 1- In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?

It is important for Australia to remain economically competitive with the rest of the world. However, this should not be done at the expense of sensible regulation. In the context of CSEF, deregulation may negatively affect the three key objectives of securities regulation:

- Protecting investors;
- Ensuring market fairness, efficiency and transparency; and
- Reducing systematic risk.

These objectives are not only enshrined in the *Australian Securities and Investments Act 2001* (Cth)[1] and the *Corporations Act 2001* (Cth)[2] but they are also promoted by the International Organization of Securities Commissions as being the three key objectives of securities regulation.

While CSEF has great potential in providing finance for start-up companies, it also is problematic as crowdfunding involves higher than normal risks for equity investors:

- Fraud and scams: As noted in the discussion paper in para 2.1.4, crowdfunding opens the door wide for fraud. Certain crowdfunding platform providers have dismissed this risk by noting that the 'wisdom of the crowd' would help discover potential fraudulent projects. As such, certain platform providers only check whether the entrepreneur behind the project has a profile on social media. No other check about the veracity of their claim is done. [3] This would, of course, raise the risk of potential scams. Additionally, the flexible funding models that certain platform providers have makes them more vulnerable to scams. For instance, Indiegogo, an international crowdfunding platform, allows entrepreneurs to collect funds as soon as they are contributed by investors. As a result, a number of scams have already occurred on

[1] *Australian Securities and Investments Act 2001* (Cth), s 1(2).

[2] *Corporations Act 2001* (Cth), s 760A.

[3] Claire Ingram and Robin Teigland, *Crowdfunding among IT Enterpreneurs in Sweden: Qualitative Study of the Funding Ecosystem and IT Enterpreneurs' Adoption of Crowdfunding* (June 2013) 33.

that platform. Even though the scams were discovered before the end of the campaign, the fraudsters escaped with the funds that had already been collected.[4]

- Failure: New data highlights that three-quarters of venture backed firms in the United States fail.[5] This number will increase as a result of crowdfunding where entrepreneurs do not have a business model but are selling an idea. A case in point is the example of Mr Frankovich and Mr Pettler. They had a goal to raise $47,500 through the crowdfunding platform Kickstarter to fund an idea, and they ended up raising $215,000. While crowdfunding provided them with access to liquidity, it also meant that they had to implement their idea. This came at a higher cost that both entrepreneurs expected: they had to quit their job, borrow more money from an institutional investor to supplement the crowdfunding money they received and they had to set up the business from scratch. Mr Frankovich stated that:[6]

  > We had to use [Kickstarter] money to not only get our patents done, but our incorporation… manufacturing, tooling, design… all that stuff had to fit into that $215,000'.

  The lack of a business model in most enterprises promoted through crowdfunding platforms may lead to a higher rate of failure for these ventures leaving investors in a vulnerable position.

- Selling ideas: As noted before through crowdfunding, the entrepreneurs are selling ideas that may or may not be successful in the future. For example, it is difficult if not impossible, to assess the quality of the final product until the project not only completed its funding but also established its business model.[7]

In addition to this, the promotion and support of this new source of equity in different national jurisdictions by entrepreneurs and investors will depend on the investing culture and equity needs of that country. Here are a few examples:

- United States and Italy: these two countries have suffered major financial losses during the financial crisis. Crowdfunding may be viewed as a method to spur small business growth to solve the economic woes these countries have suffered. As a

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[4] See for example: DC Denison, 'Crowdfunding confusion: Scammer attempt to Rip Off Successful Campaigns Using Indiegogo' *Make* (08/02/2013) <http://makezine.com/2013/08/02/crowdfunding-confusion/>.

[5] Deborah Gage, 'The Venture Capital Secret: 3 out 4 Starts-Ups Fail' *The Wall Street Journal* (20/09/2012) <http://online.wsj.com/news/articles/SB10000872396390443720204578004980476429190>.

[6] Jason Abbruzese, 'The Unexpected Cost of Success' *Financial Times* (26 November 2012) <http://www.ft.com/intl/cms/s/42ee668c-302c-11e2-891b-00144feabdc0,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F42ee668c-302c-11e2-891b-00144feabdc0.html%3Fsiteedition%3Dintl&siteedition=intl&_i_referer=#axzz2lzdwNNmA>

[7] Chris Ward and Vandana Ramachandran, 'Crowdfunding the next Hit: Microfunding Online Experience Goods' (Paper Presented at Computational Social Science and the Wisdom of Crowds, Whitler, Canada, 10 December 2010), 1.

result, crowdfunding exemptions have been introduced.[8] This new type of funding is deemed as a supplement to capital from venture capitalists, angel investors and bank loans.

- Sweden: While two crowdfunding platforms have been established in Sweden, there is a perceived cultural barrier that has prevented entrepreneurs from embracing crowdfunding. There is a perception that Swedes are not known for 'confidence or risk taking' investments.[9] As such, unlike the United States and Italy, crowdfunding is considered as complementary rather than supplementary to the search for larger investors.[10] Consequently, crowdfunding in Sweden is lagging behind other countries.
- Egypt: Two crowdfunding platforms, *Shekra* and *Yomken*, have recently been established in Egypt. However, to adapt to the culture in Egypt, these two platforms have been advertising themselves as *Sharia* compliant.[11] This is reminder of the importance that culture plays in investments.
- Australia: To determine whether crowdfunding will be popular in Australia, it is important to assess the Australian investment culture. As a result, studies have to be conducted to highlight Australia's attraction/ or lack of attraction to crowdfunding as a source of equity. Further, Australia is not facing the economic woes of the United States and Italy, and so the imperative to raise funds this way is lacking.

In view of all this, the law in Australia does not need to be changed to establish a crowdfunding exemption. CSEF provides a risk for consumers/investors who may have low financial literacy or who may be carried away with an exciting idea. Further, the fact that they are investing small amounts of money does not justify deregulation. When a scam occurs, confidence in the system is shaken and regulators will be at the front of the firing line. Additionally, honest entrepreneurs will be negatively impacted.

Question 2- Should any such provision:

i take the form of some variation of the small scale offering exemption and/or
ii confine CSEF to sophisticated, experienced and professional investors?
iii adopt some other approach

As mentioned previously, this submission does not support the introduction of a crowdfunding exemption. The fundraising provisions currently in place are effective and provide the necessary protection to investors. Start-up companies and small and medium

[8] *Jumpstart our business Start-upds Act* (US), Title III – Crowdfunding; *Decreto Crescita, Raccolta Diffusa di Capitali di Rischio Tramite Portali Online*, Article 30.

[9] Claire Ingram and Robin Teigland, *Crowdfunding among IT Enterpreneurs in Sweden: Qualitative Study of the Funding Ecosystem and IT Enterpreneurs' Adoption of Crowdfunding* (June 2013) 38.

[10] Claire Ingram, Robin Teigland and Emmanuelle Vaast, 'Solving the Puzzle of Crowdfunding: Where Technology Affordances and Institutional Entrepreneurship Collide' (2013) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2285426>.

[11] Immaculada Macias Alonso, 'Crowdfunding in Islamic Finance and Microfinance: A Case Study of Egypt' (9th International Conference on Islamic Economics and Finance, Istanbul, 9-11 September 2013).

enterprises may be involved in crowdfunding but they will need to issue an offer information statement (instead of a prospectus as long as these entities are raising no more than $10 million from the issue of securities). An offer information statement is a simplified, less costly disclosure document than a prospectus. It will also provide the investors with the information they may need to invest in the company. Further, the exemption regime under Chapter 6D (including the sophisticated, experienced and professional investors' exemption) does not need to be modified. Modification of these exemption categories should only be considered when a broader review of Chapter 6D is conducted.

This submission proposes that the *Corporations Act 2001* (Cth) provides clarification of when it will apply to crowdfunding. Currently, ASIC's guidance regarding crowdfunding is minimalistic. ASIC's commissioner, Mr Tanzer, has noted that: 'Crowd funding, as a discreet activity, is not prohibited in Australia nor is it generally regulated by ASIC.'[12]

This statement needs to be clarified as a number of enterprises that are seeking to raise money through crowdfunding may be classified as financial products. CSEF would fall under the fundraising provision in the *Corporations Act 2001* (Cth).[13] Further, reward or prepayment funding is more likely to fall under Chapter 5C of the *Corporations Act 2001* (Cth) as these types of arrangements may be classified as managed investment schemes and as such the regulation of managed investments schemes will apply.[14]

While the application of chapters 5C and 6D to crowdfunding may make it more expensive and complex to run the enterprise, they would provide the entrepreneur with time to reflect on the business model they would like to implement and as such they will not just be promoting ideas but also a viable business model. This will enhance the chances of success of the venture and the regulation in place will also provide the public with more confidence in the system.

The lack of awareness of the legislation that may apply to entrepreneurs and crowdfunding platforms in Australia may lead to confusion regarding the way the venture should be structured. For example, Pozible is an Australian crowdfunding platform which may fall under the definition of financial market (s 767A). However it does not currently have a financial market licence. Accordingly, the current legislation needs to be amended to clarify whether there is a need for such platform to apply for a financial market licence.

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[12] ASIC, 'ASIC Guidance on Crowd Funding' (Media release 12-196MR, 14 August 2012).

[13] *Corporations Act 2001* (Cth), Ch 6D.

[14] Terence Wong, 'Crowd Funding: Regulating the New Phenomenon' (2013) 31 *Company and Securities Law Journal* 89, 94

Question 3- In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

i proprietary companies
ii public companies
iii Managed investment schemes

No changes are needed.

Question 4- What provision is any, should be made for each of the matters as they concern CSEF issuers?

No changes are needed.

Question 5- In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

Clarification is needed regarding the role of intermediaries. As noted previously, crowdfunding platforms can be classified as financial markets and as such they need to be licensed. The existing licensing regime should specifically include CSEF as being covered by the current licensing regime. This will provide investors with the necessary confidence to invest in the market as compensation arrangement would also be available.[15] Through regulation, crowdfunding will become a legitimate way of raising equity and not just a fad.

Question 6- What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries

No comments.

Question 7- In the CSEF context, what provision, if any, should be made for investors to be made aware of:

i the difference between share and debt securities;
ii the difference between legal and beneficial interests in shares;
iii any classes of shares in the issuer and its implications for investors.

One of the issues that arises when the 'crowd' is investing in a product is the following: each investor has different levels of financial literacy. However, with the current protection available to the investors and the information available through ASIC's MoneySmart, no further education about investments in general is needed. However, education regarding the dangers that may surround crowdfunding may be needed.

[15] *Corporations Act 2001* (Cth), Part 7.5.

Question 8- What provisions, if any, should be made for the following matters as they concern CSEF investors

No comment.

Question 9- Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

No. the only proposal is for the legislation to clarify that it does apply to crowdfunding.

Conclusion

History is filled with situations where people have been the subject of scams and fraudulent activities. It is important that we learn from past experiences. While crowdfunding solicits small financial contributions from a large number of investors, it still needs to be regulated to ensure the protection of the public and to promote confidence in this type of equity funding. Lastly, the International Organization of Securities Commissions is currently analysing the crowdfunding regime in different countries to develop guidance on the regulation of this new form of funding.[16] It will be good policy to observe the standards that will be set at the international level before finalising the changes to the Australian regulatory regime.

Dr Marina Nehme

29 November 2013

[16] The International Organization of Securities Commissions, 'Securities Markets Risk Outlook 2013-2014' (October 2013) 71.

Submission to the CAMAC Discussion Paper on 'Crowd Sourced Equity Funding' September 2013

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1. Introduction

The Australian Research Council-funded research project 'Between Social Activism and Social Enterprise: Socio-legal Support Structures for Grass-roots Responses to Climate Change' was devised to engage with a range of enterprises working inventively between the economic and social domains. Professor Bronwen Morgan and Dr. Declan Kuch together with PhD student Jarra Hicks and UK researcher Caroline Bird have, since April this year, collected data on how organisations are navigating various regulatory, business and social challenges in establishing transport, food, energy, co-working waste management and re-use enterprises. We have been tracking career paths in these spaces, mapping ways in which the enterprises encounter formal law (particularly in relation to legal entity status, risk management and gradual formalisation of diverse internal practices), and exploring both informal legal consciousness and specific legal disputes via open-ended unstructured interviews with enterprise founders and key personnel. Further information about the project can be found here.

2. Our key perspective and motivation for making a submission

Despite not having an explicit focus on finance, our research has found that the importance of sources of finance for social enterprises is an unavoidable facet of their development. This is particularly so for inventive 'hybrid' entities which are effectively small scale experiments with new ways of organising economic activity. There is a substantial and growing interest at a fairly

grass-roots level in the wider community in initiatives that are sometimes grouped under the banner of a 'sharing economy' or 'collaborative consumption'. We would argue that changes to fund-raising regulations could significantly benefit these kinds of initiatives, and could consequently assist in harnessing a fresh source of social innovation that is simultaneously an opportunity for business development and for reducing resource use intensity in the larger economy. In this submission, we will illustrate our points by reference to a particularly fruitful 'sector' for such benefits: community-owned renewable energy.

We do note that not all of the research during this initial period has been detached observation but has rather entangled us with the initiatives we have been studying in often exciting ways. However we have no direct affiliation with any of the specifically mentioned initiatives or examples discussed below. We have participated in a range of community events to deepen our understanding of the challenges faced in each sector.

3. Key submissions

3.1. We suggest that the discussion paper underplays the positive enabling role of legislative change in this area**. We would answer 'Yes' to the overarching Question 1 and support in principle legislative reform to accommodate CSEF.** The message of the discussion paper often gravitates towards this quotation "… it could be argued, the risks to investors, including fraud, the extremely high likelihood of loss of capital, lack of liquidity and inability to assign value easily to equity issued through CSEF, make CSEF, in general, an unsuitable form of investment to offer publicly" (p.54). We suggest this underestimates the net effect of dense social relations in sharing economy settings, and in community-owned renewable energy in particular.

3.2. These social relations potentially substitute for a legal response to many (though not all) of the risks raised by the discussion. We acknowledge that some risks raised by the discussion paper remain, particularly in relation to investor loss, but propose that a **stand-alone regime (option 5),** particularly when linked to an accreditation approach to sector-specific platforms/intermediaries **(our key response to Question 6),** could largely address such risks.

3.3. We suggest that **an experimental phase of a pilot period** could be trialled with a stand-alone model **(the latter option suggested by Question 9),** followed by review and further public comment. The pilot could be in a particular field such as community energy. Community energy projects provide an excellent opportunity to experiment with an enabling regulatory framework for existing groups. Their social embeddedness makes the risks of failure and fraud low, their rates of return have been above-average and investors' appetite high. We note that there are existing potential platforms here (eg CleanTech discussed below), and there are distinct advantages to enabling these platforms to test ways in which the social relations of a specific community of interest and place can combat the risks of fraud. Community energy is a field with some coherence and some considerable current momentum at present which would qualify it well for such a pilot.

In the rest of this submission we lay out how, from the perspective of our research, we envisage that sectors such as community renewable energy could benefit from changes to fund-raising regulations. Where appropriate we refer back to the options and questions raised in the CSEF discussion paper.

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4. Opportunities for CSEF in community energy

Our initial findings of relevance to this inquiry include:

- Australia has a burgeoning community energy sector.
- The motivations for investor interest and involvement with this sector so far are diverse, ranging from economic concerns about rising electricity prices due to sharply increasing network charges and carbon pricing, to broader support for climate change mitigation and concerns about energy security.
- This sector comprises a range of organisational forms and fund-raising models including the donation/gifts model. Many participants in the community groups also have expertise with commercial energy project development, for example as solar pv installers. Such expertise is a defining feature of most groups.
- Wealthy investors who would meet the criteria for 'sophisticated investors' have played an important role in initial projects such as Hepburn Wind. However, many existing groups lack access to such investors yet could be considered a low risk of fraud and failure due to their embeddedness in strong local rural/regional social ties
- Wealth does not correlate with knowledge of energy systems and the risk of investment in them. Thus, restricting investors in a pilot for community energy investment to sophisticated investors would be entirely unsuitable.
- Rather than making wide-ranging exemptions to the Corporations Act, an enabling framework to foster small-scale, experimental projects explicitly aimed at existing organisations would be preferable

5. Renewable Energy Financing

5.1 Community Renewable Energy (often abbreviated to CoRE) is often defined as energy production larger than household (5kw) and smaller than commercial (around 100kw).

5.2 There are over 300 people in over 40 groups, mostly formed within the last 2 years, who are actively seeking to develop CoRE projects. These projects are at various stages of planning. Many require financing to cover site feasibility assessments, planning processing, ongoing maintenance of capital, and administration costs.

5.3 Photovoltaic solar installations of approximately 100kw are now price competitive with retail electricity rates in most states. Several actors, most notably Embark, are developing a model

of 'solar-behind-the-meter' whereby local investors can finance installations on nearby buildings with local demand

5.4 Barriers to the development of community projects have been identified as access to expertise, and financing initial stages such as site feasibility. A number of intermediary support organisations are equipped to handle some of these barriers

Issuers (Project Developers)

The largest and most well-known is Hepburn Wind, a community co-operative responsible for a 4.1 MW installation of two turbines approximately 100 km north-west of Melbourne. Hepburn Wind is a co-operative owned by its members, numbering more than 1900 (as of 1 November 2011). Just over half of Hepburn Wind's members identify as local to the project. Local ownership is a priority for the board.

6. Investors and Intermediaries

6.1 Initial Australian projects such as Hepburn Wind have generally been well received by investors in the local area and their social contacts further afield seeking modest returns. Initial findings suggest these investors tend to be patient, investing for reasons beyond financial return alone. They are also engaged investors, a community of interest as well as, or as much as, a geographical community, and this provides a measure of transparency secured by social relations.

6.2 Comparatively onerous administrative requirements around investment disclosure have stifled the emergence of innovative project financing models that have been popular in the United States and the United Kingdom. Intermediary support organizations in Australia include the Community Power Agency, established "to support community groups in navigating the complex process of setting up a community owned renewable energy (CRE) project"; and Embark, established as a charity to capitalise on the lessons from developing the Hepburn Wind project.

6.3 A dedicated crowd-funding platform has emerged for Clean Energy projects in Australia called CleantechFundr: http://www.cleantechfundr.com/. Although currently offering only donation-based investment according to current rules it is clearly expressing interest in sourcing equity investment). New peer-to-peer lending businesses such as SocietyOne have developed platforms to collate and manage some project risks while still maintaining the social embeddedness of community lending. SocietyOne connects local businesses with customers through web and mobile platforms allowing fast and easy 'crowd-funding' of capital. There is strong potential to link these emerging platforms to the emerging community energy sector in a constructive experimental pilot initiative.

7. Community Share Offer

7.1 Question 10 of the Discussion Paper invites submissions to point to matters not mentioned elsewhere in the paper as relevant. We note the absence of any reference to non-company legal

structures in the discussion paper. We realise that this is inevitable up to a point given the constitutional division of powers in Australia, but we note the relevance and importance of the 'community share offer' model of the UK that would seem to balance well the risk of fraud or loss with the positive opportunities of legislative reform.

7.2 The key features of this as described by Baker Brown Associates,[1] a key professional support services firm in the UK in the area of community shares, include:

5. Limitations on the amount of interest that can be paid on share capital
6. An upper limit for investors (in the region of $20,000)
7. Investors can withdraw share capital at or below the price they paid for it, subject to terms and conditions (eliminating the need for a secondary market)
8. Withdrawable share capital exempt from many specific regulatory requirements applied to the public offer of securities, making a public offer cheaper and simpler
9. One-member one-vote : this last feature arises because community shares in the UK are almost always offered by an entity using the Industrial and Provident Society legal form, which is roughly analogous to a cooperative

7.3 While the cooperative legal form in Australia is governed by state law and thus poses challenges to this particular enquiry it is submitted that the features of a community share offer as practised in the UK could still usefully inform the thinking of a standalone regulatory scheme, especially one shaped initially as an experimental pilot.

[1] Taken from *Community Investment in Community Supported Agriculture*, a pamphlet summarising a workshop led by Jim Brown of Baker Brown Associates under the UK Community Shares Programme www.communityshares.org.uk.

Submission to

The Corporation and Markets Advisory Committee

(CAMAC)

By

Bryan Vadas

Co-Founder iPledg Pty Ltd

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1. Overview

Camac has called for submissions (Govt considering Crowd Sourced Equity Funding - CSEF) In Advancing Australia as a Digital Economy: An Update to the National Digital Economy Strategy (June 2013), reference was made to holding an independent review of the regulation of crowd sourced equity funding (CSEF). CAMAC was asked to conduct that review.

Our understanding of the market indicates that the primary considerations must be:-

- Open up scope and market breadth to fund start ups and small business, from the broadest range of community or number of potential funders
- Investor protection concerns, espe-cially the "mum and dad" or retail investors
- Ensure costs of funding and subsequent compliance do not outweigh the benefits or the gains of CSEF. Need to ensure that sufficient compliance is called for to offer protection or comfort to investors, whilst keeping costs to the issuer to a minimum, offering quick and low cost access to funding for small business and start-up companies.
    - Best summed up by Canada's experience:-
        - *if the costs associated with investor protection are excessive, crowdfunding may not be a cost-effective capital raising method. At the same time, the Investor Survey suggests that investors would be concerned about the risks of crowdfunding and might not be prepared to invest through crowdfunding if they do not think there are adequate protections in place.*

2. Methodology

Given the existence of CSEF in various forms around the world for a number of years, there are many practical and working options with varying degrees of proven history. Most of the "heavy lifting" in terms of the framework has been addressed in one form or another, so the components exist for the Australian regulators to choose from to build our framework. We also are privileged to have the experience of the Australian Small Scale Offerings Board (ASSOB) who has more years of experience in CSEF than any other company in the world. With local knowledge relative to the local market, combined with many of the learnings from platforms and frameworks from around the world, we need not re-invent the wheel, but simply make incremental changes to the existing provisions to deliver the desired outcomes of CSEF, namely to provide start-ups and small business (relatively) quick, easy, low cost access funding from a broad based investor pool protected by a simple and transparent regulatory environment.

The introduction of new regulatory framework will have a flow on effect beyond simply that of the rules governing CSEF, which we recognise in this document and make some recommendations as to how such regulations may be slightly modified to accommodate the introduction of CSEF in Australia, whilst not losing the essence or the intended outcome for which they were implemented to regulate and protect.

Our proposed solution prefers the liberalising of the small scale personal offers exemption from the fundraising provisions, combined with making targeted amendments to the existing regulatory structure for CSEF, thus opening up CSEF to all investors. The timelines, dollar values, and figures used are for illustration purposes and are open for discussion and debate.

We therefore respectfully submit the following recommendations and suggestions to CAMAC to consider in each area of the proposed changes to regulation of CSEF in Australia.

3. Fraud

Guarding against fraud is perhaps the key consideration for the introduction of broad scale CSEF in Australia. ASSOB, who has had more experience in this field than any other organisation in the world, has found extraordinarily few cases of fraud in the current environment, namely due to:-

- The intermediary completing due diligence on the Issuer
- The initial cost to list the offering on the intermediary's platform
- The preparation of offer documents
- Minimum of 3 directors (as per pubic company requirements) who vouch for the business and have legal and fiduciary responsibility for the running of the company
- Having to issue audited accounts
- A mandatory 48 hour cooling off periods for investors

Such requirements make it more difficult for fraudsters who tend to opt for easier channels to commit deceit.

It can also be argued that whilst one of the concerns about CSEF is that fund raising being conducted on the internet may allow for broad scale fraud, the crowd may also be potentially more aware of any fraud due to the ability of such news to spread quickly over the internet.

4. Issuers

Our suggestions for the draft legislation are as follows:-

4.1 Scope

- The market experience in Australia through ASSOB indicates most raises are for amounts up to $2mil. It would therefore follow that a cap for CSEF raises of $2mil would accommodate the needs of a majority of the market.

4.2 Issuer Definition

- The purpose of CSEF is to provide a funding mechanism for start-ups and small business.
- The USA has recognised this in excluding investment companies from the CSEF provisions of the US JOBS Act.

- Italy, too, has confined CSEF to designated 'innovative start-ups'.
- We would suggest limiting Issuers to start-ups or small business with a maximum asset or capital value, a ceiling on the number of employees, a maximum of (three) years trading history, and/or a turnover threshold which they must come under to permit them to raise funds through CSEF.

4.3 Structure and Costs

- Need for issuer to be an incorporated entity.
- With regard to the structure of the overall legislation, we would recommend that there be an increase from the current small scale personal offers exemption allowing for a personal equity investment offer to investors, provided that no more than $2 million is raised in any 12 month period from no more than 20 investors, opening it up to 400 investors instead of 20.
    - We figured 400 investors based on allowing issuers to raise $2mil from the broader "crowd" including retail investors who could be capped at $5,000 in CSEF investments in any 12 month period.
- Given the above suggestion to allow up to 400 shareholders, thus exceeding the private company structure, the cost of compliance for a public company shareholding cap would be too onerous on a startup or small business. Therefore perhaps a new class of company or a sub-class under the definition of "Public Company" be considered, and we would suggest the class / sub-class of "**Provisional Public**". Provisional Public companies would be allowed to raise capital through CSEF public offerings and trade as a public company, albeit on a restricted or considered basis. Some of these may include:-
    - Allowed to raise capital with an Offer Information Statement (OIS) and/or Profile Statement rather than a full registered prospectus
        - Such a document could contain the following as currently being implemented in the USA:-
            - *a description of the business and its anticipated business plan*
            - *a description of its financial condition (including financial statements: see below)*
            - *the names of officers and directors and persons with a shareholding of more than 20%*
            - *the stated purpose and intended use of proceeds*
            - *the specified target offering amount and deadline to reach that target*
            - *the price of the securities*
            - *a description of the ownership and capital structure*
            - *Provision of financial statements, certified by an officer of the issuer if the specified target offering amount is $100,000 or less, reviewed by an accountant if that amount is up to $500,000 and audited if that amount is over $500,000*
                - Although for Australia we would suggest changing this to certification by an officer of the issuer if under $500,000 and

reviewed by an accountant if over $500,000, thus removing the need for auditing costs, and

- *such other information as the SEC prescribes by rule*

- The document could also contain additional documentation as required in Canada:-
  - *the type/nature of the securities being offered*
  - *the rights attached to the securities (including the impact on those rights if the issuer's operations and/or assets are located outside Canada)*
  - *A statement as to whether any directors, officers, promoters or related parties of the issuer will receive any of the proceeds*
  - *resale restrictions*
  - *statutory rights in the event of a misrepresentation, including a right of withdrawal*

- An alternative to the suggestion to move to a cap of 400 investors (sophisticated or non-sophisticated / retail investors) may be a cap of 200 retail investors, but allowing this number to be incrementally increased by an additional 25 retail investors for each sophisticated or institutional investor that comes on board – e.g. the cap of 200 retail investors is allowed to extend to 225 if one sophisticated investor invests, with the cap increasing a further 25 for each additional sophisticated investor that comes on board, until a total of 400 investors is reached.

- Allow provisional public classification until turnover meets a predetermined minimum, say $3mil per annum, at which point they must comply as per a full public companies.
  - Alternatively, provisional public companies may need to comply as full public companies after a period to time – say 3 years – to ensure they are focussed on accelerated growth in their initial years.
- Existing legislation regarding making false or misleading statement should obviously still apply.

4.4 Reporting

- As suggested above, Provisional Public companies should provide annual reports certified by an officer of the issuer if under $500,000 and reviewed by an accountant if over $500,000, thus removing the need for auditing costs, and
- The requirement for public disclosure of key financials and activities that may be of interest to shareholders.

4.5 Sophisticated / Informed Issuers

- Issuers need to acknowledged that they are "sophisticated" or "informed" issuers, acknowledging their understanding of what it means to be a public company offering shares to investors who will be registered shareholders with rights under the current and proposed legislation

- Perhaps the intermediary can provide an online questionnaire for the issuer to complete, demonstrating that they have the required knowledge to be informed issuers.

4.6 Foreign Participation

- Foreign issuers – precluded, to keep investment in Australia

4.7 Bad Actor Disqualification

- We would welcome similar legislation as adopted in USA with regard to their "bad actor" disqualification provisions, whereby issuers or other "covered persons" are disqualified from CSEF if they have been subject to a relevant criminal conviction, regulatory or court order or other disqualifying event . Covered persons include:
  - the issuer, including its predecessors and affiliated issuers
  - directors, general partners, and managing members of the issuer
  - executive officers of the issuer, and other officers of the issuers that participate in the offering
  - 20 percent beneficial owners of the issuer, calculated on the basis of total voting power.
- Many disqualifying events include a look-back period (for example, a court injunction that was issued within the last five years or a regulatory order that was issued within the last ten years).

4.8 Permissible Projects

- The Issuer is solely responsible for the content of the Project. The content must not:
  - infringe any intellectual property right, confidence or privacy of any third party
  - breach any applicable law
  - be defamatory of or likely to offend any person
  - be obscene or likely to offend any person
  - contain any link to any other website which contains information that would be in breach of any of the above clauses.

5. Investors

Our suggestions for the draft legislation are as follows:-

5.1 Share definition

- Investors are to be given a legal interest in shares rather than simply a beneficial interest in shares

5.2 Sophisticated Investor - Definition

- We do not believe that under new CSEF regulations that the definition for a Sophisticated Investor needs to be changed
    - Under the current regulation, a Sophisticated investor is defined as one who has AUD2.5 million net assets or a gross income of at least AUD250,000 for last two financial years

5.3 Foreign Ownership

- We believe that the current laws governing International investors need not be changed with the introduction of legislation permitting CSEF
    - Where offers are received from outside Australia these rules do not apply but local rules (from where the offer is made) may be applicable.
- This will then open up further potential funding opportunities for Australian start-ups and small business

5.4 Investor Limitations

- We believe that capping the potential investment of retail or unsophisticated investors will limit their risk exposure
    - In the USA the limits are $2,000 or 5% (whichever is greater) for people earning (or worth) up to $100,000, and $100,000 or 10% (whichever is less) for people earning (or worth) $100,000 or more.
    - We would recommend a similar cap in Australia relative to the average wage, and simplifying the cap methodology. We would suggest capping the investment of individuals at $5,000 per annum which may be spread over a number of CSEF investments.
- Self Managed Superannuation Funds should also be limited or capped to contain their exposure, albeit at a slightly higher rate, perhaps $10,000 per annum
- Laws allowing sophisticated and institutional investors should not be changed in the context of CSEF
    - It should be noted that whilst it is implied that sophisticated investors are knowledgeable regarding investment and that unsophisticated investors are not, many unsophisticated investors are well informed, and their ability to make informed and considered decisions should not be underestimated

5.5 Tax Considerations for Investors

- We believe there is merit in the UK model (ref the *Seed Enterprise Investment Scheme*) whereby the British government has offered tax incentives for investors purchasing equity in CSEF offerings to offset some of the risk associated with such investment. We see merit in both a consideration for the partial tax deductibility of the investment and relaxation of Capital Gains

Tax laws in respect of all CSEF investments or perhaps in those targeted industries into which the government wishes for funds to be channelled.

5.6 Risk Acknowledgement

- We see merit in the Canadian example where one equity crowdfunding portal requires that each potential retail investor answer a questionnaire to demonstrate that the investor understands the key risks associated with investing in a SME, including dilution, illiquidity and risk of loss. If they fail to answer the requisite number of questions correctly, the investor is not permitted to invest unless he or she successfully completes a tutorial. We would like to see such a qualification process made mandatory in Australia.
- Perhaps an industry body such as the Crowd Funding Association of Australia could act as a neutral and impartial educator for investors, providing guidance and awareness via online training and certification to potential investors.

5.7 "Tag Along" Rights

- We applaud Italy's CONSOB which mandates that start-ups using CSEF must insert a clause in their constitution which guarantees investors the right to withdraw from the investment and to sell their shares back to the firm, in case the major shareholder sells its stake to a third party ('tag along' right).
- Such rights also extend to where a minority shareholder can tag onto any offer a majority shareholder receives for their shares.
- We would welcome "Tag Along" rights being made compulsory under CSEF legislation in Australia to further protect retail investors and give them the same rights as larger shareholders.

5.8 Secondary Markets

- CSEF should be limited to new issues, excluding on-selling of existing securities
- Given that the primary consideration in legislating CSEF is the interest and financial well being of the retail investor, their ability to make a capital gain in the short to medium term should not be impeded.
- There should be no restriction on investors on-selling shares given that their success in achieving a capital gain augers well for the reputation of CSEF.
    - The ability to on-sell their equity also allows them to recoup should they require cash (guarding their liquidity) or should they feel that the investment is no longer for them.

6.0 Intermediaries

We believe that the role of the intermediary or platform must be to inform issuers and investors about the process, and not necessarily promote or make recommendations or provide financial advice. As such, their role is one of a business introduction service and therefore they should not be required to

hold an Australian Financial Services License. Defining platforms in this manner will keep licensing and compliance costs at a minimum for intermediaries, with any operating costs of the platform ultimately being borne by the issuer.

As mentioned previously in our submission, ASSOB has the most experience of operating a CSEF platform anywhere in the world and their excellent record of probity has lead us to base many of our suggestions and recommendations on their current operational process.

Our suggestions for the draft legislation are as follows:-

6.1 Licensing

- ASSOB operates under Class Order 02/273 which provides an exemption from the fundraising provisions of the Corporations Act for persons involved in making or calling attention to offers of securities through a business introduction service. We would recommend this be extended to intermediaries under the proposed CSEF legislation.
    - By virtue of the fact that it is the issuer who has intimate knowledge of the industry and the business, as well as being the ones being charged with the management and operation of same, all responsibility should be upon the directors of the issuer and not the intermediary to meet the disclosure and operational requirements.
    - Accreditation may also be acceptable whereby such a registration as suggested above be acknowledged by the Minister on the advice of ASIC, once sufficient evidence is provided by the intermediary that they have sufficient resources (including financial, technological and human resources) as well as Australian ownership.
    - Should the above recommendation regarding the role of the intermediary be followed, it would not constitute a managed investment scheme, therefore compliance costs for the intermediary (and ultimately the issuer) would be removed.
        - With the intermediary simply acting as a business introduction service and not as a managed investment scheme, communication between issuer and investor would be more direct with little chance of interference or misinterpretation from a third party.
- This is further supported by the proposed USA legislation which we feel should be cloned as part of the CSEF legislation in Australia:-
    - *Funding portals* (intermediaries) *cannot*:
        - *offer investment advice or make recommendations to investors. The concept of investment advice could, for instance, include any promotion of a particular offering, such as a funding portal pointing out that the offering is attracting a number of investors*
        - *solicit transactions for securities offered or displayed on its portal, or compensating employees or agents for doing so*
        - *hold or manage any investor funds or securities*

6.2 Pecuniary Interest

- We would strongly recommend the legislation include that the operator or associate cannot have any pecuniary interest in the outcome of an investment decision.

6.3 Guidance

- The government may wish to issue guidance as to the requirements for any offering by way of the information which should be required to potential investors. Such a template could then be adopted by intermediaries to use to present public offerings of issuers.
    - Perhaps guidance for the contents of such a template could be given by the Association of Australian Angel Investors based on the investment criteria required by Angels from issuers.

6.4 Disclosure

- It is imperative that it is incumbent upon intermediaries to explain the risks and speculative nature associated with investing in CSEF, as well as the illiquidity of the shareholding of investees.
- Both investors and issuers must acknowledge their understanding of the risks and liabilities of either party when they sign up to the site, as well as prior to listing or investing in a project.

6.5 Public Solicitation

- In the USA, Public Solicitation Ban has been lifted in light of CSEF, allowing the advertising of small scale personal offers
- Currently, in Australia, intermediaries can advertise an offer, but only to accredited, sophisticated or professional investors, or (at least) qualify any enquiries as being from such a person should the offering be advertised more broadly.
- We would recommend extending the current position in Australia to include the legislation as it exists in Canada:
    - *no advertising by an issuer would be permitted except through the funding portal or the issuer's website. However, the issuer would be able to use social media to direct investors to the funding portal or the issuer's website.*
- We would welcome the ability of the intermediary to display on the home page of its website the project "badges", outlining the name and type of the project (by category), their funding target and timeframe, and the dollars raised to date. Prospective investors could then "click though" after identifying their position (sophisticated or retail), as well as acknowledging their understanding of the risks associated with CSEF investing.

6.5 Reporting

- It would be beneficial to both the probity of the platform, the regulators and the industry as a whole if we followed the USA proposal regarding reporting and centralised data collection:-

- *Intermediaries must collect and transmit CSEF transaction data to the (SEC) for administration and data analysis.*
- This needs to be based on high level reporting for industry statistical data and not for governance or compliance purposes.

6.6 Transparency

- To enable the open flow of communication amongst the general public and so that experience, good and bad, can be shared between investors and prospective project supporters, we should adopt the following recommendation from the USA:-
  - *Intermediaries may be required to provide a public chatroom for investors to communicate with issuers and with each other. These means of communication provide opportunities to share information and views on the merits of particular investments, and may in some cases alert participants to possible fraud.*
    - No moderation of such a chatroom should be allowed other than removal of inappropriate comments or spam (with strict guidelines set down by the legislation) and a manner for storing any information which may have been moderated should it be necessary to revisit at a later time.
- In the interests of probity and transparency, we would suggest that the intermediary be a public company, subject to transparency and a public disclosure regime.

6.7 Minimum Operating Standards

- Given the breadth of experience of ASSOB in the CSEF space, much of the framework around the minimum operational standards already exists. As such, we would suggest the following ASSOB procedures be adopted as the mandated industry standard for CSEF in Australia:-
  - **Prior to investing**
    - Intermediary to make mandatory sign in and sign acknowledgement of risk awareness prior to being able to look at offerings
    - The platform to have issuer rules of admission, which are acknowledged prior to involvement by the issuer
    - Due Diligence undertaken by the intermediary to ensure a company is suitable for admission to the Platform
      - An example template of the format for due diligence checks is best demonstrated at www.crowdcheck.com under their "Compliance Check" product
    - Companies to be mentored by a corporate advisor to assess business model, scalability, path to market, competitive advantage, financials & valuation, board & management team strength, use of funds, development milestones and many other factors critical to success.
      - This perhaps may not form part of the minimum service offering required by a portal, but would definitely add value and protection to those involved in the process.

- Facilitate a session for the investors in which they could meet the founders, directors and management personally and 'walk-the-floor' of the business.
    - Again, this may not be part of the base service offering, but a suggested part of the service offered by intermediaries.
- Intermediary to provide templates of professionally prepared documents for the capital raising and make these available for easy download, as well as guidelines on how these need to be completed.

- **Services during the investment process**
    - Provision of templates and guidelines to proper equity ownership recording.
    - Minimum Subscription clearly detailed and managed.
    - Provision of guidelines around non-statutory trust accounting practices to hold funds until preconditions are satisfied.
        - An example of such a condition would be the “minimum amount to proceed” clause that is contained within each capital raising investment document. Until such time that the Minimum Subscription Amount (MSA) the company needs to fulfil its objectives through the equity capital raising has been received into the trust account, no funds are to be released to the company. If the company's offer fails to reach its target MSA within 4 months, all investor funds will be refunded by the trust account operator without loss or fees to the investors.
    - ASIC lodgment monitoring.
    - Adherence to initial and ongoing compliance requirements (as outlined by the intermediary) in addition to legislative obligations.
    - Cooling off periods prescribed.
    - Outline of reporting requirements for issuer.
    - Provision of guidelines regarding a quarterly directors responsibility statement.
- **Services provided after investing**
    - Company Profile page which tracks the company's performance and communication.
    - Enhanced investor relations through announcements.
    - Company Documents archived for download.

6.8 Share Issue and Transfer

- Should CSEF get the support and following as anticipated in Australia, there will be a need for a quicker, simpler, automated and more cost effective manner of registering the issue and transfer of shares.

6.9 Bad Actors

- We would welcome an extension of the “Bad Actors” disqualification proposed in 4.7 above to include intermediaries, their directors, general partners, executive officers, other officers, and beneficial owners.

6.10 Dispute Resolution

- As an intermediary only facilitates any transaction utilising the proposed model suggested in this submission, it would not be giving advice or taking a position in the transaction. As such, any disputes would only be between the issuer and the investor. The intermediary would act as a conduit to ASIC in reporting any breeches, or providing evidence and expert opinion in the event of any claims.

6.11 Small Scale Trial

- We would suggest a small scale trial for CSEF in Australia, with an initial trial period of (say) 4 to 6 platforms to trial the concept for (say) 2 years to review the operation of the concept before opening it up for all players to be allowed to run a CSEF intermediary platform.

We commend the Commonwealth Government for its forward thinking approach to funding small business and start-ups in Australia, and welcome any request for further discussion or involvement in the move to initiate changes in legislation to make broad based CSEF permissible in Australia.

Submission to the Corporations and Markets Advisory Committee regarding Crowd Sourced Equity Funding

This submission is made by CrowdfundUP Pty Limited (CFU) in response to CAMAC's discussion paper regarding Crowd Sourced Equity Funding (CSEF).

The author of this submission is the founder and Chief Executive Officer of CFU, Mr. Jack Quigley.

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Introduction

CFU welcomes the CAMAC review of crowd sourced equity funding, and strongly supports the guiding principle that project promoters and intermediaries should be subject to appropriate legislation and regulation in order to protect the interests of all parties involved in CSEF, in particular funders.

Within that context, CFU also believes that the current legislative and regulatory framework is not well suited to this fast growing and evolving activity. An inappropriate, inflexible or overly prescriptive regulatory framework has the potential to stifle an exciting new avenue for Australian startups and Small to Medium Enterprises (SMEs) to efficiently source equity capital, potentially harming Australia's competitiveness, employment and reputation for innovation.

There have been many recent examples of high growth Australian companies (eg Atlassian, 99Designs, OzForex) being forced to source capital offshore, ultimately resulting in the majority of economic benefits flowing to offshore parties.

CFU has provided its responses to the specific questions raised in the discussion paper below.

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?

Amendments to the Corporations Act 2001

Current Australian corporations legislation imposes rigorous licensing, compliance and disclosure requirements that would cause CSEF in Australia to be at least unwieldy, or potentially unfeasible altogether.

Law reform should be undertaken to enable CSEF as a feasible alternative to traditional sources of equity capital, thereby encouraging entrepreneurs and business owners to advance innovation in the Australian economy, and to keep pace with international peers and competitors.

Of particular importance in this context are:

- the broad definition of "dealing" in a financial product, defined in s766C of the Act, and the consequent AFSL licensing obligations in Part7.6 of the Act;
- the fundraising disclosure requirements in Chapter 6D of the Act;
- the definition and compliance obligations of Managed Investment Schemes under Part 5C of the Act (assuming there are more than 20 funders); and
- the broad definition of “financial market” in s767A of the Act.

Advantages for the Australian economy

In the context of SME financing, we believe that CSEF has the potential to provide a viable alternative to bank debt, venture capital or initial public offering (IPO) financing. CSEF could effectively contribute to bridging the "finance gap" that currently exists for small firms and innovative projects between personal sources of finance, and institutional funds. Improved access to finance for small businesses would in our view promote entrepreneurship and ultimately contribute to economic growth. [1]

Ultimately CSEF creates opportunities for those who otherwise would not have access to traditional forms of finance to engage in entrepreneurial activity.

Advantages for Project Owners

CSEF brings many further advantages to project owners in addition to access to funding. These include early market testing and market validation, reduced product development and marketing costs, and broad reach to consumers. Project owners further benefit from feedback, advice or other resources from the "crowd". [2]

Advantages for Contributors

CSEF offers the opportunity for individual investors to participate in emerging and entrepreneurial ventures, which is currently restricted to a small population of professional and institutional investors and venture capitalists.

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

(i) Yes. The small scale offering exemption should be varied to allow for up to 100 purchasers or investors.

(ii) No. CSEF should be made available all legally capable prospective purchasers.

(iii) To enhance investor protections, we recommend consideration be given to a cap on the amount that may be invested by those not considered to be

[1] European Commission, Directorate General Internal Market and Services , Consultation Document, "Crowdfunding in the EU – Exploring the added value of potential EU action" (3 October 2013) - http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/docs/consultation-document_en.pdf

[2] Ibid.

sophisticated investors of, for example, 2 investments totalling no more than $10,000 per annum.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

(i) The current proprietary company shareholder limit under s113(1) of the Act should be amended to allow up to a minimum 100 non employee shareholders, to allow a viable level of CSEF to be conducted.

While this amendment would allow an additional number of shareholders, it would also allow the CSEF provider to set a lower individual funding requirement, thus limiting financial risk for individual funders.

(ii) We do not believe any changes are required to the regulation of public companies.

(iii) Due to the differing characteristics of MIS, the following additional disclosures should be required;

- the identity of the Manager
- fees and expenses charged by the Manager
- available mechanisms to remove / change the Manager

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) types of issuer: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

(ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF

(iii) maximum funds that an issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors

(v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer

(vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

(viii) any other matter?

(i) Restrictions should not be put in place on the type of company which may issue shares through CSEF. In practice any restrictions would be subject to difficult issues of interpretation and compliance.

(ii) Only ordinary shares and preference shares should be offered through CSEF. The rights and obligations of shares issued through CSEF should be identical to shares already on issue.

We oppose special classes of shares being created for CSEF purposes, potentially with restricted rights. We believe this may allow sponsors to issue shares at an economic disadvantage to existing shareholders.

(iii) Yes, we believe the ceiling should be $5 million within a 12 month period. The ceiling should be inclusive of all funds raised by whatever means.

We note that median CSEF equity raised is increasing quickly in all markets, and in Australia ASSOB has already conducted an equity fund raising of $3.5m.
For that reason we recommend an increased limit of $5m to accommodate expected ongoing growth and to allow larger enterprises to utilise CSEF.

(iv) The disclosure regime should mirror that of the Offer Information Statement contained in the Corporations Act 2001 s715, excluding ss6 which would be irrelevant.

"An offer information statement for the issue of a body's securities must:

(1) identify the body and the nature of the securities;
(2) describe the body's business;
(3) describe what the funds raised by the offers are to be used for;
(4) state the nature of the risks involved in investing in the securities;
(5) give details of all amounts payable in respect of the securities, including any amounts by way of fee, commission or charge;
(6) state that a copy of the statement has been lodged with the Australian Securities and Investments Commission ('ASIC') and that ASIC takes no responsibility for the content of the offer information statement;
(7) state that the offer information statement is not a prospectus and that it has a lower standard of disclosure than a prospectus;
(8) state that investors should obtain professional investment advice before accepting the offer;
(9) include a copy of a financial report for the body; *see note below
(10) include any other information required by regulations"

* While we support the requirement for financial reporting under s715, we believe the requirements of s715(2) in the case of startups and SMEs are overly prescriptive, costly and burdensome. We recommend an abridged form of financial report be allowed for CSEF purposes.

(v) Typically a crowdfunding campaign will rely on the issuer to generate at least 90% of traffic and investment from their existing networks.

"The truth is, you need to drive the bulk of the traffic to your campaign page yourself. Platforms do a good job of promoting interesting projects but even then, the majority of the views and dollars (usually 80-90 percent) come from other channels and promotional efforts outside of the platforms."
Clay Herbert

We therefore believe that an issuer should be allowed to advertise freely, however such advertising:

- must not be misleading or deceptive;
- must not make financial forecasts which are unreasonable or unrealistic;
- must not contain a recommendation to invest; and
- must not solicit funds directly.

However while advertising should be freely allowed, the provision of investment related information, and the collection / management of funds should be restricted to the CFP. This prevents the potential solicitation and handling of funds outside the regulated (CFP) environment.

(vi) Section 728(1) of the Corporations Act already provides a sufficient issuer liability regime:

"Offering securities under deficient disclosure document. A person must not offer securities under a disclosure document if:[3]

1) there is a misleading or deceptive statement in the disclosure document, in any application form that accompanies the disclosure document or in any document that contains the offer if the offer is not in the disclosure document or the application form;
(2) there is an omission of information required to be included in the disclosure document; or
(3) a new circumstance has arisen since the disclosure document was lodged and the new circumstance would have been required to be included in the disclosure document if it had arisen before the disclosure document was lodged.

The person who offers the securities, a person who is involved in the contravention and other specified persons may be liable to compensate a person who suffers loss due to the contravention.[4]

(vii) We believe CSEF intermediaries should be able to facilitate both issues of new securities, and the sale of existing securities. In the case of new securities, we recommend that new securities only be permitted to be "traded" after a period of 12 months - in order to promote an orderly market for both issuers and investors.

(viii) No further comments.

[3] Corporations Act 2001 s 728(1)
[4] Corporations Act 2001 s 728(3)

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

The Australian Market Licence (AML) regime is in our view overly restrictive, and onerous, to facilitate the viable use of CSEF by intermediaries.

We believe that a modified form of AFSL licensing is appropriate. We favour the principles of the recently enacted Financial Markets Conduct Act in New Zealand.

"License applicants will be subject to various background and other checks, including an assessment of their ability to effectively perform the service.

In that context, the FMA must be satisfied that applicants:

- will conduct open online platforms accessible to all eligible investors
- will act as neutral brokers between issuers and investors
- will have key processes involved in the platform that are fair, orderly and transparent, including:
  - the processes for issuers and investors to access the service
  - the processes for matching of issuers and investors by the service
  - where applicable, the processes for handling of investment funds and payments to investors."[5]

[5] CAMAC Discussion Paper (September 2013), section 6.3.1.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of intermediary

(a) should CSEF intermediaries be required to be registered/licensed in some manner

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

(i) (a) Yes, using a modified AFSL license

(i) (b) As for an AFSL

(i) (c) A platform must have the following minimum information platform available on its site:

Background information of executives and key personnel
"About us" section
Terms and Conditions
Copyright Policy
Privacy Policy
Contact details
AFSL / MIS or equivalent registration number
Section to explain how the platform works and the risks involved
Where the funds are kept until paid out to the fundraiser
Detailed schedule of fees
Stated policy for handling disputes

(i) (d) Yes, intermediaries should be required to have a stated internal dispute resolution process.

Yes, intermediaries should be members of an approved external dispute body.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(ii) intermediary matters related to issuers: these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

(ii) (a) We recommend that projects should not be allowed by any persons who have been declared bankrupt, banned from being a Director of a company and have any previous fraud convictions. Additionally we will not allow "inappropriate" projects such as those related to pornography or gambling.

(ii) (b) We recommend that a compulsory National police check be carried out.

(ii) (c) Intermediaries should conduct pre listing due diligence for CSEF projects. As a minimum, intermediaries should conduct reviews to ensure;

- the company is properly incorporated
- the company has the authority to conduct a fundraising
- financial forecasts are not unrealistic or unreasonable, and are based on reasonable assumptions
- appropriate risk disclosures are made

We do not believe it is the responsibility of intermediaries to conduct ongoing due diligence. In our view this would place an unreasonable cost and resource burden on intermediaries.

(ii) (d) We do not believe intermediaries should bear any liability for statements made by issuers, in particular if appropriate due diligence has been conducted.

If however an intermediary becomes aware that a project is acting illegally, without taking timely action (such as delisting the project) the intermediary could be held liable to a limited degree.

(ii) (e) Intermediaries should not be held accountable for investor losses, in particular if appropriate due diligence has been conducted.

(ii) (f) Intermediaries should not be permitted to hold, or buy shares in any company raising funds by way of CSEF. This prohibition may be lifted after 12 months after the completion of the project.

While we acknowledge the potential for a conflict of interest arising from the intermediary's remuneration and a project fund raising target, we believe that this risk is negligible.

(ii) (g) Funds raised during a project should be held on Trust in a segregated account until the completion of fundraising. Funds should only be released to the issuer when legally binding share ownership documentation has been provided to funders.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(iii) intermediary matters related to investors: these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

(b) what risk and other disclosures should intermediaries be required to make to investors

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

(iii) (a) We do not believe any form of screening or vetting is necessary. The platform however should state clearly that funders must be legally capable of owning shares.

(iii) (b) The intermediary should be required to provide a general risk warning regarding investment risk.

(iii) (c) Intermediaries platforms should automatically monitor limits for;

- overall project funding limit
- funders individual limit

(iii) (d) Intermediaries should be prohibited from providing any investment advice.

(iii) (e) Intermediaries should be allowed to promote their service, and solicit business in accordance with relevant laws. However intermediaries should not be permitted to promote their service on the basis of projected or forecast project projected returns.

(iii) (f) All investor funds should be held in Trust, in segregated client accounts. Funds should be disbursed to project sponsors only when appropriate share ownership documentation has been provided to investors.

(iii) (g) Intermediaries should provide a messaging facility to allow for direct communication between issuers and investors.

(iii) (h) Intermediaries should be required to provide a clear, prominent and up-to-date avenue to refer complaints both for internal resolution, and to an external dispute resolution service.

(iii) (i) Intermediary fees or commissions should be clearly and fully disclosed.

(iii) (j) No further comment

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(iv) any other matter?

(iv) We strongly believe that tax relief measures be considered in relation to CSEF to encourage the growth of small to medium enterprises. We believe measures similar to those of the UK's Enterprise Investment Scheme (EIS) should be considered.

Corporations and Markets Advisory Committee

Crowd sourced equity funding

Discussion Paper

Submission

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Sent to **john.kluver@camac.gov.au (**cc **camac@camac.gov.au) Date Friday 29th November**

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Key

CSEF Crowd Sourced Equity Funding

CMAC Corporations and Markets Advisory Committee

AFSL Australian Financial Services Licence

TFN Tax File Number

LPC Large Proprietary Company

PC Public Company

MIS Managed Investment Scheme

Scope comments

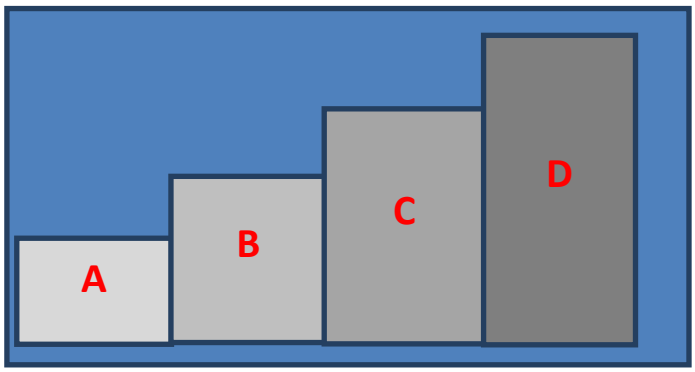
Par1.2 outlines the scope applicable to the review and while it is understood many aspects of the broader issues associated with crowd funding cannot be addressed, the writer believes the current scope restricts innovative thinking by

1) Limiting the review to the existing concepts in our regulatory framework
2) Limiting the concept of an intermediary to on-line portals only
3) Restricting investors to Australian residents and
4) By having a pre-conceived / traditional market view of the term "investor" rather than a broader view i.e. a supporter who is not necessarily looking for future financial gain.

This paper aims to provide additional commentary in regards to these matters and believes these deficiencies should be addressed in any final report or through further submissions to a preliminary draft report.

Furthermore, a decision on CSEF should not be delayed due to the current enquiries and reviews being conducted in relation to the wider financial services matters including the role of regulators.

The objective of CSEF is to support via large volume "small scale" investment a more accessible funding regime. By creating a new security type with limits and restrictions around the capital and investors this is considered achievable without significant alteration to the existing law.



A) New – CSEF / Start-up funding Company

B) Proprietary Company

C) Large Proprietary Company

D) Public Company

Executive Summary

- Utilise existing framework but amend existing laws to accommodate CSEF.
- Generally, the Canadian authorities approach to CSEF is considered more appropriate except in regards to intermediaries, where the US approach is considered more beneficial.
- Some concepts from other jurisdictions have also been incorporated into the suggested solution.
- **Suggestion:** ***Introduce a new type of company (e.g. Start-up Limited "SU Ltd) that carries with a simple capital structure with restrictions to enable multiple individuals to support (invest) in that entity up to specific monetary limits.***
- The definition of a Public Company (PC) would need to be altered or a new classification established due to the volume of members under a CSEF capital rising breaching the current definition for a public company.
- The new company type (e.g. Start-up Limited "SU Ltd") would only support a simple capital structure, and would be restricted to 3 years and/or maximum of $5m in capital before being converted to either a Large Proprietary Company (new definition required) or Public Company (new definition required).
- The transfer of equity in the new company type would be restricted during the initial 3 year start-up period.
- The offer document to be used would clearly state the risks involved (including the lack of transferability of the investment, that opportunity is high risk and it is possible some or ALL funds invested may be lost) and that there would be limited recourse available to investors.
- The maximum amount able to be raise on the initial offer would be limited e.g. $1m in any 6 month period, with each investor limited to $2,000 per offer document, except for those identified as a sophisticated investor. Note: recommend changes to the qualification criteria for a sophisticated investor to reflect knowledge and skill rather than restricted to asset or income.
- A seed investor being a sophisticated investor must subscribe to at least 5-10% of the capital (in each offer document); this approach assists in ensuring the initial offer is priced appropriately.
- The rules around small scale personal offers for existing company types (i.e. $2m, 12 months, max 20 investors) should stay initially, however, these limitations should be reviewed after the success or otherwise of the new equity raising provisions and changes to the definition of a sophisticated investor. In addition, similar rules for the new company type should exist e.g. $2m in 12 month but there would be no limit on number of shareholders. A total $5m in capital should be imposed before a company must revert to either a LPC or PC.
- The new company type would have restrictions on the entity structure and changes to capital structure would be limited until the entity progressed from start-up to a either a LPC or PC.
- The 50 shareholder limit for defining a proprietary company must be altered or a new category created to recognise that an entity that commenced through the new company type will have more than 50 members. An option may be necessary to distinguish this by reference to a "Large Proprietary Start Up Company".
- The amount able to be invested by an individual should be limited to a specific dollar amount e.g. $2,000 (for each offer document) and there would be a restriction on transferring equity acquired while the entity remained in the start-up period (i.e. 3 years).
- Cumulative limits on the total amount invested are NOT considered necessary as the cost to implement and monitor would be difficult to justify given and there are sufficient other restrictions and protections proposed. Each offer document would assess separately.
- Existing businesses may still utilise the new company type to raise funds for new start-up ventures but would be restricted to raising capital in a new entity within the rules mentioned above.

- No special or additional taxation rules should be necessary; the new structure can work within the existing tax legislation.
- Restrictions around the manner and size of further equity are required to prevent manipulation and dilution of initial supporters/investors.
- Funds raised can either be debt or equity, although limiting to equity only IS recommended.
- The use of a managed investment scheme is NOT recommended.
- Participation should be open to any person across the globe provided this does not breach any local jurisdiction of the county of the investor.
- Only an intermediary should be able to raise money for the new entity type using the CSEF provisions, however, that intermediary should NOT be restricted to platform operators only.
- An intermediary should be subject to an AFS Licence and be either an existing licensed market participant broker or be approved as a CSEF Portal/Platform provider. As the intermediary is only collecting initial interests in a single issue supported by an offer document and is not facilitating a secondary market an Australian Market Licence (AML) is not considered necessary, only an AFSL.
- Both types of AFSL holders (Existing broker and a platform operator) would be responsible for enforcing the specific disclosure rules for the new investment type and ASIC would be responsible for monitoring compliance to these and ongoing disclosures by the intermediary.
- A model that facilitates access to capital beyond a web based platform will open up more avenues to raise capital, support a struggling stock broking industry, increase competition, and enable access to an existing pool of qualified professionals to support capital raisings.
- A wider avenue to capital beyond an internet portal is likely to improve the adoption of CSEF provisions as a source of funds for start-ups.
- The intermediary under its AFSL would be subject to meeting requirements around management capability, technology, accounting, compliance monitoring, PI cover (guarantee / minimum capital).
- Existing annual AFSL audits would assist reduce the risk of fraud at an intermediary.
- It is NOT feasible for intermediaries to be responsible for testing a supporter/investors understanding of investment risk as this subjective.
- An intermediary must be responsible for is collecting evidence that the investor is aware and acknowledges the investment is high risk, there are restrictions on the transferability of the investment, the investor may lose some or all of their invested capital, AND that the investor is able to afford this loss if it eventuates.
- It is NOT recommend the intermediary is in any way rewarded by the long-term success of a project, as this may imply an endorsement of the potential success of the project.
- The intermediary's responsibilities should be limited to validate compliance to minimum disclosure, facilitate capital rising and ensure ongoing compliance.
- An intermediary should be held accountable to assess and enforce the completeness and accuracy of the disclosures in the offer document and manage the identification and investment limits proposed.
- Intermediaries should be responsible for monitoring fraudulent applications, restrict access to capital raised until capital rising is completed.
- To help mitigate the risk of fraud, all promoters should be responsible for lodging personal guarantees to an amount proportional to the capital being raised to assist with recovery in the event of fraud.
- The should be limited ability to sue an intermediary promoting a start –up entity except for negligence or dishonesty.

- There should be a requirement on the new entity type to provide quarterly updates, (link reporting obligation to quarterly BAS lodgement cycle) and those quarterly updates should be reviewed by a professional accountant or a qualified auditor (depending on size) including a reconciliation of actual spend to the proposed application of funds in the original offer document.
- The concept that equity could be offered / set-aside in exchange for other contributions beyond monetary contributions should be considered / addressed. In a CSEF environment a supporter of a project may offer services or other support in exchange for equity, as the service is delivered payment in the form of new equity issues should be possible within the framework and financial limits.
- Modern databases, advancement in social media marketing strategies and polling capabilities now enable the effective management of client lists. The management of a large number of shareholders is a not considered a major concern. Modern databases and electronic communication tools will enable registers to be managed efficiently and effectively and therefore this should not be seen as a reason not to implement a CSEF solution.
- The promotion of a CSEF opportunity does not prevent an external outside offer (from sophisticated investor) being made prior to a capital raising being finalised on a CSEF platform. In fact the volume of interest generated on the CSEF platform provides an indication of the likely success of the venture and may assist in raising additional capital from sophisticated investors.
- Alter current restrictions on who can invest by altering the suitability criteria to be based on RG146 and also allow for existing provisions to be retained

I

Introduction and background

This paper refers to a person willing to invest in a CSEF as a **supporter** (and not an investor) the reason for this interpretation is essential in understanding the reasoning behind the recommendations made in this paper.

The traditional capital markets view of the goals of an investor is unlikely to match the objectives and reasoning behind a supporters decision to provide funding support.

This distinction is a key physiological difference and one the committee must first acknowledge and appreciate before they can provide and constructive decision on the way to move forward.

Within some clear constraints (outlined in this document) the writer supports the introduction a new type of equity classification, that enables a wider group of people to invest to a small specified limit based on an offer document that has less initial disclosure requirements, but supported by initial and ongoing reporting obligations.

The writer encourages the committee to consider and acknowledge that our existing regime around capital raisings is outdated and has not adjusted for the advancements in technology, people's access to information, people's wealth, spending power and improved financial literacy.

The current system, due to its restrictions in the ability to invest being based on a person's income and/or asset size creates a bias towards the wealthy and denies access to people of sufficient means accesses to new opportunities. Neither an income or asset measures actually supports the proposition that an individual is more capable of making an effective or better investment decision than someone below the stated limits. The approach may protect an individual from financial loss but we do not impose such restrictions on individuals in regards to lotteries or gambling. A balance needs to be struck between allowing individuals to support an opportunity they believe in and denying them this right purely because of their income or asset base.

Australia is a country with an aging population and population growth being supported by immigration. Many migrants and young people do not have the financial position to meet arbitrary income and asset limits yet they have other knowledge and skills that enable them to make effective investment decisions. By preventing or limiting these people from participating in early stage businesses significantly limits the amount of capital being invested and restricts these people improving their financial position.

The writer encourages the committee to investigate a solution that facilitates an individual's rights to choose to support an opportunity and to prevent a "nanny state" mentality of assuming a person is incapable of making an investment decision unless they meet certain criteria or have access to a prospectus, a prospectus that is often made illegible due to the volume of information presented and the constant disclaimers around risk.

It is essential a viable solution is found to assist promote innovation and bridge the funding gap between start-up and "investor ready" entities and to overcoming the preferential access to new opportunities for the wealthy. Supporting innovation is not solely the responsibility for the government or a right only available to the rich. The right to support an idea is a right for everyone.

Advancements driven by the creation of the internet and GPS have enabled developments of new services, productivity tools, information portals, games and many other new products and services. Through access to funding, innovation in these areas will continue to create new jobs and income streams for. Australia

must grow its global export income through innovation by supporting new ideas especially as our manufacturing competitive advantage is being diminishing by developing companies.

Due to the internet's global reach, globalisation of markets, improvements in market research, new market channels, and significant improvements in the speed to markets, the cost to launch has reduced significantly resulting in a smaller amount of initial capital being required to launch an idea globally. By diversifying this risk across a wide group of supporters the chances of success increase due to the powerful impact of social media driven by these initial supporters/investors. The current legislation restricts innovators from sourcing early stage funding from knowledgeable and skilled supporters by imposing a member limit and/or financial limit on who can invest.

Few, if any, real effective laws exist to prevent people from gambling excessively or beyond their limits. Few, if any, real effective laws exist to prevent people from buying lottery tickets beyond their means. While it is prudent to put limits in place, it is critical individuals have access to an opportunity that they understand and believe in. We allow people to set up a self-managed super fund and make investment decisions on a range of products without any effective controls over their investment capabilities or suitability to their needs.

The concept of crowd funding should not be linked solely to a "platform" or "website" access.

A controlled / licensed environment is considered necessary but the concept of utilising CSEF should be made available to existing AFSL holders licenced to offer securities i.e. stockbrokers. These businesses have in place the necessary systems and controls to manage a capital rising without the need to establish a web based platform.

The risk of a CSEF/Start-up project should be clear due to the nature of the equity you are investing in, the disclosures and acknowledgements that are made and the exposure limited to the individual investor limits imposed.

To suggest that only bankers, business angels & private equity personal should determine the allocation of capital to start-ups would continue to deny suitable people access to potential growth opportunities and continue to support the manipulation of the innovative promoters by bankers, business angles and private equity by exploiting their need to access finance. Interested supporters aim to bring much more than just financial contributions, in fact, there potential to assist promote the service/product across social media can't be underestimated. A well-managed CSEF intermediary will introduce effective completion to what is currently a protected / closed shop environment.

Response to questions

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

1 YES.

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

2

i) The small scale offering should be reviewed in light of changes recommended in this paper i.e. introducing a new company type and adjusting the definitions for Public and Private Companies.

ii) Definitely NOT. As outlined in this paper an asset/income based approach is not considered appropriate, an educational based approach should be adopted rather then and asset based i.e. utilise the existing RG 146 qualification as an appropriate measure.

iii) YES.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

3

i) Either Change definition to remove focus on member limits or introduce a new classification acknowledging that an entity initially formed via the new entity type proposed will have greater than 50 members.

ii) Focus only on asset size and or income.

iii) The use of MIS for start-ups is NOT recommended.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

(ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

(iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

(iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

(v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

(vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

(vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

(viii) **any other matter?**

4

i) YES. The application of the funds raised must not be for investment, acquisition of other entities or for fund management / investment vehicle purposes.
ii) Limited to simple structure – refer Canadian proposal.
iii) $2,000,000 initially $5,000,000 in aggregate before compulsory transition to a redefined definition of Large Proprietary or Public company.
iv) efer Table 1.
v) All advertising must direct people to either an approved CSEF platform or an existing broker to receive the final offer document in an approved format. Advertising must not make any suggestion about earnings or future distributions. The offer document must highlight it is a capital rising for a start-up / speculative project and is subject CSEF rules (as defined).
vi) Document meets CSEF disclosure requirements, advertising rules, ongoing disclosure for false, misleading statements. Any fraud or breaches of director's duty would be addressed under existing laws.
vii) YES – During the suggested start-up transition period (3 years) no secondary market, approved transfers for no changes in beneficial owner and to facilitate death or family law matters.
viii) Refer to other comments in this document.

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

5 The use of the AFS Licensing regime is recommended. An AFSL holder would be required to meet existing standards around systems, procedures, skills, compliance and be subject to external review. The need for any capital requirements or security bond is considered necessary to ensure only appropriate resourced and funded businesses act as intermediaries and offers some protection in the event an intermediary acts dishonestly. However, these should not be onerous and should be able to be addressed by guarantees and other forms of security.
An intermediary should not be limited to web based providers and should include existing market participants due to their ability to stay involved with a business and support it in accessing additional funding in the future. Existing market participants have infrastructure and systems in place to support CSEF immediately.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

(a) should CSEF intermediaries be required to be registered/licensed in some manner

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

6

i)

a) YES – refer 5. And commentary in paper.
b) Utilise expectations of market participants, for web based providers there should be additional requirements around technology and data security.
c) The allocation policy and management of oversubscriptions should be outlined in the offer document and managed by the intermediary.
d) YES, to minimise the need to create new procedures, external dispute bodies such as FOS should be utilised. However, bodies such as FOS should issue guidelines on their role and how claims will be assessed. The starting position is that an issuer should not be liable to support the initial challenge for loss and the burden of proof for claims of misrepresentation sits with the investor. Given the nature of the new type of investment i.e. speculative start-up, recourse for financial loss is limited to claims of dishonesty, false or misleading statements as such the accuser should fund their initial claim and the claim.

Question 6(Cont.) What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(ii) **intermediary matters related to issuers:** these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

6

ii)

a) Funds to be applied to investment purposes, funds management or trading in securities.
b) Refer Table 2.
c) Refer Table 2.
d) Fully liable, initially decided via an external dispute body but subject to judicial review.
e) To be assessed by regulator and managed by enforceable undertaking if due to diligence, subject to judicial review.
f) The writer supports the right for the intermediary to take a financial interest in the capital raising provided such interest is less than 10% and the investment is not used to determine the price of the offering (i.e. an independent sophisticated investor is still required to determine pricing).
g) All funds should be managed through a trust account subject to audit.

Question 6(Cont.) What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(iii) **intermediary matters related to investors:** these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

(b) what risk and other disclosures should intermediaries be required to make to investors

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

6

iii)

a) Proof of ID. Submission (validation) of TFN for Australian Investors. For foreigners evidence of Tax registration details consistent with identify of applicant.
b) Validate contents of offer document confirming it is accurate and disclosures their initial and ongoing fees or any financial interest they have either directly or through a related party.
c) Limited to capturing applicants ID and certification collection i.e. investors has not breached any limits imposed, acknowledge risk and is warn of the consequences for false statements
d) Adequately covered under existing advice rules such as Best Interest, Statement of Advice or Record of Advice. Advisor must be qualified. Possible implications for accountants advising businesses to be addressed.
e) Normal advertising controls around truth and accuracy - Refer to comments on advertising.
f) Must use a trust account.
g) The assumption here is the platform must manage this. The intermediary should ensure the issuer has these capabilities but the issuer should not necessarily be responsible except for communication facilitated or managed through their systems whether they are a CSEF platform or not.
h) Should form part of the offer document and the limited recourse available should be highlighted and the applicant acknowledges prior to transaction occurring.
i) Full disclosure, full transparency on all transaction initially and ongoing with intermediary or a related party should be continually disclosed.
j) None - If provided by and AFSL holder subject to oversight and audit including their technology platform.

Question 6 (Cont.) What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(iv) **any other matter?**

6

iv) Intermediaries should not be restricted to an electronic platform.

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

7

i) Separate capital raisings with separate offer / disclosure documents.

ii) Address by disclosure but application process would require information to facilitate accurate recording.

iii) Refer Canadian proposal, limited options, simplicity and clarity of rights critical to the success of a CSEF model.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

(xi) **any other matter?**

8

i) No
ii) Yes. The sophisticated investor involvement will assist in pricing the security being offered. Most start-up opportunities are speculative and will be priced based on market opportunities if deemed a successful prospect. A critical requirement of this approach is that the founding sophisticated investor does not get any preferential access or pricing to any capital, benefit or additional capital rose beyond those available to all initial investors.
iii) Yes. $2000.
iv) Yes, positive acknowledgment to each specific question and not hidden in single acknowledgement.
v) No. Suggestion over complicates matter, an alternative is to require a pre-registration, offer document provided and option to invest open two days later. This could be easily managed by technology.
vi) No.
vii) Yes. No transfers except for situations where there is no change in beneficial owner, death, or family law direction.
viii) Refer Table 2.
ix) Dispute resolution process (e.g. FOS) and then judicial (although a class action would be the most likely be the most efficient and effective appropriate).
x) None, part of the initial decision to invest and this risk adequately and continually highlighted.
xi) Respect a person's right to support and initiative they believe in and most likely understand because of their interest and knowledge, remove current system where access to opportunity is limited to a privileged few.

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

9 I believe it will require a combination of both. A separate self-contained regime will assist people understand the new regime without being confused by a clumsy attempt to integrate new provisions into laws that didn't support many of the concepts being explored. Equally, changes will be required to existing terms and stated limits in order to support a progressive capital raising system.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

10

i) Refer Executive Summary at start of this document

Table 1 – Disclosures by issuer (promoter)

MINIMUM Descriptions in SU CESF Document

- Target Amount
- Minimum amount to be raised (Statutory minimum $50,000)
- Maximum Amount to be raised (Statutory maximum $5,000,000)
- Minimum Amount per Shareholder(Statutory minimum $1)
- Maximum amount per Shareholder (Statutory limit $2,000 – sophisticated investors excluded)
- Capital Structure, promoters and intermediaries interest, distribution policy
- Treatment of oversubscription and the allocation process
- Voting rights – all equal simple ordinary share capital structure
- Purpose of capital rising
- A description of the market and revenue opportunity but NO financial projections
- Initial balance sheet – pro-forma balance sheet
- Board & Business Experience & Professional Qualifications (minimum of three and independent chairman & majority independent)
- Details of the application of funds
- Any related payments to be made to a promoter to be disclosed, otherwise an offence
- Management (if any)
- Risk Disclosure – Start-up risk, liquidity, investment, etc

Table 2 – Preliminary & Ongoing due diligence by intermediaries on issues

Pre – due diligence

- Verification of promoters & their history included in offer document
- Verification of ownership and charges against any asset included in balance sheet
- Source a founding investor for 5-10% of capital and used to establish initial ownership % on offer
- Police checks on senior staff
- Offer document is compliant
- Financial systems in place, registrations in place, accountant and /or auditor appointed

Ongoing

- Ensure reporting is put in place
- Quarterly reporting of Revenue & Expenses to format in initial offer document while utilising new company type
- Certified by an officer & an accountant verified by an auditor if over $500,000 (special wording and expectations on level of review to be determined and agreed with profession)
- Annual statements certified by officer and an auditor

NOTE: Initially a light touch review process is recommended but the ability to change if there is evidence this approach is not effective in protecting investors

NOTE: There must be provisions created that have consequences for non-compliance including the removal of directors and the appointment of the intermediary to arrange for elections to appoint new directors.

Table 2 (Cont.)

RISK MITIGATION

- Limits in size of offering and an individual's exposure
- Not an investment fund / vehicle or a financial product
- Identification of investors
- CSEF via approved intermediaries with appropriate control procedures and in accordance with a specific form (to be defined). I.e. ensure disclosures are clear and comments outside this document cannot be relied on (address chat room/board posts)
- Disclosures and acceptance by supporter/investor funds are being placed in a highly speculative project and is likely some or all of the capital may be lost
- Recovery limited to breach of law in regards by promoters and officers
- Ban on secondary market until status of entity moves from the new type into one of the other acceptable type
- Compliance certificate to be signed by promoter prior to any advertising, managed by intermediary
- Possible requirements to have a seed investor who is sophisticated investor or corporation with at least 5-10% and in effect provides some validity to the pricing of the security

Submissions to CAMAC Discussion Paper: Crowd sourced equity funding

Thank you for the opportunity to provide a submission on the Crowd Sourced Equity Funding Discussion Paper (**CSEF paper**), released by the Corporations and Markets Advisory Committee on 10 September 2013.

1. Squareknot's business

1.1 Squareknot aims to provide an industry leading platform for registered investors to make investments in viable investment opportunities. This will be achieved through facilitating the funding of specific projects and business start-ups, the expansion of existing businesses, providing additional working capital funding, or the finance required for acquisition, and at the same time providing exciting and rewarding investment opportunities to individuals or advisors who have cash funds that they are seeking to invest. Squareknot will also assist with the provision of essential management support to businesses to help them grow and prosper, through a panel of independent specialists.

Square knot provides its comments on the paper and brief response to certain questions below.

2. Response

2.1 At a high level, SquareKnot understands that the CSEF paper suggests that crowd sourced equity funding (**CSEF**) mechanisms have not previously been contemplated by lawmakers in the development of Australian law. Consequently, the CSEF paper invites a response on whether the regulatory environment inhibits the development of CSEF in Australia and negates the main advantages of CSEF, namely the ability to efficiently raise funds through soliciting small financial contributions from a large number of people - a source of funding that may not otherwise have been accessible.

2.2 In summary, Squareknot submits that the current regulatory environment is, to a large extent, suitable for the growth of CSEF in Australia. CSEF is regulated by the relevant securities-related laws generally, predominantly the *Corporations Act 2001 (Cth)*, and will be subject to relevant licensing, disclosure and conduct obligations. SquareKnot submits that these obligations should not be relaxed given that, as the CSEF paper notes, 'the number of persons potentially affected can be significantly greater than for more traditional means of fundraising' because of the central role of the internet.

2.3 The class of persons potentially affected will predominantly be retail investors who, as a class of investors, are afforded a greater degree of protection by relevant financial services laws given that they are more likely to misunderstand or be misled about the risks of financial products.[1] SquareKnot further submits that reducing investor protection

[1] Australian Financial System Inquiry, Parliament of Australia, *Financial System Inquiry Final Report* (1997), 188.

also increases the reputational risk to the CSEF industry as a result of rogue operators or even retail investors who do not properly understand the risks of a financial product.

2.4 In view of the above, regulatory responses to CSEF should be incremental and be based upon characteristics peculiar to CSEF. Commentary such as Baxt, Black and Hanrahan's text 'Securities and Financial Services Law'[2] has suggested three broad principles guiding modern securities regulation including:

» the interlocking goals of investor protection, market efficiency and systemic stability

» that these goals are likely to be realised when participants in markets act with integrity and there is adequate disclosure facilitating informed judgments by the market, and

» market integrity and adequate disclosure would not otherwise be achieved without regulatory intervention (for reasons of market failure).[3]

Our submissions have been made in the context of these guiding principles.

2.5 In summary, Squareknot's submissions recommend:

» liberalising the small scale exemption offer

» maintaining the current Australian financial services licensing regime for CSEF intermediaries

» that CSEF intermediaries should be required to conduct limited due diligence on financial product issuers looking to raise funds (issuers) but, after this due diligence has been conducted, will not be held accountable for misrepresentations, misleading statements or fraudulent statements made by issuers

» a disclosure approach to the responsibilities of CSEF intermediaries is appropriate, and

» a cooling off period is not appropriate for CSEF but CSEF intermediaries should be required to disclose the absence of a cooling off period to potential investors.

3. Question 1 - accommodation/facilitation of CSEF in corporations laws

3.1 As previously stated, any further introduction of laws specifically regulating current regulation of securities issuing should be introduced incrementally. Further, attempts to update the law specifically to cater for CSEF should consider the impact of, and avoid,

[2] Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis, 8th ed, 2012).

[3] Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis, 8th ed, 2012), 9.

undesirable regulatory arbitrage and inconsistencies that financial services reform has been attempting to remove over the past decade.[4] One way in which CSEF can be facilitated without producing apparent regulatory inconsistencies is through liberalising the exemption for small scale personal offers ("Option 2", paragraph 7.2.2 CSEF paper). Increasing the limit on small scale offerings better facilitates access to funds without significantly removing investor protection - it merely expands on an available exemption.

4. Question 5 and 6 - CSEF intermediary obligations

4.1 As noted in the CSEF paper, it is likely that CSEF intermediaries will need to at least obtain an Australian Financial Services Licence (**AFSL**) if not an Australian Market Licence which generally requires that the conditions in Question 6(i)(b) - (d) are met. We suggest that most CSEF intermediaries will structure their business so as to avoid obtaining an Australian Market Licence given that it is of a different nature from other Australian Market Licence holders. Squareknot considers that, contrary to the commentary referred to in the CSEF paper,[5] obtaining an AFSL does not prevent quick and low-cost access to funding for issuers. However, given the Further, an aim of the licensing regime is to enhance investor confidence in the operation of financial markets and to protect investors (in particular, retail investors) from unscrupulous and incompetent operators.[6] A reduction in licensing requirements, disclosure or conduct standards relative to securities issued by other means invites issuers and intermediaries looking to exploit regulatory arbitrage and may tarnish the CSEF industry's reputation. Further, the requirement to have adequate resources to carry out its role, transparent processes and membership of an external dispute resolution scheme appears to be an appropriate threshold requirement for any CSEF intermediary.

4.2 In relation to Question 6(ii) (intermediary matters related to issuers), Squareknot considers that a requirement on CSEF intermediaries to conduct limited due diligence checks on issuers as not being overly onerous and providing a suitable level of investor protection. However, once a CSEF intermediary has met its due diligence requirement, a CSEF intermediary should not be held accountable or responsible for investor losses result from misleading statements made by issuers or fraudulent issuers. To place the responsibility on an intermediary greatly increases the risk exposure (and costs) of CSEF intermediaries who are not always exposed to the gains of a successful business. Further, the requirement on a CSEF intermediary to vet every statement made by an issuer on its CSEF platform greatly increases resourcing requirements on an intermediary.

4.3 In relation to Question 6(iii)(b) (intermediary matters related to investors), Squareknot submits that CSEF intermediaries should make disclosures to investors of its responsibilities and, importantly, the limit of its responsibilities. For example, disclosures

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[4] See, for example, Australian Financial System Inquiry, Parliament of Australia, *Financial System Inquiry Final Report* (1997), 235.

[5] Terence W Wong, 'Crowd funding: Regulating the new phenomenon' (2013) 31 *Companies and Securities Law Journal* 89, 98.

[6] Australian Financial System Inquiry, Parliament of Australia, *Financial System Inquiry Final Report* (1997), 243.

should be made about whether a CSEF intermediary conducts any due diligence on product issuers, the kinds of due diligence it performs and the circumstances in which a CSEF intermediary will take responsibility for investor losses (if in any circumstances). This is consistent with an approach of ensuring that investors receive adequate disclosure in order to make informed judgments without unnecessarily placing obligations on CSEF intermediaries.

4.4 In relation to Question 6(iii)(f) (controls on intermediaries holding or managing investor funds), SquareKnot supports broad legislative requirements on intermediaries controls holding or managing investor funds in a manner such that an issuer will not have access to funds raised until a specified target amount is reached (if the 'all or nothing' funding model is used).

4.5 Squareknot does not consider that a prescriptive approach to other matters in Question 6 significantly furthers investor protection goals.

5. Question 8 - cooling off period

5.1 In relation to Question 8(v), giving investors access to cooling off rights disproportionately increases the complexity of CSEF without greatly increasing investor protection. For example, the standard 'all or nothing' CSEF fundraising method involves irrevocably pledging to contribute or contributing an amount of funds until a target amount is reached before a securities issue is successful. Introducing a cooling off period means that it is not clear whether the threshold amount has been reached until the cooling off period has expired for the final contribution required to reach the threshold amount. Further, a disclosure approach that investors do not have access to a cooling off period better strikes the balance between investor protection and market efficiency.

6. Question 9 - incremental or self-contained regulatory approach

6.1 As previously stated, regulation of CSEF should be in the form of incremental adjustments rather than a self-contained regulatory regime that adds more regulatory requirements and introduces further barriers to entry.

Please do not hesitate to contact Patrick Schilling on 0408 399 989 if you have any questions or require clarification on Squareknot's submissions.

Kind regards

Patrick Schilling

SQUAREKNOT

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CLEANaS Submission to the CAMAC in response to the discussion paper on Crowd Sourced Equity Funding

Thank you for the opportunity to provide input to the discussion regarding Crowd Sourced Equity Funding (CSEF). CLEANaS believes that debt or equity crowd funding, should it become available in Australia, will remove a key barrier to the growth of broad-based community owned local renewable energy schemes. CSEF schemes available in other countries, such as those facilitated by Mosaic Solar in the US (www.joinmosaic.com), have demonstrated the potential for small investors to drive the development of local renewable energy projects.

CLEANaS is the Clean Energy Association of Newcastle and Surrounds, a not-for-profit association formed in 2012 by a group of locals passionate about clean energy. CLEANaS is dedicated to driving the uptake of clean energy that our region can transition from our current dependency on fossil fuels to a more competitive and sustainable local economy. We will achieve this by working with our partners to demonstrate profitable community-led and community-owned clean energy projects; raise the profile of clean energy in the local economy through education and awareness raising; and by improving access to financing mechanisms and affordable technologies so that investment and activity grow.

Our initiatives must deliver a win-win for local community investors, local enterprise and, of course, our environment.

CLEANaS is also aware of a number of other similar community groups in NSW and throughout Australia that are also looking to establish community renewable energy projects and which face similar barriers to appropriate finance. Our discussions suggest that they share similar concerns as CLEANaS and may also benefit from the introduction of CSEF.

Community support to clean energy and environmental issues in the region is strong and there are many examples where community has come together to support these activities through donations of time and money. Local people want to see the expansion of renewable energy and reduced reliance on conventional energy services. They also want to see the local economy diversify so as to capitalise on green economic opportunities including green jobs and markets. They also want to take control of their energy costs and have access to the means of managing their energy risks.

This requires investment, and CLEANaS believes that community is ready and willing to lead the way as long as there are clear and tangible shared benefits with strong local ownership and control.

Local investors for local benefit!

Our aim is therefore to involve broad-based community investors in profitable renewable energy projects which not only deliver a return on the investment but which also provide other tangible benefits to the local community. These other benefits include, strengthening the local renewable energy industry, reducing energy costs and risks to local business and social services, providing local people with an opportunity to engage in addressing global issues.

In 2013, with the support of the NSW Office of Environment and Heritage, CLEANaS prepared its Lighthouse Community Renewable Energy (CRE) Toolkit. This is a set of technical, legal and policy tools created by CLEANaS in order to support community groups in the Newcastle and surrounding

areas to develop profitable community solar energy projects. The Toolkit includes, amongst other things, an analysis of corporate structures and financial regulations in order to determine feasible mechanisms whereby CLEANaS could facilitate small investors from the local community to invest in commercial scale solar PV projects. The findings of this study are in general agreement with the analysis provided in your discussion paper. The study identified that there is currently no cost-effective mechanism that would meet our needs, the reasons being that current regulations either restrict the number of investors (thereby not enabling broad-based ownership) or have prohibitively high compliance costs for the size of projects anticipated. Other options, such as working through existing industry managed funds, risked diluting the "local" ownership which is central to our aims and which differentiates these projects from other commercial clean energy developments.

While not in a position to provide expert commentary on many of the technical and legal questions raised within your discussion paper, CLEANaS hopes to provide the perspective of a concerned community stakeholder who sees CSEF as a mechanism to remove a key barrier to fundraising for projects which prioritise broader social and environmental benefits. Also, it is not necessarily our intention to establish a CSEF portal or other CSEF mechanism as long as an appropriate service was accessible.

These issues remain topical for CLEANaS and removing these barriers to wide scale ownership of commercial scale renewable energy is central to our mission. We welcome the questions posed in your discussion paper and provide below our response and commentary for your consideration. We remain available to support your further progress on these matters.

Best regards,

Daniel MacDonald

CLEANaS Chair

on behalf of CLEANaS

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Responses to Questions

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

Yes. CSEF presents an opportunity to strengthening community participation in local development by enabling shared ownership, strengthening social capital, and ensuring a stronger link between investment and local priorities.

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

CLEANaS is not in a position to provide specific guidance on how the provision is formed, however we offer the following comments on each point:

(i) The small scale offering is limited to 20 investors which is not a sufficient number to represent broad-based community participation. The alternative is to move to a public offering, however as individual projects are likely to be less than $2million with individuals contributing relatively small amounts (less than $2000) then this approach is not cost effective.

(iii) We advise against limiting CSEF to sophisticated, experienced or professional investors as this will exclude the potential for broad based community participation as envisaged by CLEANaS. Community investors are looking to invest smaller sums of money and may accept low rates of return and higher risk in order to generate non-financial benefits to themselves, their families and the broader community.

A local person investing in a CLEANaS project will be looking for both a financial and non-financial return on their investment. To illustrate, consider a hypothetical project where local parents are invited to invest in solar power for their kid's surf life saving club. In this case they may look to recoup their investment but will primarily be looking to see that the club has benefitted. These parents may previously have considered a small donation, whereas via CSEF they may now consider increasing their commitment. The financial return on investment is therefore NOT their primary motivation for participating although it is a motivation for them to increase the amount they would make available to the club.

(iii) No comments

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

We have no comments on specific changes. However we would wish any changes to consider that general community owned projects will:

- *involve more than the number of investors currently permitted for proprietary companies;*
- *will not be so large as to be feasible given the compliance costs associated with public companies;*
- *risk losing the "local community" emphasis if aggregated within a managed fund;*

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

We have no proposals with regards to who / what should be restricted. However, from CLEANaS perspective, we see that the types of investments likely to be serviced by CSEF are diverse yet fall outside the scope of current issuers. We would therefore caution against using any overly restrictive classification, such as 'innovative start-ups', which may unnecessarily rule out many potential projects that are based on proven approaches (e.g. crowdsourced grant funding), but which have a new emphasis (e.g. equity finance).

(ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

No comments

(iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

CLEANaS projects are unlikely to be viable under a public offering or managed fund due to compliance costs and minimum size investment. Consideration of maximum fund ceiling should take into account compliance costs and minimum size of individual investments so as to ensure that overall compliance costs balance risks to investors but are not a barrier to broad-based participation of small investors.

(iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

CLEANaS has no specific comments, however we recognise that if issuers are engaging many smaller investors who are investing relatively small amounts, then requirements for disclosure and subsequent compliance costs should be correspondingly reduced. There should also be some recognition, in the case of community projects, that "local" linkages increase investor awareness and that the perceived benefits are not solely financial (as is generally the case for normal commercial investments).

(v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

No specific comments, however for community projects such as proposed by CLEANaS there is clearly a geographically and/or socially delineated cohort of prospective investors to whom we would wish to advertise, which would differentiate us from other issuers.

(vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

From CLEANaS' perspective the investments will be in specific project offerings and as such we would expect liabilities for CSEF to be similar to those of a proprietary company.

(vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

No comments

(viii) **any other matter?**

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

No comments

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

(a) should CSEF intermediaries be required to be registered/licensed in some manner

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

CLEANaS offers no specific comments on these matters although intermediary requirements should reflect their specific role as "facilitator" and be balance with their overall contribution to the underlying risk factors to which the investor and issuer are exposed.

(ii) **intermediary matters related to issuers:** these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

General comment to (ii):

The good initiative should not be suffocated by over-regulating it. The liabilities should sit at the issuer, not at the intermediaries. To avoid scams the intermediaries should conduct some basic checks to ensure that the issuer and investor. Additionally the intermediaries should have some checkpoints to detect different fraudulent activities (like scam schemes, money laundering, etc.).

(iii) **intermediary matters related to investors:** these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

(b) what risk and other disclosures should intermediaries be required to make to investors

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

General comment to (iii):

We believe that the intermediaries should not be seen as offering investment advice, but only as the providers of the platform. Hence the disclosure requirements should be placed on the issuers. Generally, the risks and fees should be transparent upfront.

The intermediaries should however provide the means for the investors, potential investors and issuers to discuss the projects openly.

(iv) **any other matter?**

No comments

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

No comments.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

CLEANaS recommends not having any restrictions on type of investor as we believe that CSEF is filling a gap in investment mechanisms which targets a specific type and size of investment which will be naturally differentiated from other types of investments (and hence investors).

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

Instead of looking to sophisticated investors to "vett" an enterprise, CSEF should look to "crowd vetting" instead. This is a mechanism used in some current crowdsourcing schemes whereby a project is not funded unless it

reaches a critical funding pledge level, this being a proxy measure of the crowd's expectations for success of the venture.

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

The limit on maximum funds may be appropriate to limit the risk exposure of individual investors but should not be so much as to create unnecessary fragmentation of the equity. Also, the limit should not be so high as to reduce the potential for "crowd vetting" of investments.

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

Yes. The risks related to the platform as well as to the project should be made transparent and they should be acknowledged by the investor.

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

No comments

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

No comments

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

No comments

(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

No comments

(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

No comments

(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

No comments

(xi) **any other matter?**

No other comments

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

No comment

Question 10 What, if any, other matters which come within the scope of this review might be considered?

It should be remembered, that there are currently other ways available for funding large scale projects, but relatively small projects struggle due to the cost related to the high regulatory requirements. CSEF could be the long awaited solution for these problems, but only, if the requirements are proportional to the project size and to the risk that an individual investor takes.

Discussion paper for:	Australian Government. Corporations and Markets Advisory Committee
Topic	Crowd Sourced Equity Funding
Opinions of:	Tony Camphin of Strategic Corporate Direction tcamphin@corporatedirection.com.au +61 411176693

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Background:

Tony Camphin is a Chartered Accountant and Australian Small Scale Offerings Board (ASSOB) sponsor working with a range of family and small to medium businesses to assist in corporate, business and strategic planning, professionalising management and the challenges facing these businesses trying to commercialise their operations be they start ups, scale ups and going concern business valuations.

The following comments are offered to the questions raised in the discussion paper dated September 2013.

Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

- There should be changes made in the corporations legislation to facilitate CSEF based on the following reasons:
    - The level of regulations protecting investors is very restrictive and has given rise to the CSEF and investor incentives such as inexpensive gifts, trinkets etc.
    - Investors of amounts above say $1,000, I suggest, would rather have equity, they know they are taking a risk and don't really want a gift anyway.
    - The result is less financial support than would be available if equity was permitted.
- The level of funds raised under the CSEF model should be set at an amount that helps bridge the funding gap between an idea and being able to build a prototype or prepare a section 708 capital raising, IPO etc. Suggested upper level of say $500K.

Preparing an offer document and assisting in the raising of capital in compliance with Section 708 of the Corporations Act can cost anything up to $50K. While section 708 is designed to help target certain unsophisticated investors it is really more applicable to raising funds from overseas and sophisticated investors.

Because a potential investor is not independently wealthy doesn't mean they don't understand the market or cannot evaluate the risks associated with certain investments. If a $500K capital raising under section 708 were to rely on unsophisticated investors, under the 20/12 rule each would have to invest

$25K. If however the rule was 100/12, investments of $5K would be considered and this is far more palatable.

Restricting investors because they are not independently wealthy is somewhat an over precaution. Many an investor may have the knowledge to invest but are not be classified as wealthy why shouldn't they be at liberty to invest under section 708 in smaller amounts.

- Sophisticated investors should not be restricted to people who have money, educational standards and risk assessment tools have a role to play here.
- Methodologies such as Blue Ocean Strategy identify 6 areas of risk that face all early stage ventures and how they can be mitigated.
- In addition to considering the warnings and disclaimers incorporated in a Section 708 offer document consider including a profile of the areas of risks faced by the venture and how these are to be mitigated.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

- CSEF suits seed capital raising, once sufficient funds are available options present such as an offer document under section 708.
- The proprietary company structure is really not suitable for raising funds even under section 708, proprietary companies are better suited to existing alliance partners, family, friends and work associates. There need be no change for these entities in existing regulations.
- Public companies with the need of 3 directors and external audit are more suitable for raising capital, however the 20/12 rule imposes a number of shortcomings as eluded to above.

1. The current definition of a sophisticated investor assumes that if you don't have assets or a high paying job you are restricted in making investment decisions in start-ups and/or early stage ventures.
2. From discussions with (ASSOB) it appears the average investment in an ASSOB listed company is above $25,000, which is far too high for what is currently classed as an unsophisticated investor. As a result many good projects don't reach minimum subscription restricted by the 20/12 rule.
3. It is very difficult in Australia to raise funds for any early stage venture, high net worth (HNW) investors tend to be very unresponsive to early stage investment (see page 28 PWC report April 2013), as a result reaching minimum subscription for a section 708 capital raising is

difficult. A change to the 20/12 rule to say 100/12 rule would enable smaller investments from accredited investors.

One solution to the problem is redefine sophisticated/accredited investors to include those with the knowledge and ability to assess risk and not assume because an investor has neither $2.5 Million of net assets nor a $250K income they cannot assess an investment.

To address this problem, consideration should be given to the following:

1. The level of education a potential investor has and their ability to assess risk, which need not be linked to net worth or income levels.
2. Warnings tend to be general, not project specific and highlight the fact that early stage ventures are risky and investors should seek the advice of an expert.
3. The areas of risk are seldom addressed specifically in a methodical fashion. If this was done it would highlight even to the most unsophisticated investor, risks that they should be aware of.

Addressing Risk in CSEF.

Almost all CSEF ventures:

- Have limited funds,
- are challenging the status quo,
- target uncontested market space,
- developing some new and/or innovative technology,
- are seldom built around lowest cost strategies, their target is more likely to be directed at needs that is currently unmet.

Blue Ocean Strategy (BOS) is an example of a methodology that addresses the risks associated with establishing businesses in this uncontested market space and has been embraced by the Malaysian and Slovenian governments with great success in establishing innovative opportunities.

There 6 risks that need to be understood and addressed by potential investors in CSEF when assessing the possibility of success, they are:

1. Search risk: Does this specific opportunity look to make the competition irrelevant?
2. Planning Risk: Does the plan create and capture new opportunities?
3. Scale Risk: Does the opportunity unlock new demand, hence minimising scale risk?
4. Business Model Risk: Is there a viable business model that identifies the ability to produce and maintain profitability?
5. Organisational Risk: Does the offer identify how the leaders and managers overcome the key organisational and operational hurdles?
6. Management Risk: This deals with the team leadership and is associated with peoples attitudes and behaviours.

Managed Investment Schemes

These schemes have a role to play despite the failure of many agricultural/ horticultural schemes. The experience, competencies of and agreements with management need to be carefully reviewed and once again emphases on addressing risk and how it is being mitigated.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

(ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

(iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

(iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

(v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

(vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

(vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

(viii) **any other matter?**

Q4.

I. The types of issuers needs to be relatively broad, for example if an applicant has received an R & D grant then they should qualify in being able to raise CSEF. The US system is attractive, it broadens the scope and the ability to promote investment opportunities, however the accredited investor should be expanded to include less wealthy individuals who can demonstrate a degree of knowledge and the offer should highlight the risks and how they are addressed.

II. Ordinary Shares, Convertible Notes and Preference Shares

III. There should be a ceiling and a minimum subscription for all fund raisings.

IV. A brief description of the opportunity the management and relevance of the 6 risks addressed earlier and how they are mitigated.

V. Along the lines of the US model, which allows entrepreneurs to publicly advertise and market their company's investment opportunity of whatever size to accredited investors. (expand accredited to include educated/knowledgeable investors).

VI. Issuers need to be accountable for the truth and correctness of the information they provide the investors. The defences of a reasonable man need to apply.

VII. Secondary markets should be available once the initial capital raising has closed.

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

1) The obligation to attest to the fame and character of the issuers and
2) the expanded accreditation of the investors.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

- (a) should CSEF intermediaries be required to be registered/licensed in some manner
- (b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role
- (c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
- (d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

(ii) **intermediary matters related to issuers:** these matters include:

- (a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
- (b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
- (c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
- (d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites
- (e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors
- (f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with
- (g) what controls should be placed on issuers having access to funds raised through a CSEF portal

(iii) **intermediary matters related to investors:** these matters include:

- (a) what, if any, screening or vetting should intermediaries conduct on investors

(b) what risk and other disclosures should intermediaries be required to make to investors

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

(iv) **any other matter?**

Q6

I. Permitted types of intermediary

a. Yes Chartered Accountants, CPA and Lawyers in practice. Stock brokers and perhaps certified financial planners.

b. See (a.)

c. Guide as to information to be covered in the documentation, which covers the risk associated with the venture and how they are addressed if at all.

d. Possibly for disputes relating to misrepresentation.

II. Intermediary matters related to issuers

a. Should not be related to medications or cures for cancer etc. Citizenship programs, or matters related to immigration and exclude real estate ventures.

b. General enquiries that issuers are of good fame and character, check say 3 specific credible character references.

c. None unless responsibility is specified in the offer document.

d. None unless responsibility is specified in the offer document.

e. None unless it can be shown that the character checks were not properly undertaken or were falsified.

f. Financial associations with the issuer must be outlined in the offer document. Funds to be held in trust and only released when

minimum subscription is reached. All investments to pass through the trust account.

g. Details of a register of members as specified in the offer document.

h. Information about complaints should be first to the issuer then the intermediary and finally ASIC, all procedures being detailed in the offer document.

i. Full disclosure in the offer document.

j. Web address for complaints.

III. Intermediary matters relating to investors

a. Intermediaries should ensure that the accredited investor is actually accredited.

b. See 6 risks detailed earlier.

c. Ensure that the funds are held in trust until minimum subscription is reached. There should be a cooling off period of say 5 days from receipt of funds.

d. Intermediaries should declare their interest and confirm that investors understand this.

e. No, provided there is full disclosure in the offer document.

f. Investments should be handled through a trust account of a third party and only released on the conditions in the offer document being met.

g. All fund raising amounts over $500 should be identified and in the event of minimum subscription not being reached refunded to the investor. For applications less than $500, these should be offset against fees of intermediaries and any balance to a charity identified in the offer document.

h. Website with a pro-forma in the offer document, which an investor can follow easily.

i. All fees and commission should be detailed in the offer document.

j. Web platform similar to ASSOB.

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

I. Yes the differences between various shares, convertible notes and debt should be detailed in the offer document.

II. Yes

III. Yes

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

(xi) **any other matter?**

I. No limitation

II. No

III. No

IV. General notice in the offer should be sufficient.

V. 5 days for amounts $500 and above.

VI. No just V. above.

VII. Resale restricted until offer closes.

VIII. Annual accounts and significant events notification on the web.

IX. As per unlisted public company.

X. No recourse unless fraud or misrepresentation.

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

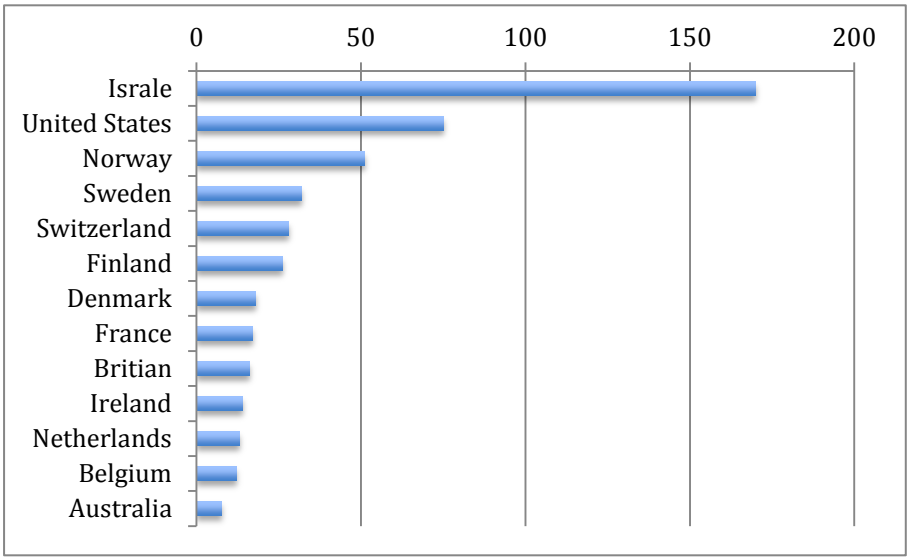
In the form of a self contained regulatory regime.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

Please consider the problem that confronts early stage ventures and start-ups raising funds.

Australia is behind other developed nations when considering equity investment in venture capital. See the chart below taken from the PriceWaterhouseCoopers paper "The Starteup Economy, how to support tech start-ups and accelerate Australian innovation" commissioned by Google Australia April 2013[1];

VC per capita (2010 US $)



Australia at US$7.50 (FY10 & FY11 average), is at the bottom of the list.

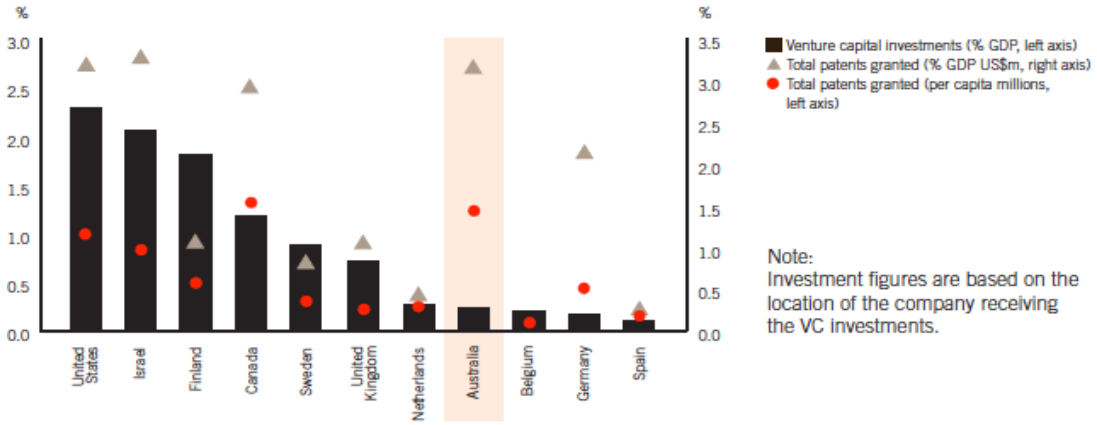
Australia has a poor record in VC Investment and especially when compared to the number of patents granted. The following Graph shows that Australia can boast a world-class innovation pipeline for patents granted both per capita and as a % of GDP. But venture capital investments per capita are abysmal as is evident from the following graph:

[1] *http://www.digitalpulse.pwc.com.au/wp-content/uploads/2013/04/PwC-Google-The-startup-economy-2013.pdf*

World-class innovation pipeline

Figure 2: VC investments vs. patents granted in selected OECD countries (2000 – 2011)

Sources: AVCAL, ThomsonONE, EIU, WIPO Statistics Database



The above snapshot shows Australia is great coming up with the innovative and patentable ideas but does not provide the environment for their development or commercialisation.

Commercialisation Australia is supposed to address this shortcoming however from my approaches (to date all unsuccessful) it is evident that you must have ticked a number of boxes, which include the following:

- Your idea/process must be patentable IP.
- You must demonstrate that you have exhausted all possible avenues of finance for the project.

This second point ensures that the whole process is a funding option for those ideas that couldn't get funding from the private sector (applicants are often referred to as second stringers).

Considering the first point it is in the DNA of those seeking to come up with innovative new ideas to get them patented. However, in the real world very few if any of these early stage operators can fund protection of such a patent. CA ignores being first to market unless you have something patentable.

The current Research and Development Grants offered by the Federal Government encourage this process and result in the siloing of good ideas as is evident in the earlier chart.

What is needed to compliment the R&D Grant is a Collaboration and Development Policy offering tax advantages for individuals or firms to fund smaller innovative under capitalised firms or ideas. This would take the emphases and financial drain away from R&D grants and focus attention on commercialisation of the many bright ideas that need capital.

Numerous small businesses wouldn't survive but for the R&D grant. If their IP was stolen it is doubtful if they could finance any challenge to stop the theft.

Collaboration & Development Policy in Australia

Discussion Points – Tony Camphin & Bruce Billson:

There is ample research here and abroad that points to the following:

- Some estimates put 95% of all patents commercialised, and only 3% as profitable. Also, Australian R&D is skewed away from being conducted within business, and towards being undertaken at Universities, ***suggesting it is more likely to be pure and academic research and less commercially focused***

- Australia lags significantly in attracting overseas investment and collaboration in R&D, suggesting we are not leveraging IP created overseas nor capital available from overseas, and we may be relying too much on home grown solutions and reinvention, or simply managing without innovation.

- Somewhere in the order of 70% of all innovation is not driven by new technology, but by the redeployment of existing technology or innovation in business models and processes. "Value Innovation" is the phrase that has been coined to define innovation that is not simply pure and academic (i.e. the use of technology for technology's sake), but has value to end-users. ***Suggesting that our academic approach to R&D will most likely focus on technology and overlook the broader pool of value innovations***

- "First to market" is often beaten by "first to monetise the market", which suggests our potentially more academic, less commercial focus on R&D is probably sub optimal for driving economic growth.

- R&D spending both by the private sector and government creates economically perverse behaviours such as hoarding IP (hiding it from competitors, buying and burying it to avoid it arising as a path to substitutes and alternatives, holding IP despite not having the resources to commercialise it). ***This suggests that policy should attempt to encourage organisations to free up and share IP, partially by providing greater practical protection from poaching***

- Companies already recognise the importance of collaboration and development and have commenced their own experiments in this area, unfunded by Government.

- Industries that receive large government subsidies and support often use this to prop up ailing and outmoded business models, maintain return on existing assets, upgrading capital and the retention of labour resources but in a declining industry, and generally fail to innovate themselves into sustainable new industries, business models and markets.

- There is a false view that small to medium business is the engine of ingenuity, creating new and disruptive innovations far in excess of "lazy and rigid" large businesses, ***when in fact most highly successful innovation comes about through collaboration between businesses of all sizes.***

Robyn Donnelly

42 Bosworth Falls Rd
O'CONNELL NSW 2795

Dear Mr Kluver,

Please find attached my brief submission in relation to the Discussion Paper on Crowd Sourced Equity Funding.

You will note from my submission that the focus relates to the relationship between funding regulation for cooperatives in so far as this is impacted upon by the funding regulation under the *Corporations Act, 2012.*

My professional background over the last 20 years has been as an academic at a regional University, as well as an employee within the Registry of Cooperatives & Associations (part of Fair Trading in New South Wales). Indeed the last 8 years of my professional career I was involved with the development of the inter government agreement for a Uniform Cooperatives Law and the drafting and passage of the template Cooperatives National Law and Regulations in New South Wales. The law relating to cooperatives is closely linked with the Corporations Act and indeed community equity fundraising is the principle tool for cooperatives to commence their operations.

I have retired from full time professional work however I have a strong ongoing interest in the cooperative sector in a private capacity, providing training and other advisory services for cooperatives.

Please accept my submission and I look forward to reading further material and deliberations regarding this important topic from the Committee.

Yours sincerely,

Robyn Donnelly
B.Com, Ll.B., Ll.M

The CAMAC Review of crowd sourced equity funding (CSEF) is a welcome initiative.

General comments

Funding for new or start up entities has been a longstanding problem. The recent success of various crowd funding internet platforms both here and overseas for new start ups is a strong impetus for a regulatory approach that facilitates these fundraising methods.

Existing regulatory restrictions for CSEF are not facilitative and fail to recognise the ability of individual investors to both assess and accept risk for small start ups.

In simple terms, doing nothing is not an option. Rather, permitting or facilitating CSEF activity is necessary in a manner that results in a low transactional cost for new start ups and the requirement to clearly and simply state the risks for ordinary investors. Whilst it may be necessary to place an upper limit on the amount that can be raised through CSEF either as a total or by way of an upper limit on individual investment commitment levels, in truth the more important regulatory refinement of CSEF would be to require a plain English statement to specify the risk attached to any such investment.

Specific comments

My interest in the CAMAC Review arises from my experience and role in the cooperatives sector.

Cooperatives are incorporated bodies that are well suited to community investment and social business enterprises. The number of cooperatives in Australia is small compared to the number of companies, however they have a significant presence in the agricultural sector where they have a proven track record in increasing the sustainability in rural and regional areas. Cooperatives in more recent times are developing a presence in renewable energy generation and the development of local produce networks. Cooperatives have broader purposes than the pure investment or economic return focus of companies and research in the UK shows that they are a good 'fit' for community equity fundraising platforms[1]. Just like companies, they experience difficulty in marshalling start up capital, although the regulatory regime for this is in some respects not as restricted as for companies.

Changes to the regulatory regime to accommodate CSEF for companies will have an impact upon the ability of cooperatives to offer shares to new members, because of the interaction of laws governing cooperatives and the *Corporations Act, 2001.*

Fundraising regulation for cooperatives

The division of regulatory power between the Commonwealth and States is such that States (including Territories) govern cooperatives and the Commonwealth governs companies. However, the Commonwealth power over companies also includes power over the financial markets and as a result, fundraising (both equity and debt) by cooperatives within a State is governed by that State, but fundraising across a State border will attract the additional regulatory control of Chapter 6D of the *Corporations Act 2001*. [2]

A cooperative is an incorporated body with the same powers as companies, including the power to issue shares and debt instrument. Each State and Territory has a *Cooperatives Act*, however in March 2014, a new template legislative scheme will commence in New South Wales and Victoria, with other jurisdictions following. The new template law is referred to as the Cooperatives National Law, and its development has been progressed through the COAG Consumer Affairs Forum. A driver for the development of the Cooperatives National Law has been the need to remove competitive barriers for cooperatives who are currently required to register as 'foreign cooperatives' in other jurisdictions in order to carry on business outside their home jurisdiction. Under the Cooperatives National Law there will be mutual recognition of cooperatives in each jurisdiction in recognition of the fact that cooperatives compete with companies in the Australian market, which is a national market.

Community equity fundraising by cooperatives

Cooperatives face similar difficulties to companies in raising start up capital, however, for cooperatives access to capital or funding is exacerbated by the fact that it is an entity type that is not well understood by funders or professionals.

As already noted, cooperatives are empowered to issue both equity and debt instruments. My comments in relation to CSEF apply principally to equity or share offers by cooperatives[3] The disclosure requirements under State laws for equity are different because a share in a cooperative is substantially different from a share in a company.

Shares in a cooperative are not investment interests in the same way that shares in a company are. In particular they :

- have a fixed par value,
- cannot be traded on a public stock exchange,
- can only be issued to a member,
- do not carry a vote, as the vote (one vote only)is a right attaching to membership, and
- are withdrawable or repayable if the membership ceases or the member asks that the cooperative repay them.

Typically the share capital required to establish membership is modest, because the raison d'etre of the cooperative is the expected cooperative interaction between the cooperative and its members.

Accordingly, the disclosure regime in respect of share offers is a disclosure statement that is more about the member relationship rather than the

investment potential of any share capital in the cooperative. State regulation requires that the disclosure statement must be current and there are penalties and liabilities for misstatements and omissions. Typically, cooperatives do not engage in a specified public offer to raise a specified amount of capital, although there are instances of this in start up cooperatives in renewable energy. The nature of a cooperative as an entity that is open to all persons who are able to utilise the services of the cooperative means that its disclosure is ongoing. It is continually open to new members who 'buy in' by purchasing shares. The disclosure statement is continuous because of the statutory obligation that it must be current.

Less risk associated with cooperative share offers

The nature of cooperative shares is such that the risks are low compared to the risk in investing in company shares. Whilst there is no statutory limit on the amount of shares that a cooperative might require for a person to establish membership, there is no immediate benefit in buying a large parcel of shares as there is no capital gain component and no additional voting rights.

Cooperatives adhere to the international cooperative principles[4], which require them to be open to any person who is able to use their services and to work towards the sustainable development of their communities. These principles make cooperatives a good fit for crowd sourced or community equity funding models that look to the broad community for small investments and offer either small returns in kind or to satisfy desires to help develop new or community enterprises.

Need for competitive neutrality

Cooperatives would benefit from the access to funding through internet crowd funding platforms, but are subject to a competitive disadvantage because of the operation of the fundraising provisions on cooperative shares when they are offered outside their home jurisdiction. Furthermore, the fundraising provisions under Chapter 6D of the Corporations Act are designed to protect investors from risks associated with company shares; risks that are very different from the risks that attach to shares in a cooperative. Cooperatives already operate at a competitive disadvantage to companies by having to comply potentially with two distinctly different disclosure regimes to offer shares across a State or Territory border.

If the regulatory regime for equity funding through crowd funding platforms is relaxed for companies, without recognition of the existing restrictions on cooperatives, then the competitive disadvantage will be significantly increased.

Conclusion

It is my proposal that the CAMAC review of crowd sourced equity funding

a. takes note of the impact of any changes to the Corporations Act disclosure requirements on share offers by cooperatives, and

b. that it recommends that existing disclosure provided for these securities under the Cooperatives National Law (and existing State and Territory laws) is sufficient to enable cooperatives to raise equity funds outside their home jurisidiction without the need for any additional regulatory control under Chapter 6D of the Corporations Act.

I am happy to supply any further information to the Review regarding the regulatory requirements and constraints affecting cooperative share offers.

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[1] Brown, J., *Community Investment Using Industrial and Provident Society Legislation,* 2008, Co-operatives UK

[2] Division of regulatory power is governed by the Corporations Agreement. Securities of a cooperative are exempt when issued within a cooperative's home State: ss66A and 708(21) *Corporations Act 2001*.

[3] Disclosure requirements for the public offer /issue of debt securities is modeled on Chapter 6D of the Corporations Act.

[4] Section 10 Cooperatives National Law: The Cooperatives National Law is an Appendix to the *Co-operatives (Adoption of National Law) Act* NSW 2012

CSEF SUBMISSION

OSCAR SCHERL

Preface;

I have read the Crowd Sourced Equity Funding (CSEF) Discussion Paper and am encouraged to read that the Australian Government is considering opening channels for small and large investors to participate in CSEF. I make this submission based on many years of experience in Intellectual Property development in the Screen Industry and to some extent in the development of an Innovation project.

Creation of the CSEF's will provide opportunities, especially needed in the areas of Intellectual Property and Innovative development, given that most investors are traditionally 'Brick and Mortar' oriented. In general, people involved in Innovative and Intellectual Property development, the world over, have little money or backing to start-up and bring their projects to a successful conclusion. Through properly structured internet offerings we can now reach investors world-wide. When implemented, CSEF's will boost Australia's image as an innovative nation, welcome local and international investment and create jobs.

Proposal Outline;

Based on my experiences it is my suggestion that Intellectual Properties, specifically for the Screen Industry (SI), should be offered separately from Innovative projects.

The reasoning is simply that the people who are in, or want to be part of the SI, they can be anyone, including fraudsters, (i.e. the 10BA system for the SI). They are able to raise finance for an idea or based on few written words, unless it is managed by SI professionals.

In the Innovation area people generally are concerned with a concept or have developed a (secret) innovation which they wish to protect and are therefore less prone and more careful about fraudulent attacks.

I believe that it is vital for both entities (government bodies and / or organisations) running such CSEF websites, to have people on board with relevant expertise. Also, they must be true equity crowd funding structures, without the limitations of advertising, investor participation restrictions or the expensive and bureaucratic means of the existing systems; DGR, Section 708 or the Prospectus requirements. ASIC's involvement should be limited to facilitating any change to the corporation laws, if required, but not in an ongoing manner.

Intellectual Properties or Screen Industry projects website

There are 2 possibilities, Screen Australia or a Government supported private organisation, (for this purpose I shall name such a private organisation; Screen Industry Resources Australia – SIRA)

Screen Australia – Advantages

a) It does not require ASIC approval or a license.
b) It has, or will have experienced personal.
c) It can operate on a professional selection level, in addition to the Pozible website.
d) It has a very well developed website, and can easily add elements for CSEF purposes, (similar to the 'Producers Offset' operated on behalf of the Dept. of the Arts)
e) Screen Australia is obligated to raising additional finance under the SA 2008 Act.
f) Screen Australia has industry people knowledge to avoid fraudulent activities.
g) Screen Australia has the means to pursue fraudsters, if required.
h) Screen Australia has already an international image and is known for quality projects.
i) Screen Australia can avoid a disastrous happening such as the 10BA debacle.
j) Screen Australia can operate with no or very low expenses, important for start-ups.
k) Screen Australia can control the investment money without outside participation.

l) Screen Australia can operate 'Managed Investment Schemes' without any licensing requirements, keeping costs at a minimum, and
m) The Screen Australia option can be implemented soonest; importantly it can be the first website for screen projects, well before the Part III US Jobs Act comes into operation, (reported to start late April / May 2014).

Screen Australia - Disadvantages
i) It will be seen by screen industry participants as the only 'door' available to them, (which is not true, in any case; so what? There is Pozible for Awards crowd funding, DGR funding, Section 708 funding, ASSOB and Prospectus Financing).
ii) Screen Australia, as an autonomous Government corporation, may not wish to participate.

SIRA proposal for the SI project website**;**
To be competitive such a website will need to keep costs at a minimum for Investors and Issuers versus a profit driven SIRA. Therefore, I do not expect a privately financed organisation to be involved. However, I do believe that a SIRA private held entity can be established if it is government supported to establish its website, to advertise itself and to have the expertise on board, plus to have the means to pursue any miss-appropriation of funds or fraudulent activities. (Government supported SIRA proposed funding; $5 M in the first year, $4 Million the second year, thereafter, $3 M, $2 M and $1 M in the 5th year).

To keep expenses to a minimum ASIC should license SIRA without demanding the $5 Million security requirement, or the ongoing disclosure requirements. SIRA must also be able to operate in an unrestricted manner in terms of the number of investors, the type of investors and off course, be able to advertise its website and projects. My reading of the various existing corporation laws do offer a number of opportunities to amend or introduce minimal change to the regulations which could provide the basis for a SIRA to exist.

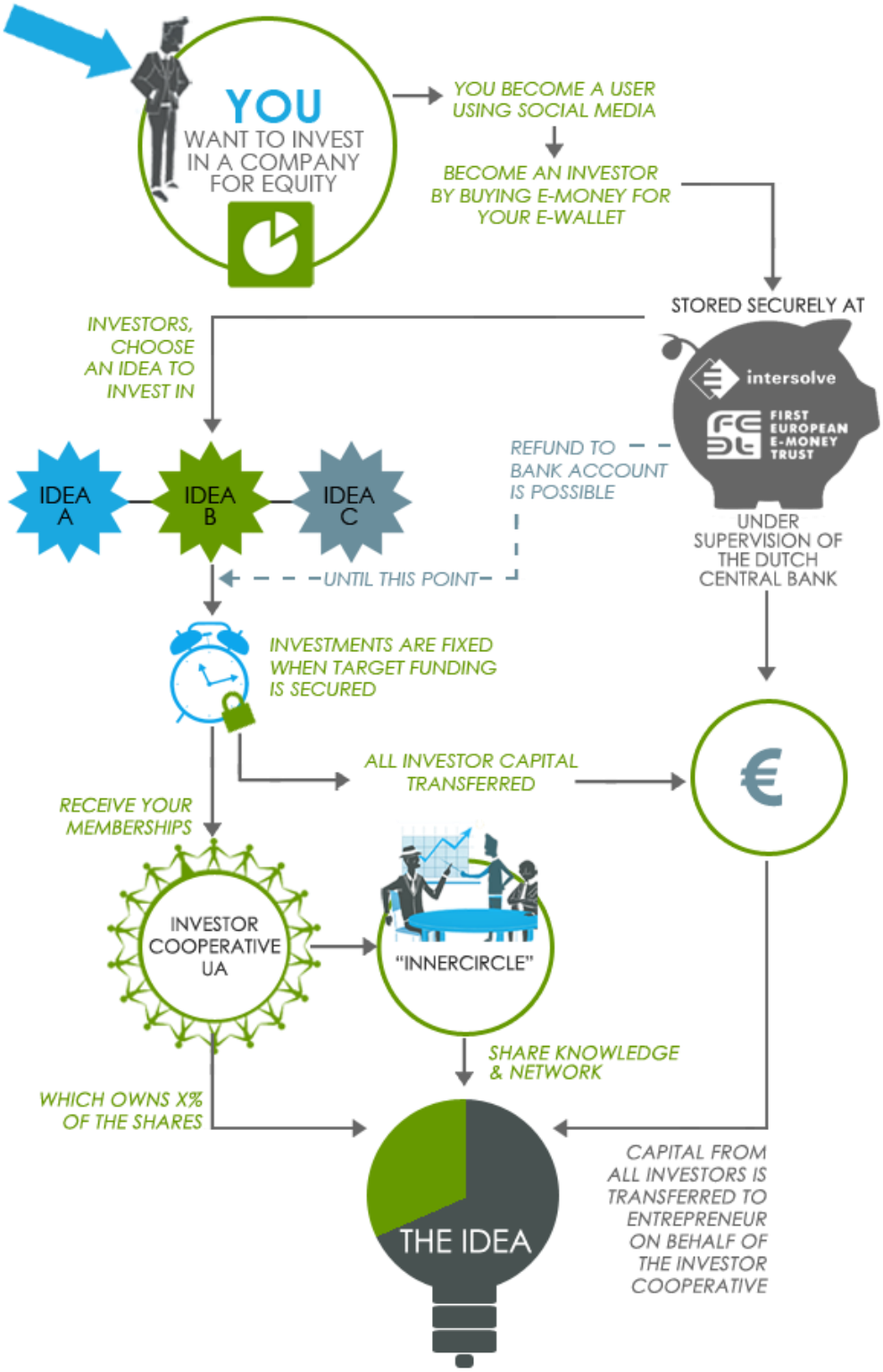
The disadvantages I predict for a SIRA organisation is a long in-gestation period due to changes of regulations, the search for or the establishment of a SIRA organisation, the limited profit potential, the investors lack of trust of a privately run organisation and the involvement of ASIC.

Innovation Projects Website

Again, there are 2 possibilities, IP Australia or a government supported private organisation, (for this purpose I shall name such a private organisation; Intellectual Property Resources Australia – IPRA)

IP Australia, being a government organisation has similar advantages as does Screen Australia.
a) It does not require ASIC approval or license.
b) It has, or will have experienced personal.
c) It can operate on a professional selection level.
d) It has a very well developed website, and can easily add elements for CSEF purposes.
e) IP Australia has the knowledge and system to avoid fraudulent activities.
f) IP Australia has the means to pursue fraudsters, if required.
g) Already government funded IP Australia can operate with no or very low expenses, important for start-ups.
h) IP Australia can control the investment money without outside participation.
i) IP Australia can operate 'Managed Investment Schemes' without any licensing requirements, keeping costs at a minimum, etc.

Similar problems would present themselves for a privately held IPRA entity as would exist for a SIRA privately held entity. However, with the appropriate corporations law changes, government supported, to keep cost at a minimum and the non-involvement of ASIC, a structure similar to the one established on the Dutch website www.symbid.com could be established, see diagram below.



I have made this Submission in an overview manner, principally researching and exploring the concept of two separate entities for the CSEF concept, which in my view attend to and overcome the major considerations which CAMAC addresses in the Discussion Paper.

I'm available to discuss details with the committee, should you feel that this 'Overview Submission' has merit, in order for me to consult and work on a detailed submission.

OSCAR SCHERL
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Cassandra Wilkinson
President FBi Radio 94.5FM
cass@fbiradio.com
0437009920

Thanks for the opportunity to make a submission.

FBi Radio is a privately funded public access community radio station that broadcasts new Australian music to around 250,000 listeners a week (McNair figures).

We get less than 1% of funding from government so we are an usually successful sustainable social enterprise as well as being Australia's only dedicated Australian music radio station.

We have experience in many types of innovative fundraising including having recently negotiated one of the first Social Enterprise Finance Australia social business loans to buy our own building.

We have a strong desire to complement the debt we have raised from SEFA with equity from supporters. Currently are essentially restricted to crowd funding donations due to the onerous nature of the regulations. The opportunity to offer supporters a way to help us while preserving their capital would be a valuable addition to our fundraising options.

The success of projects such as Save the Rat for the Red Rattler show how much support is available in the community for the crowd funding model. Allowing genuine investment to complement giving would expand that pool of support.

We are very pleased to support this proposal – in fact we recommended something just like it to the Arts Council review last year. I would be delighted to talk in more detail with you if it’s valuable to your process.

Best regards,
Cass Wilkinson

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Re: Submission re your public consultation around Crowd Funding

For over thirty years I have been an active and entrepreneurial angel investor. The exclusive focus my investment company has been to invest seed capital in dozens of start-ups and early stage research and IP-based technology companies, several of which have achieved public listings or been acquired by large multinational companies. Together, they have created substantial employment of highly skilled scientists and engineers and required substantial services from legal, accounting and IP professionals.

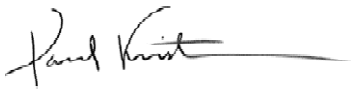
The Crowd funding model is extremely well suited to today's start-up funding requirements that are typically much smaller than used to be the case for the research intensive ventures I have been involved with. Young entrepreneurs need to be given easy access to this new type of web-based funding in order to get their ventures off the ground and keep Australia competitive.

My submission overleaf deliberately sets out the simplest possible approach to the subject of crowd funding regulation. A 'light touch' regulatory framework will give the best results.

A successful crowd funding platform ought to be open, transparent, easy to implement, simple to monitor and easy to enforce, However, investors and authorities should demand standard reporting and governance from those who accept funds from the public.

It is my conviction that an extremely simple framework for crowd funding, as outlined in my submission, has by far the greatest potential to spawn innovation, entrepreneurialism, new company formation and national economic growth.

Yours sincerely



Paul Kristensen
Founder and Chairman
Capital Technologies Pty Ltd

Crowd Funding in Australia –

a submission by Paul Kristensen

Capital Technologies Pty Ltd

The discussion paper prepared by CAMAC is of a very high standard and offers a wide ranging background on the subject.

The objectives of crowd funding are well understood and need no further commentary. However, in considering the many potential crowd funding regimes the views and opinions differ greatly, as should be expected.

In my opinion, there's most to be gained in taking as simple an approach as possible when attempting to open this type of high risk investment to all investors, including those on low incomes and with limited assets. I therefore believe it would be appropriate to consider the following points:

- Nothing inherently prevents crowd funding from being treated simply as another form of gambling or lottery, i.e. most likely to result in a total loss of the investment or stake, but occasionally yielding an exceptionally high return. My argument is that there are no current regulations that prevent any person, whether wealthy or poor, from spending whatever amount they themselves determine appropriate on lottery tickets, poker machines, sports betting etc. Crowd funding could therefore deliberately be classified as a variation of gambling, thereby avoiding the introduction of cumbersome, new legislation or regulation.
- It may be reasonable to set a fixed, upper investment limit per investor (probably somewhere between $1,000 or $5,000) to protect the most vulnerable. This also gives an issuer access to the broadest possible spread of investors when crowd funding a venture.
- As with other forms of gambling, there should be no restrictions requiring investors to be in possession of a minimum income or fortune.
- Regulation (perhaps through ASIC) must be imposed on the issuer to provide any crowd funding 'investor' or 'gambler' with proper answers to the standard list of questions that an investor ought to ask and receive answers to. This would require a simplified information document to be prepared by the issuer, containing a prescribed wording that warns of the high risk of start-up investments and that a total loss of the investment is more likely than not.
- The issuer (if a person) must declare if he has a criminal record or has been declared bankrupt in the past. If an entity, its directors must similarly disclose any adverse criminal and financial records.
- Once investment funds have been received by the issuer, reporting standards must be legally imposed on the issuer to the same level as are currently required of a public, unlisted company, regardless of the type of entity or vehicle chosen by the issuer. This should ensure that the investors gain sufficient insight into how the invested funds were spent and enables the detection, reporting, prosecution and punishment of any outright fraud by the issuer.

The investors are thus protected to a reasonable extent by the reporting requirements imposed on the issuer, as well as by the limited amount of funds an investor can commit to

a particular crowd funding investment. Crowd funding investors would arguably by better protected than is the case for ordinary gambling or betting.

The risk taking and the outcomes enjoyed or suffered will over time provide strong educational benefits to crowd funding investors so they become progressively better risk takers and investors.

Likewise, the issuers will benefit educationally from having to learn about and conform to the current corporate governance and reporting standards that apply to any entity seeking and accepting funds from the public. This would be a considerable but perfectly reasonable onus on the issuer that should prevent outright fraud, while of course not avoiding genuine mistakes or ordinary mismanagement whether through ignorance or lack of business skills.

I submit that a much simplified framework for crowd funding, such as outlined above, has by far the greatest potential to spawn innovation, entrepreneurialism, new company formation and national economic growth.

Pete Cooper

0. Background

I refer in this letter to startups, by this I mean tech and tech and tech enabled early stage businesses focused on the internet and disruptive innovation.

Given my unique position in the market, I estimate Australia has around 3,000 possibly as high as 5,000 of these businesses. This contrasts with an April 2013 estimate of 1,500 by PwC (valued by 2033 of $109b in GDP contribution and 500K jobs).

So, to cut to the chase the prize could be easily $300b in GDP domestically.

But I write also to encourage you to consider the international, specifically SEA and Greater CN opportunity too which could double or triple this figure.

My name is Pete Cooper, I have one of the deeper backgrounds in startups in Australia/Asia as -
- co-founder of a division at Macquarie Bank based on Prof. Clayton Christensen's disruptive innovation work in 1999
- angel investing since that time
- early in silicon beach
- co-organiser of the largest tech meetup
- founder of SydStart in 2009 the largest professional tech startup event and community
- pre-incorporation co-founder of fishburners
- regular mentor and speaker and advocate and more for the ecosystem across hundreds of companies and events including startup weekends, lean startup weekends, university startup weekends etc.
- CXO for $100m+ of startup trade sales and projects
- in the first 50 people invited to form and be behind startupaus

You can find more about me on linkedin or twitter (@pc0) or via my blog (anydex) but you will see a wide reach (tens of thousands in Australia and Asia).

Perhaps this conversation is best done face to face but I just wanted to give some feedback on the scope, approach and timing of the review.

1. Scope

The scope alone probably looks fine on paper but I think you need to step back a little, most of the people that would benefit from getting this right are startups themselves. Unfortunately the way is framed (existing legislation, narrow and out of date industry terms mainly) is going to generate responses from only one minor segment that are familiar with them or from that generation.

To be frank, you are going to miss the main audience.

Even the highly engaged SydStart and StartupAus audience and founders have found it obtuse at best. I can not formally speak for them but am paraphrasing based on (some relatively exclusive access and other wider market) online forums and 1:1 first hand conversations.

2. Approach

The industry is looking for structural solutions, sure, but the problems and framing can be done more easily. For example if you said in a survey -

- Should AU have angel list raising model, should we have simpler p2p lending (better than equity if you are successful) or crowd funding (e.g. kick starter - better than debt or equity regardless of success). Such as 200 lots of $1,000 investment by a professional (not professional investor) e.g. a dentist or computing science graduate - is as much as many (I would argue most) tech and tech enabled startups need in seed capital
- Should $1.7Trillion of Au superannuation be able to be direct or indirect (via above platforms) invested in startups (sure... cap at 1% of inflows for risk reasons and union appeasement reasons but asset allocation consultants will say more and for good reason).
- Should tech startup founders themselves be widely consulted directly rather than engaging (as current scope and approach) with the people who live off the industry (suppliers, corporate investors).
- Should there be a regular format for this type of consultation (e.g. democratic entrepreneur association).
- Should there be a simpler form of employee share plan scheme (e.g. a pre-approved ATO compliant PDF emailed directly to the Directors on the day they register the company rather than pay thousands and risk unplanned outcomes).

In short entrepreneurs are highly time poor, more so than most business people. The current scope and approach are going to get bias results from people (e.g. VCs, legal professionals) that have opinions but <u>are ultimately outside the industry servicing it not inside it creating the companies that create wealth for our nation</u>.

It would be better to ask entrepreneurs themselves in open terms, not bias by existing frameworks but in plain language and then and only then revert back to exploring implementation options in the regulatory and legal frameworks.

Taking this approach is more likely to enable simple, well directed action (to use a startup set of terms) that will be <u>lean</u> and get <u>product market fit</u> with enable meaningful <u>customer and product development</u>.

3. Timing

As I understand it, this current review was initiated prior to the recent federal election. As such any results are going to be subject to a degree of scepticism by the new government.

Better to recognise this and restart it, perhaps with a round table in Canberra of national tech and tech enabled startup leaders (entrepreneurs <u>in</u> the industry not suppliers and others making a living <u>from</u> the industry).

Or indeed complete it but suggest that as a next step.

Or spin off a subset of consultation now with more greenfields context.

Closing

Australia's around the world have been fundamental in creating the globally successful financial structures of the global (e.g. systems inside the leading markets such as LSE, NASDAQ, NYSE and Angel List are all using core people and technologies from AU).

Let us be realistic and say we are not aiming high enough here.

We have 150 languages on the east coast and 61% of the 2.5billion internet users in our time zone. 68% on the west coast.

London and New York as the leading financial centres did not choose to be disrupted by San Francisco based businessed including Angel List but they are because it is precisely what Prof. Chrsitensen predicted.

We have a choice here, we can act or ignore it. If we act we could reposition our country as a world or regional leader in this new field.

Australia, with our widely respected legal and financial system could be home to not just the worlds fourth largest pool of funds administration but also be the next Angel List or similar global open exchange platform (or platforms if we consider another may be required for each segment consumer, business, fund, fund of fund etc) transforming Asia with a non-US centric platform friendly legislation that favours Australia.

I also advise that I have no conflicts of interest in terms of investments or relationships with any of the above mentioned firms.

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Question 1 In principle, should any provision be made in the corporations' legislation to accommodate or facilitate CSEF. if so, why, if not, why?

1) Number of unaccredited investors for a small scale offering should increase to at least 100 as although the average investment on the ASX is $5000 the average investment on ASSOB is $30,000 per unaccredited investor. This makes raises from friends, family fans and followers difficult. To achieve this corporations legislation does not need to be changed. ASIC can make this change via amending the existing class order.
2) Pty Limited should be made more investor friendly. This is the dominant form among Angels and early stage corporate forms and complicated and restrictive shareholder agreements cost companies a lot of money.
3) In terms of marketing and promotion the portal should be able to display on the public facing part of the website the tiles/badges outlining the project, funding target and progress to date.

Question 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

(iii) adopt some other approach (such as discussed in Section 7.3, below).

1) Experience worldwide in has shown that seldom more that 200 investors are involved in an Equity Crowdfunding campaign. Any more than this will be because of misrepresentation of the opportunity or an external influence like a celebrity or recognised investor. As Crowdfunding equity raises need to keep the ability to pump them up out of the equation an increase to 100 or 200 would suffice.
2) Experienced or knowledgeable is the right word here. Just because someone has money doesn't mean they are "sophisticated". Maybe they inherited the money or made it in one single business. Why should they not be protected also? Professional investor is OK. Crowdfunding for the rich or sophisticated and professional investors is already legal in Australia. In regard to experienced or knowledgeable the following is suggested: The 100 points system. Example follows. Why not use a self certification system where say 100points need to be reached as they do for identification in some countries for drivers licenses The latter category may possibly work on a self certified 100 points system. (just a guide not meant to be accurate they need to reach 100 points)

* Member of Angels Group 80 points
* Director of Public Company 40 Points
* Member of Directors institute 80 points
* Company Secretarial Course 40 Points
* Corporate Governance course 40 points
* CPA/ CA / etc 50 points

* Have one of the following entrepreneurial qualifications 30 points

* Has attended an incubator or accelerator intake 30 points

* Immediate family 80 points

* Relative 40 points

* Have known the issuer for more than 10 years 40 points

* Etc etc

3) Our experience has shown that in an CSEF that has run for 8 years around 61% of investors are retail and 39% are sophisticated and professional. The latter category does not generally invest on average (as opposed to a silicon value ready raise) until friends, family, fans and followers have invested. Restricting small early stage raises to accredited investors will kill an activity that takes place every day where family members assist friends, family, fans and followers to get started in a business endeavour or grow an existing business.

4) Despite the above it is essential that any variations or adopted procedures do not entail excessive disclosure requirements and onerous costs. It is easy here to end up like the U.S. where they will have some well-written regulations but to raise under a million is cost prohibitive.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Answer Q3

1) Proprietary companies. Pty Limited should be made more investor friendly. This is the dominant form among Angels and to make it work, complicated and restrictive shareholder agreements are used which cost companies a lot of money.

2) Public companies up until now have been the only ones allowed to raise funds on the ASSOB platform. This has worked well but during the last few years reluctance to use this form due to the cost relative to raise size has limited our market. By the time a startup engages accountants and auditors to manage a "public" company they wont get away with under $20k a year of additional costs.

3) Early stage investors like to have direct relationships. They invest in the familiar and having an intermediary entity like a MIS would demotivate many. There is a place for this if more than say 100 investors wanted to invest in a matter.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF

provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

ANS: Issuer needs to be an Australian Pty or Public company with one business operation. Investment companies should be excluded.

(ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

ANS: Ordinary Shares, Preference shares, Convertible Notes. Hybrids are too complicated for retail investors and most issuers.

(iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

ANS: Max $5 million from unaccredited investors. Should include small scale offerings amounts in the cap if a raise had been carried out under both small scale offering and CSEF legislation. No limit for funds from an accredited investor but the raise would be limited to the amount in the offering document. Investors don't want to be suddenly watered down like what happened to (some) of the early investors in Facebook.

(iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

ANS: Mandated warnings. Everything that is material for the investor to know.

(v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

ANS: Small scale offering regs OK here except the portal should be able to publish on it's front page the same details that Crowdcube, Symbid etc around the world publish. Small Scale offering legislation does not allow this at present. If a viewer wants investment information they need to log in, accept the warnings to read.

(vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

ANS: When they misrepresent the opportunity or break the law

(vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

ANS: Matchmaking is OK as here no market is needed and doesn't usually exist. Secondmarket.com has proved in the U.S. that Doctors and Dentists don't search around for investments in unknown unlisted companies. ASSOB has had a similar experience. As it takes 3 to 5 years to create value in these early stage companies there is limited demand for a secondary market. All that is needed is an efficient matching service.

(viii) any other matter?

ANS: Founders should not be able to sell more than 10 % of their holdings for a year after the raise begins.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

(a) should CSEF intermediaries be required to be registered/licensed in some manner

ANS: Yes. They should be registered and certify they will follow a code of conduct. If they do not give advice they need not come under financial services regulations. ASSOB requires its Sponsors to observe the highest standards of professional conduct and ethical behaviour in all of their ASSOB-related activities.

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

ANS: Intermediaries work with Portals. Seldom do early stage companies have the knowledge and expertise to raise funds. They need handholding. A portal needs legal competence to assess misrepresentation in marketing materials including the offer document. An intermediary needs to be computer literate, have high integrity and be financially literate.

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

ANS: Depends what intermediary you mean. Our experience has been that raises with just portal assistance are difficult as the Issuer hasn't the time or knowledge to do the job properly and compliantly.

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

ANS: No. Intermediary's are just facilitators. Any Disputes will be between the Issuer and the Investor as it is their raise. The intermediary should not colour this relationship by wording content on the portal or taking actions that create a dispute. In 300 raises ASSOB has not had any disputes fulfilling a role like this that would need to go to arbitration.

(ii) **intermediary matters related to issuers:** these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

ANS: Anything illegal and inappropriate

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

ANS: Initial due-diligence on the entity, IP and people involved including background checks. Then once marketing materials are ready due-diligence to ensure the documentation fairly represents the offering.

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

ANS: That it is a legal entity, has no blemishes and is in a form to issue the shares in the offering document

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

ANS: No statements should be made by intermediaries. All documentation on the portal should be prepared by issuers and signed off by them. Any misleading statements are the responsibility of the issuer not the intermediary. However if the intermediary rates raisings, publishes viewpoints, embellishes text etc they should be fully liable.

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

ANS: Not at all provided they can show they carried out the required due-diligence. The relationship is consummated between an issuer and an investor by them. All representations made are by the issuer.

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

ANS: We see already in Australia Incubators, Accelerators, Angel Investors and others in the early stage space taking percentages in companies and promoting them through the media about their investments which implies publically the company is in raise mode. It is doubtful all of these are professional or sophisticated investors. The existing small scale offering legislation does not allow pecuniary interest, nor to promote investment as it happens during a raise, so our platform is at a disadvantage here. Especially when most early stage companies always ask if they can pay their "upfront fees" in shares. Some simple rules could enable intermediaries to have a pecuniary interest in lieu of fees and no more. This ability would propel the number of companies raising capital. As there is a limited secondary market the pecuniary interest is usually lost or gains value many years down the track.

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

ANS: They should only be released once a prescribed minimum subscription is reached.

(iii) **intermediary matters related to investors:** these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

ANS: They meet legislated requirements and money laundering regs.

(b) what risk and other disclosures should intermediaries be required to make to investors

ANS: Those legislated like detailed in small scale offerings legislation. Disclosures however are the domain of the issuer.

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

ANS: Should monitor every transaction to ensure limits not breached. They need to have full access or control over the share registry as issuers can se; extra parcels not realising the consequences or otherwise.

(d) what controls should be placed on intermediaries offering investment advice to investors

ANS: No advice should be given. I know of no CSEF platform worldwide that gives advice

(e) should controls be placed on intermediaries soliciting transactions on their websites

ANS: If you mean obtaining issuers no. If you mean obtaining investors then they need to be obtained by promoting the portal generally or using the issuers own words not their own.

(f) what controls should there be on intermediaries holding or managing investor funds

ANS: Funds should be in an independently managed trust account

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

ANS: They should not communicate via the portal. Meetings can be arranged via the portal but interactions should be kept off the portal.

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

ANS: This is not relevant unless the intermediary steps over the line and gives advice or uses words to market the offering that are not the issuers words. It is a dangerous road if portals position themselves as the principal in transactions. They would need an AFSL if they wanted to do this and then it is not CSEF. The crowd need to deal directly with the issuer to be CSEF.

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

ANS: Should be fully disclosed and transparent

(j) what, if any, additional services should intermediaries provide to enhance investor protection

ANS: Need to have control or full informational access to the share registry to ensure every investor gets their share certificate.

(iv) **any other matter?**

ANS: No

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

ANS: Debt securities have their own area in Crowdfunding. The Australian platform SocietyOne.com.au does this well and it has nothing to do with shares. They are totally different areas under different legislation.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

ANS: No other than max 200 retail investors. Retail, Family, Experienced, Professional, Sophisticated and Overseas are the categories that should be available.

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

ANS: No. It seldom happens this way. After experiencing 300 raises on ASSOB's CSEF platform very few are attractive to accredited investors as first investors. The accredited investors usually wait until friends, fans, family and followers have invested.

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

ANS: We have never found this to be an issue. I know the Americans are going down this path but it is a nightmare to manage and in the end will be self certification as getting certificates from Accountants etc is just too cumbersome and costly for the investor and the issuer. If the authorities are honestly concerned about citizens overcommitting themselves then ensuring to gamble you needed a card which monitored daily and annual limits would be a good start. If it is OK for gambling and not in an area that is creating the jobs

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

ANS: Absolutley. They should sign that they are fully aware that there is a high chance they will lose all their money and that statistically they will lose their money and they accept this.

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

ANS: 10 day cooling off period

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

ANS: No unless the offer terms are discovered to be wrong and they invested on the wrong basis.

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

ANS: No

(ix) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

ANS: Intermediaries don't report. Issuers do. Issuers should give 3 monthly updates (every 3 months) on how they are spending their money.

(x) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

ANS: Full recourse if the inadequate disclosure was material

(xi) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

ANS: None.

(xii) any other matter?

ANS: No

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

ANS: There is no evidence anywhere worldwide that unaccredited equity Crowdfunding is any more than what happens normally that friends, fans, family and followers of businesses invest in businesses they are connected to, interested in or passionate about.

To date worldwide just on $300 million has been raised in equity platforms. $136 million of that by ASSOB in Australia. Crowdcube has yet to get to 20 million raised despite operating in the U.K, with a larger market, relaxed rules and press coverage to die for. Developing special legislation for something that is very very small on the world stage is overkill and a reaction to international press stories and uninformed influencers.

Equity raises do not embrace instant gratification and are thus hard work as the rewards are many years down the track. Unaccredited investors don't usually invest in things their peer groups haven't. Even reward based platforms like Indiegogo say "Don't bother starting your raise if you don't know where your funders are coming from". And equity is 10 times harder than this. Creating a contained regulatory regime for CSEF may result in shiny new legislation and no raises.

Australia is the only country in the world with workable CSEF regulations in the form of small scale offering legislation for retail investors. Even Symbid and Crowdcube haven't had 8 years of experience in dealing with $88 million raised from retail / unaccredited investors and in a much larger market they still are tracking at around on million to two million pounds a month.

At the moment, to raise $500,000 as a small scale offering 20 parcels in 12 months would require possibly 20 retail investors at $50,000 each. Back in 2005 $30k was the average ASX investment. Now it is around $6k. However ASSOB's average parcel size has hovered around $30k since 2005 due to the 20/12 restriction.

While we have managed to facilitate around 300 businesses to raise $135 million through CSEF with this high average parcel size the ability to accept contributions in the range of $2k to $6k would materially alter the ability of SME's to obtain investors. (and limit investor risk) Even with a £10 pound minimum investment Crowdcube's average parcel size in August was £3,240. Other than Seedrs and Symbid in Holland these are the only platforms worldwide transacting in the **unaccredited crowdfunding** investor space.

Crowdcube accepts investment as low as 10 pounds per investor yet in August 2013, their largest month ever the average investors per matter was just 116. Average investment was 3,240 pounds which would match for with 100 to 200 parcels of $5000 for a $500k to one million raise if adopted here in Australia.

The Crowd is predominantly "your crowd" in CSEF. Why re-invent the wheel. America is doing that and for SME's they will be priced out of raises due to compliance costs. As it is it won't work in the USA under $1 million raises. OK they have a lot more businesses and people so it may work but Australia is different.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

1) Context is important here. Early stage companies raising capital have very little money. Thus heavy hitters with AFSL's etc will not make a living in this space. This is an area where a matchmaking platforms will operate. Any attempt to turn platforms into responsible entities etc will stop Crowdfunding in its tracks. We have already seen Seedrs.com operating Europe wide under a U.K. umbrella. Word is that Singapore wants to service Asia and Australia with Crowdfunding platforms. We live in a global world.

2) Portals are facilitators not advisors.

3) One of the biggest issues in the exempt market regime is not that investors are uneducated in making investment decisions or easily duped by marketing materials (in fact, the internet has enhanced an investors ability to make better decisions about how to invest and given them access to information about companies and officeholders (social due diligence) that they would not normally know about), but that Issuers remain ignorant of the laws around capital raising, are uninformed about the importance of corporate governance and their duties and fail to understand their own capabilities and role in the business. Too many times have we seen investors disregarded by Issuers due to lack of education of the role of director or an inability for the business to perform resulting in directors withholding important information, which runs the risk of ultimately eroding investor confidence in new business or the share market generally. Unless education is embraced as a prerequisite to CSEF, the issues we have witnessed and many more, will continue.

4) ASIC has the powers now to increase Small Scale Offerings to 100, have higher visibility and responsibility from registered platforms and enable portals to have tiles that profile raisings but require acceptance of risk warnings before proceeding to offer docs etc.

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Submission on Discussion Paper: *Crowd sourced equity funding*

Dear Mr Kluver

Thank you for the opportunity to provide a submission on the Corporations and Markets Advisory Committee (**CAMAC**) discussion paper: *Crowd Sourced Equity Funding* (**Discussion Paper**). Given global developments in the regulation of crowdfunding, it is appropriate and timely that CAMAC has been asked to undertake this review.

I am a part-time graduate research student in the Faculty of Law at Monash University, currently completing a Doctor of Juridical Science (**SJD**). I am also employed as a lawyer in the Melbourne office of Ashurst, practising in corporate, regulatory and financial services law.

To date, my research for the SJD has focused on the regulation of the Internet, and the implications of recent Internet-related technological developments on the regulation of financial services. Crowdfunding has been central to this work. An article I have recently written on crowdfunding (which was developed from a paper submitted for the SJD) has been accepted for publication and will be published in the next edition of the *Journal of Banking and Finance Law and Practice*. I also intend to write my SJD thesis on crowdfunding.

Reward and pre-payment models of crowdfunding

Although the focus of CAMAC's review is on crowd sourced equity funding (**CSEF**), it seems that the opportunity of this review should be taken to consider whether any amendments to the *Corporations Act 2001* (Cth) (**Corporations Act**) (or other legislation) are necessary to support other models of crowdfunding as well.

One example arises in the context of the reward and pre-payment models of crowdfunding (discussed at 2.1.2 of the Discussion Paper). These models are currently the most common models of crowdfunding, used by websites like kickstarter.com (**Kickstarter**) and pozible.com (**Pozible**). Rather than offering shares or other securities in an entity (as is the case with CSEF), the reward and pre-payment models offer either a reward (ie something small like a cap or a t-shirt, or something larger like a specific thanks to the contributor on the inside of an album cover, or a mention in a movie's credits), or the actual product or service that the project creator is raising funds to produce.

Regulation of crowdfunded projects as managed investment schemes

In certain circumstances, projects being funded under the reward and pre-payment models of crowdfunding could be regulated as managed investment schemes. ASIC has stated that such projects could be a managed investment scheme if the funds contributed are pooled or used in a common enterprise to produce financial benefits, or benefits consisting of interests in property for contributors, unless such benefits and interests are of nominal value and not financial products themselves.[1] Accordingly, all project creators must consider whether crowdfunding their project could mean that they are operating a managed investment scheme.

A review of the types of projects being funded on Kickstarter and Pozible suggests that rather than funding projects to manage a financial risk or make an investment, people generally support projects because they either identify with the project and its aims, or they would like to purchase the product or service being produced. On the basis that people do not generally regard these projects as investments in the conventional sense, it seems that regulating such projects as managed investment schemes is inappropriate.

[1] Australian Securities and Investments Commission (**ASIC**), *12-196MR ASIC Guidance on crowd funding* (14 August 2012) http://www.asic.gov.au/asic/asic.nsf/byheadline/12-196MR+ASIC+guidance+on+crowd+funding.

There are considerable benefits to be obtained by the development of the reward and pre-payment models of crowdfunding. Producers of creative and artistic projects are using reward and pre-payment model crowdfunding successfully as an alternative source of revenue to government grants, due largely to the work of the Australia Council for the Arts and its partnership with Pozible to educate originators of creative projects about crowdfunding. Also, reward and pre-payment model crowdfunding has become a powerful way for startup businesses to test the market for their idea, obtain consumer feedback and raise capital at the same time. In order to exploit these benefits, any ambiguity as to whether projects adopting these crowdfunding models are managed investment schemes needs to be resolved. This ambiguity should be resolved by excluding such projects from the definition of "managed investment scheme" in the Corporations Act.

Merits of CSEF as an investment

I agree with CAMAC's comments in 2.1.4 of the Discussion Paper that even where projects are properly funded and administered, there is a risk that they will not be successfully completed. It could be argued that the structure of CSEF encourages offerings of inferior investment proposals as anyone with an idea and minimal resources can market an offering to a global audience of retail investors. Established capital raising structures have inherent filtering mechanisms (ie banks, angel investors, financially savvy relatives and wholesale investors) that help to ensure that only the most viable commercial enterprises are pursued and ultimately offered to the public as an investment. Crowdfunding effectively removes these filters.

A counter to this position is that because crowdfunding is fundamentally linked through social media, the crowd will keep promoters honest and weed out bad projects itself. However, such a process would necessarily involve a series of failures that, depending on the severity, the crowdfunding concept may or may not survive. Accordingly, it seems that the screening of projects and commercial enterprises should be an essential regulatory aim for CSEF.

Concluding remarks

The regulation of crowdfunding is an important issue that, given the international appetite for its development, the Australian government should not ignore. In order to remain internationally competitive, Australia must have a considered policy on crowdfunding. Government should engage with all stakeholders (project creators, platforms and regulators), as the European Commission has recently[2] in order to understand the most appropriate way forward.

Thank you for the opportunity to provide a submission on this important issue. Please feel free to contact me should you wish to discuss this submission, or any other matter (mattvitale@me.com +61 410 458 075).

Yours sincerely

Matthew Vitale

[2] See European Commission: Internal Market, "Crowdfunding: Untapping its potential, reducing the risks" (European Commission Workshop summary of discussion, Brussels, 3 June 2013) http://ec.europa.eu/internal_market/conferences/2013/0603-crowdfunding-workshop/docs/minutes_en.pdf.

Ramin Marzbani

SUBMISSION TO THE CAMA Review of CSEF.

Confidential only as to the name of submitter, otherwise can be published.

> **Question 1** In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?
>
> **Question 2** Should any such provision:
>
> (i) take the form of some variation of the small scale offering exemption and/or
>
> (ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or
>
> (iii) adopt some other approach (such as discussed in Section 7.3, below).

1) Yes, the limit on the number of individual shareholders for private companies should be increased to accommodate the likely implementation of CSEFs. The remainder of the provisions in Corporations legislation are likely fine but issues such as flexibility with the provision of notices and form of notices for General Meetings should also be considered for change to accommodate faster board and corporate decision making.

2) (i) No

   (ii) No, this would defeat the purpose

   (iii) Yes, see broad comments above

> **Question 3** In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:
>
> (i) proprietary companies
>
> (ii) public companies
>
> (iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

3) (i) Limit on the number of members expanded, notices for decisions and shareholder vote provisions be allowed to be more flexible and electronic (this can pose its own issues) to enable operation of CSEF in the first place and to allow the board of directors of a Pty Ltd to conduct affairs efficiently.

There should be some consideration given to a "representative" entity that attempts to protect the interests of investors, operating in a similar fashion to a cross between an ombudsman and Legal Aid or Government Grant Case Officer, possibly accounting-driven, to efficiently oversee and intervene if required. Funding for this service should be provided through the CSEF set-up process.

(ii) No

(iii) Possibly if worked through a hybrid mentioned in 3(i). The primary issue is assuring independence of the "ombudsman" so that they are not dependent on the company for funds.

4) **Question 4** What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

5) (i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

6) (ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

7) (iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

8) (iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

9) (v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

10) (vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

11) (vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

12) (viii) **any other matter?**

4) Provisions should ensure clear separation of entity funding, and will likely become murky when companies succeed and need to transform.

5) (i) Some scale provision should likely apply

6) (ii) All types including hybrids – innovation is essential

7) (iii) Some scale provision should likely apply - $5m or $10m maximum

8) (iv) Maximum disclosure similar to current requirements with the same onus on directors. It is essential to be able to deal with "hidden promises".

9) (vi) Controls would go hand in hand with the maximum ceiling, so likely none.

10) (vi) Full liability should apply.

11) (vii) New issues only. The asymmetry of information is too great for anything else.

12) (viii) Many ☺

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

13) It is unclear if an intermediary market similar to the current business broker operations is well suited to this model because the incentives between the promoter and the intermediary are aligned, and together, are potentially in conflict with the investors.

An intermediary model based on management of the transactions in return for a fee for service, as opposed to a % of money raised model would likely be more in the interests of investors. Else, the model will resemble Dotcom V2 on steroids.

Use could be made of the existing online stockbroking platforms, for example, where most trades are on a $ per trade basis.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

- (a) should CSEF intermediaries be required to be registered/licensed in some manner
- (b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role
- (c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
- (d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

(ii) **intermediary matters related to issuers:** these matters include:

- (a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
- (b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
- (c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
- (d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

(iii) **intermediary matters related to investors:** these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

(b) what risk and other disclosures should intermediaries be required to make to investors

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

(iv) **any other matter?**

6 (i) (a) Yes

6 (i) (b) Similar to online stockbroking platforms – the cost of building and operating these has fallen greatly over the last 15 years and they can almost be purchased and operated out of the box.

6 (i) (c) as above

6 (i) (d) Yes, but it makes more sense to make this an independent arrangement (see answer to 3 above) as arbitration and dispute resolution would require entity-specific knowledge.

6 (ii) (a) None – cannot pick these in advance
6 (ii) (b) The proposed proposed "ombudsman" should manage this – likely quarterly reviews similar to those imposed on the Dotcoms some years back by ASX (re-use templates).
6 (ii) (c) A cut down version of ASX requirements made practical – this should not fall onto the intermediary to complete – most of the intent of the IPO requirements should be kept including the escrow of shares of the promoters/founders
6 (II) (d) In the proposed model, the independent "ombudsman" would be the responsible party for managing claims for losses against the promoters/founders
6 (ii) (e) Same as above – most common losses not generally catered for are promoters/founders running off with the business or product if it is successful – which can be dome in a number of sophisticated ways without the investors getting their fair return
6 (1) (f) None in the model above
6 (1) (g) The entire transaction should be confirmed, and all investors allowed a 30 day cooling down period prior to funds access

6 (iii) (a) Identity check
6 (iii) (b) Pass on the IM
6 (iii) (c) This should fall onto the ombudsman
6 (iii) (d) No advice should be offered. Plain English but not misleading (e.g. relevant) risks advice should be part of IM
6 (iii) (e) No
6 (iii) (f) Standard Trust arrangements
6 (iii) (g) See concept of "ombudsman" in 3 above
6 (iii) (h) See broader concept above including appeals or complaints about the "ombudsman"
6 (iii) (i) Intermediaries should get no commission – see broader concept above
6 (iii) (j) Secondary source of information posting – like a "free ASIC" document search website

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

7 (i) None – all hybrids, convertibles and the likes should be allowed
7 (ii) Apart from transparent trusts and individuals/entities, other investments should not be accepted
7 (iii) Requires proper treatment in Plain English document describing impact of specific being offered (not the old style advice documents covering a huge range of unrelated risks in complicated legal talk)

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

(xi) **any other matter?**

8 (i) In general, No
8 (ii) No – limiting this to sophisticated investors would be pointless
8 (iii) Yes – something proportional to the investment and capped at $10k, $20k or $50k
8 (iv) Absolutely
8 (v) Absolutely – 30 days or possibly 21 days
8 (vi) No – the terms should be specific and this avoids a range of complications
8 (vii) Absolutely – no resale
8 (viii) See comments above – ASX style Dotcom quarterly cash and activity reporting
8 (iX) Full recourse from promoters/founders/directors
8 (x) Standard Law, but aggregated through the "ombudsman"

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

9) Depends on the form

Question 10 What, if any, other matters which come within the scope of this review might be considered?

10) Poor behaviour by founders/promoters in the case of success!

Crowd Sourced Equity Funding – Discussion Paper – September 2013

Introduction

The Corporations Committee of the Business Law Section of the Law Council of Australia welcomes the opportunity to make a submission on this discussion paper.

The Committee is generally in favour of encouraging a vibrant and thriving Australian innovation and technology sector and welcomes any steps that can be taken to that end.

While Australia has a venture capital industry and Government has made some financial and other contributions to encouraging innovation, these avenues are not providing all of the necessary solutions. New Australian funds are being established with a specific focus on investing in innovation and technology and the first significant IPO of an internet-based business, Freelancer.com, is under way. However, these developments also fall short of assisting a large segment of the market with the capital it needs.

This problem is commonly referred to as the 'valley of death'. The valley of death represents the stage in the growth cycle of an early stage business at which those early stage businesses have, on balance, not yet matured in their networks and risk profile to identify and attract sufficient capital from external sources to enable them to commercialise their products and services to a level at which the risk profile is sufficiently improved to enable sophisticated investors and professional investors to risk their capital in such companies.

In short therefore, it is the Committee's view that Crowd Sourced Equity Funding ('**CSEF**') is an appropriate vehicle for dealing with the above identified systemic market failure to fund early stage companies.

In the Committee's opinion, specific amendments to the existing regulatory structure for capital raising would provide the best means of addressing this current market failure. The Committee does not believe that the approach of creating a self-contained statutory and compliance structure for CSEF is appropriate. In our view, a self-contained structure would throw up discrepancies in the regulatory environment for capital raising that could be exploited to the detriment of what is arguably a successful regime in its current application for more sophisticated businesses.

Questions in the Discussion Paper

1. **Question 1**

In principle, the Committee considers that any laws regarding CSEF should be incorporated into the corporation's legislation rather than in new legislation. The

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corporation's legislation already deals with capital raising, investor protection and regulatory supervision and enforcement and any CSEF laws would fit logically with and complement this legislation.

2. **Question 2**

The Committee does not consider that CSEF should be confined to 'sophisticated, experienced and professional investors' but should be open to any type of investor. However, the Committee does not advocate a 'free for all' but favours the use of protective mechanisms for 'unsophisticated investors' along the lines provided for in the JOBS Act.

The small scale offering exemption should be varied (discussed further below).

3. **Question 3**

The Committee does not believe any changes are required to the current regulatory regime relating to managed investment schemes in relation to the operation of CSEF. Any use of CSEF should in its view be limited to direct offers by an issuer operating the underlying business. Accordingly, there should be no need to structure investments through a managed investment scheme and no need to make adjustments to the regulatory regime that applies to managed investment schemes.

There are a number of key restrictions under the corporation's legislation that, in the Committee's opinion, restrict the ability of companies to raise capital cost effectively through a CSEF approach. These include:

- the terms of the personal offer small scale offering exemption. In particular, the fact that the number of issues is limited to 20 in any 12 month period; and

- the restrictions on the advertisement and hawking of securities.

In general terms the Committee advocates a relaxation of these provisions to enable a more broadly directed offer of securities to persons other than those to whom an offer of securities could be made without the need for a formal disclosure document.

While the Committee's inclination is to limit the compliance burden on companies seeking to utilise the CSEF regime, in order to maintain the integrity of the current regulatory framework (particularly as it relates to the benefits of relaxed regulation accorded to proprietary companies), the Committee suggests that any ability to utilise CSEF be limited to entities that are public companies limited by shares. The cost and expense of converting to a public company would not be great and while the additional costs of ongoing compliance as a public company may be greater for the issuer, the stricter corporate governance requirements (particularly around director conflicts of interest, disclosure of constitution and accounts with ASIC and potential application of the takeovers regime under the corporations legislation) provide a check and balance which could assist in protecting persons who will most likely be minority retail investors. Consideration should be given to reducing or eliminating the fees payable to ASIC for public company filings for CSEF entities.

4. **Question 4**

4.1 **Types of issuer**

The Committee agrees that the type of issuer should be restricted to 'genuine start ups'.

4.2 Types of permitted securities

CSEF capital raisings should be restricted to an issue of ordinary shares only. Market practice would suggest that any subsequent capital raising from sophisticated investors may require the issue of preference shares with superior rights to the ordinary share capital. Investors holding ordinary shares would be entitled to the protection of the 'class rights' provisions under the *Corporations Act.* Appropriate disclosure should be made to CSEF investors as to the risks associated with future capital raisings causing dilution or a potential impact on the rights attached to the ordinary shares.

4.3 Maximum funds that an issuer may raise

The Committee considers that there should be a cap on the amount of capital that an issuer utilising CSEF should be permitted to raise. In the Committee's experience, the application of the current personal offers small scale offering rules does not generally negatively impact on the ability of a company to raise a sufficient dollar amount of capital. Said another way, the $2 million ceiling under that rule is not what is preventing early stage companies from successfully raising capital to grow their businesses. Rather, it is the restriction on the number of issues that can be made that is problematic in assisting companies to navigate the valley of death. However, we note that ASIC Class Order 02/273 in relation to business matching services provides relief for capital raisings up to $5 million. The Committee recommends that such an amount (indexed as appropriate) would provide a workable threshold that would enable companies to utilise CSEF to address the valley of death concerns.

In addition to this restriction, the Committee advocates a limit on the amount that any one investor may invest under any CSEF exemptions. Further work should be undertaken prior to setting such limit, although the Committee expects that a limit of $5,000 or less may be appropriate. However, the existing tests for exemption from the need for a formal offer document under section 708 of the *Corporations Act* should apply equally to a CSEF capital raising (such that there would be no limit on the amount that any individual could invest if they fall within one of those exemptions and are not a "retail" investor under the terms of a CSEF capital raising).

4.4 Disclosure by an issuer to investors

The Committee considers that the standard for disclosure should be the same as for capital raisings by a proprietary company. Accordingly, companies should ensure that the information that they provide is not misleading or deceptive. The Committee **does not** advocate that such an exercise should require the same regulatory compliance as is currently required for public offers under the *Corporations Act*. However, the Committee considers that consideration could be given to requiring elements of any disclosure to be mandated in a particular form that is directed specifically at protecting less sophisticated CSEF Investors. In particular, it seems appropriate that a form of template disclosure document could be mandated (or at least the form of certain disclosures could be required to be included in order to identify key risks of which a less sophisticated retail investor should be aware).

4.5 Controls on advertising

As with disclosure, the Committee advocates certain mandatory disclosures be required in conjunction with any advertisement of an offer of securities. However, issuers should have capacity to advertise their offer broadly. The purpose of a CSEF capital raising is to open up the offer to a broader range of potential investors. Restrictions on when and how a company can advertise will negate the impact of this approach. However, the Committee advocates that advertisements should be limited to information that identifies the name and business of a company, the investment opportunity and where the potential investor can obtain a formal offer document.

4.6 Liability of issuers

The Committee considers that directors of issuers should be as liable for the issue of a misleading and deceptive offer or disclosure document as any other issuer. However, in considering what defences to a claim for liability should be provided, consideration must be given to the costs of complying with the current defences relating to misleading and deceptive statements; under the public company offer regime, the cost of these defences would be prohibitive and negate the effectiveness of a CSEF model. Further consideration should be given to a basis that provides appropriate defences to directors, who have acted honestly and reasonably in their conduct without putting them to the expense of having to undertake full verification as would currently be required for a public company issue under the *Corporations Act*.

Further consideration should also be given to the question of the inclusion of forecasts or other forward-looking information in any disclosure or offer document.

4.7 Ban on secondary market

The Committee considers that a ban on secondary market sales is appropriate. CSEF is directed at new capital raisings for a company. If a relatively low threshold is placed on the amount an investor can invest (thereby protecting them from putting too many of their assets into one investment), it appears appropriate to then place a restriction on the time for which an investor must hold their investment. There should be 'carve-outs' from any such restriction in conjunction with a formal takeover offer in respect of the issuer.

5. Question 5

The Committee considers that the current regulatory regime as it applies to intermediaries (as adjusted pursuant to Class Order 02/272 ('**Business Matching Class Order**') could be slightly adapted to provide the relevant exemptions necessary to facilitate CSEF capital raisings.

In short, the Committee does not believe that the operator of a internet based matching platform through which issuers can advertise offers to attract investors, should be required to hold a full AFSL or be taken to be advising on or dealing in securities merely by enabling investors and issuers to find each other. However, to the extent that the operator of such platform makes a market or moves beyond purely administrative actions in collating acceptances then they should be appropriately licensed and to the extent that additional services are provided to issuers in relation to the preparation of offering documentation or the sourcing of investors (outside of that online platform), they should be appropriately licensed.

6. Question 6

6.1 Permitted types of intermediary

The Committee considers that there should not be any requirement for intermediaries to be registered or licensed to the extent that they simply provide an internet based platform for investors and issuers to find each other and do not otherwise provide any financial services that go beyond mere introduction services. In short, the Committee sees the role of unregistered intermediaries as being limited to facilitating the advertisement of offers of securities by an issuer and the administration of paperwork and processes in connection with the offer. To the extent that intermediaries have more than a passive role in providing a platform (such as advising the company utilising the CSEF regime or working with ASIC to prevent fraudulent use of the platform or involvement of bad actors) then the Committee's view is that such intermediaries should be required to be licensed in some manner (even if not subject to the full licensing regime under the Corporations Act).

The Committee advocates that particular restrictions be placed on issuers in connection with the holding of investment funds pending minimum thresholds being met.

6.2 **Intermediary matters related to issuers**

6.2.1 The Committee does not favour the use of restrictions as to the nature of projects or businesses that can raise funds through CSEF (subject to the usual restrictions on projects unable to be pursued under the law).

6.2.2 On the basis that intermediaries would, in the Committee's view, merely provide a platform by which investors and issuers can find each other (and a process to manage the purely administrative actions relating to an offer) the Committee is not convinced that they should be required to undertake any particular due diligence on issuers or their management.

6.2.3 On the basis that intermediaries would, in the Committee's view, merely provide a platform by which investors and issuers can find each other (and a process to manage the purely administrative actions relating to an offer) the Committee is not convinced that they should be required to undertake any particular due diligence on the business that issuers conduct.

6.2.4 The Committee does not believe that intermediaries should be held liable for losses resulting from misleading statements from issuers made on their websites.

6.2.5 The Committee does not believe that intermediaries should be held liable for losses resulting from fraudulent activities of issuers carried out through their websites save to the extent that the intermediary can be shown to have been a knowing or reckless party to the fraud.

6.2.6 The Committee does not see a problem with an intermediary being remunerated by reference to the amount raised through their platform (on the basis that the actions of an intermediary are to bring investors and issuers together and to undertake merely administrative actions in relation to the offer). However, the Committee recommends that restrictions are placed on intermediaries to avoid conflicts of interest by reference to any share ownership or other arrangements (particularly through the provision of other capital raising services).

6.2.7 Similar restrictions should be placed on issuers in relation to access to investment funds as currently apply under the *Corporations Act* in relation to conditional offers of securities.

6.3 **Intermediary matters related to investors**

6.3.1 The Committee does not see a need for screening or vetting by intermediaries of investors. The question of whether issuers should be required to comply with any anti-money laundering requirements needs consideration. Any restriction that is required must be cost effective for the issuer if it is not to negate the purpose of a CSEF regime.

6.3.2 The Committee recommends that intermediaries operating an internet based platform should be required to make certain mandated disclosures as to the risks of an equity investment and disclaimers as to liability resting with the issuers.

6.3.3 Intermediaries should be required to restrict offers to the caps on amounts raised and individual limits referred to above.

6.3.4 Intermediaries should not be permitted to offer investment advice to investors in relation to any particular offer.

6.3.5 There should not be a restriction on intermediaries soliciting transactions on their websites. The purpose of such intermediary sites is to create an effective market place by which investors can find issuers and vice versa. Market forces should be allowed to create the 'winners' of the best such providers.

6.3.6 Intermediaries should not control or manage investor funds, which funds should in the Committee's view flow to the issuer to be managed in accordance with the current requirements under the *Corporations Act* in relation to moneys being held on trust for investors pending the meeting of minimum acceptance conditions.

6.3.7 The Committee suggests that the provision of facilities to enable investors to communicate with the issuer could be built into a CSEF platform. However, this should be market driven and such communications should be at the direction and control of those parties (not the intermediary).

6.3.8 The Committee does not favour intermediaries being made liable to investors. Any liability that might arise to investors, should be dealt with in the ordinary course of contracting. The Committee suggests that issuers should satisfy themselves that an intermediary has the necessary insurance cover for fraud, negligence or other loss that an issuer may incur to an investor arising from the use of the intermediary.

6.3.9 The Committee recommends that disclosure of fees due to an intermediary should form part of the disclosure required in connection with an offer, but only to the extent that such information is material for an investor and is not misleading or deceptive in its own right.

6.3.10 The Committee does not see the intermediary's role as being to protect investors.

7. Question 7

Please see above the Committee's view that only ordinary shares should be capable of being offered under a CSEF offer and that full disclosure should be made to investors of the implications of future issues of shares of different classes. Disclosure as to the differences between shares and debt securities and legal and beneficial interests could be part of the generally mandated disclosures that the Committee has advocated.

8. Question 8

8.1 Permitted types of investors

The Committee does not consider that there should be any restriction on who may be a CSEF investor (subject to the current restrictions on who may legally hold shares in the company such as, for example, the standard rules of capacity).

8.2 Threshold sophisticated investor involvement

The Committee does not consider that sophisticated investors need to hold at least a certain threshold in an enterprise before it can make a CSEF offer to other investors. However, the Committee suggests a protection against mis-selling of a CSEF opportunity to a broad cross section of the community would be for any company that wishes to make use of a CSEF offer to be able to demonstrate a particular level of

equity contribution (or government grant funding) in the target business. In this way, a level of protection is offered in that the issuer has committed its own funds to the development of the underlying business at a level that ensures that there is something more than a mere idea that is being funded through the equity issue. Having said this, there is currently no restriction on the public at large funding a mere idea through the issue of some form of gift or donation. Arguably therefore, extending such an approach to CSEF actually provides a potential benefit to investors that they do not have under the current regime.

8.3 Maximum funds that an investor can contribute

As noted above, the Committee advocates a limit on the amount that any one investor may invest under any CSEF exemptions. Further work should be undertaken prior to setting such limit, although the Committee expects that a limit of $5,000 or less may be appropriate. However, the existing tests for exemption from the need for a formal offer document under section 708 of the *Corporations Act* should apply equally to a CSEF capital raising (such that there would be no limit on the amount that any individual could invest if they fall within one of those exemptions and are not a "retail" investor under the terms of a CSEF capital raising).

8.4 Risk acknowledgment by the investor

The Committee agrees that the terms of any CSEF offer should require an investor to acknowledge the risk of the investment and the fact that they may lose all of their capital or subsequently find that the capital structure of the company could see their economic interest significantly decrease notwithstanding a successful business.

8.5 Cooling off rights

The Committee does not support a "cooling off" mechanism in a CSEF offer, save for the requirement that each CSEF offer must set a condition for a minimum level of subscriptions (to ensure that the proposed business plan can be implemented).

8.6 Subsequent withdrawal rights

The Committee does not support investors having a right to subsequently withdraw from the offer, subject to the specific terms of the offer. An issuer requires certainty if this form of capital raising is to be useful in addressing the 'valley of death' concerns.

8.7 Resale restrictions

The Committee suggests that restrictions be placed on the ability of investors in a CSEF offer to on-sell their shares within a minimum period of time (likely 12 months), otherwise than in connection with a formal takeover transaction (or other formal merger).

8.8 Reporting

The Committee does not consider that intermediaries should have any ongoing reporting obligations to investors. Any reporting or advertisement on the intermediaries website should be a matter for the intermediary and its contract with an issuer. Issuers should have obligations to report to investors in accordance with ongoing obligations under the *Corporations Act* (subject to any greater obligation agreed to pursuant to the terms of the offer).

8.9 **Losses**

The test for inadequate disclosure should be a misleading and deceptive conduct test, of a lesser standard than that applicable to general public offers. See our comments earlier. Recourse should be available against directors of the issuer (subject to appropriate defences that protect directors who have acted honestly).

9. **Question 9**

The Committee strongly advocates incremental adjustments to the Corporations Act to accommodate CSEF, rather than a stand-alone, self-contained regime. There needs to be a basis to integrate the use of CSEF without cutting across the existing framework in the Corporations Act for capital raising by proprietary companies and other public companies outside of the CSEF context.

10. **Question 10**

The Committee does not raise any other matters at this time.

In summary, the Committee supports liberalising the existing exemptions from the current fund raising provisions in order to provide for a CSEF structure that enables an entity to source small amounts of risk capital from a broad and diverse cross section of the public. This should, in all cases, be subject to appropriate checks and balances that seek to protect investors from inappropriate operations.

Further discussion

The Committee welcomes further discussion of the foregoing. Please do not hesitate to contact the Committee Chair Marie McDonald on 03-9679 3264 or Gerry Cawson on 08-7220 0922 to arrange any further discussion.

Yours sincerely,

Frank O'Loughlin

CSEF Australia

This Submission has been created by Andrew Ward and is representative of the personal views he has regarding CSEF and those he gathered from creating a LinkedIn Group (http://www.linkedin.com/groups/CSEFAustralia-5174120/about) and website called CSEF-Australia (www.CSEF-Australia.com.au).

This Submission has been completed by an entrepreneur - not a lawyer or economist – so uses plain language and may avoid technical terms (or occasionally get them wrong).

CSEF-Australia and Andrew Ward would not be considered an existing player in the market – i.e we aren't a platform like Pozible or ASSOB or a VC wanting deal flow – these players naturally have a view based on existing commercial interests.

This Submission contains novel ideas and thinking so perhaps should be considered an "outsiders" view on the situation. Over and above the novelty factor of this Submission, it gives cause to think of CSEF as being applicable to off-line as well as on-line businesses.

This Submission is a response to a call from CAMAC to contribute to the discussions addressing ***Advancing Australia as a Digital Economy: An Update to the National Digital Economy Strategy.***

Context

More that Tech Start-Ups

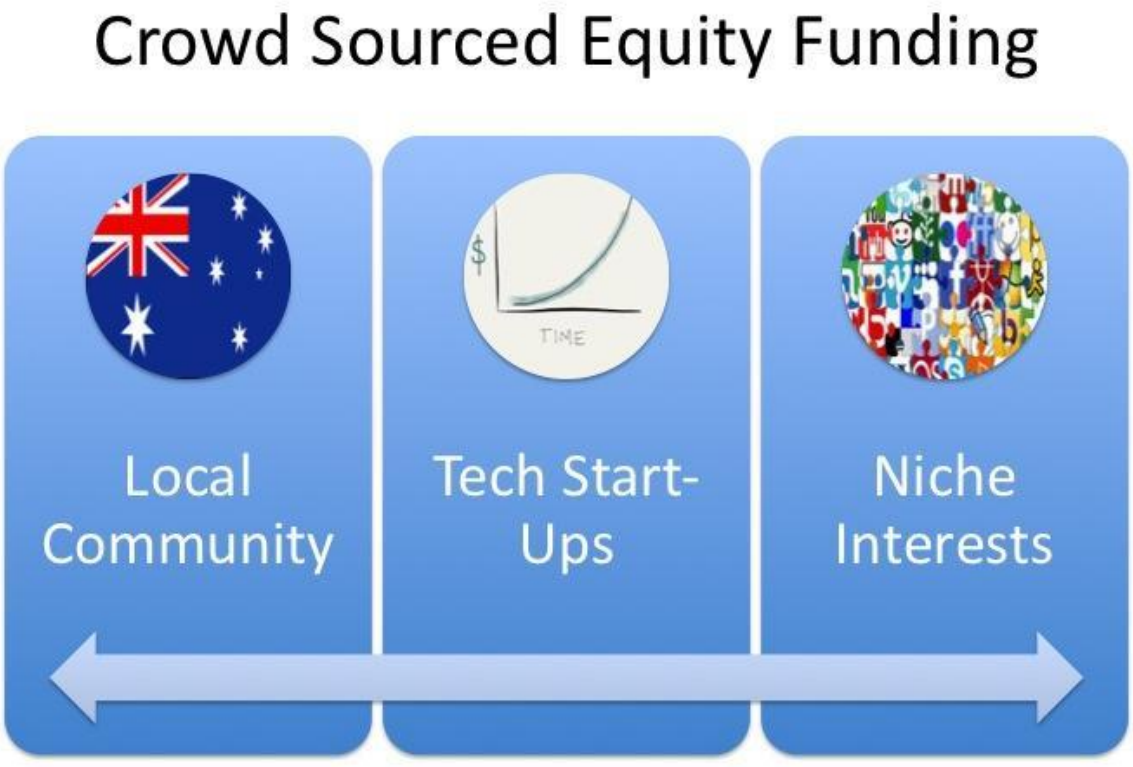
The digital economy provides new dimensions to our broader economy and to investment opportunities and consumer behaviour. It is appropriate to provide effective mechanisms to take advantage of this new way of operating.

This submission recommends that correctly constructed Crowd Sourced Equity Funding (CSEF) legislation can support a new industry in the digital economy (online) but also in local businesses servicing local customers in the off-line economy.

Local businesses benefit and enable regional development, economic activity in general and increase community resilience. For economic diversity and resilience across the country, there needs to be a way to tap into millions of dollars not (yet) available and in the hands of millions of ordinary people desiring to participate and have some influence over where and how they will spend their money.

CSEF enables community-owned ventures to emerge by giving them access to a new pool of funds and advocates for their present and future products according to the specific needs in an area. These businesses are powered by local economic factors and merely enabled by the Digital Economy.

Meanwhile there is a strong voice for IT&C start-ups, which are often high-tech or novel in some way and almost always will be internet-based and enabled. This Submission refers to them collectively as "tech start-ups". They are well advocated for in general, so this Submission largely ignores them.



Local Economic Development and Crowd Sourced Equity Funding

There are many utilities that are cheaper to consume closer to the point of production, such as electricity, which loses efficiency with greater transmission distance. The same is true of food; the longer the distance it travels, the greater the economic cost in food-miles and potential wastage. This economic reality informs the common-sense approach this Submission advocates and articulates benefits to the Gross Domestic Product (GDP) through increasing the number and variety of new enterprises.

CSEF policy needs to consider how community-based ownership can result in the provision of services that are promoted and locally consumed locally resulting in less cost to consumers. In this energy-hungry world, this is a major benefit especially to those with lower incomes who already are struggling to meet increased costs of heating and cooling. (ABC Bush Telegraph 26 Nov 2013)

As an illustration of this idea consider how CSEF legislation may enable a "crowd" in the same suburb or town to collectively pay for solar panels, large Photo-Voltaic batteries, wind turbines or wave-power technology and local power-line infrastructure – essentially a local power plant. Individually, these people could not afford such infrastructure, but collectively they can and have greater ownership and management over their own utility. This venture could then generate, store and distribute electricity from green sources much more cheaply than coal-fired conventional power. This is the power of local economics - cheaper services with other benefits.

This community-owned business could sell services to their initial investors - the "crowd" - who happen to have neighbours with a similar need. This business could scale within a community but is unlikely to expand and service the neighbouring town.

This type of business model is possible for many ventures related to Energy, Food, Water, Waste, Education and Social Services. It is possible ONLY if facilitated by smart CSEF legislation.

These types of ventures are low-tech, low-risk, moderate-return and tap into real existing needs. There are local-economic models (globally and in Australia) that are profitable and enabling regional development with the needs of future generations firmly in mind.

This new investment industry has many benefits for enterprise and economic development in Australia especially utilising the digital economy. To assure efficiency, effectiveness and success, CSEF requires fresh thinking and appropriate legislation to see it bloom.

Any idea differing from the familiar is usually treated with some suspicion; Crowd Sourced Equity Funding is a new concept yet examples from other countries illustrate how successful this concept is in many situations. Already in Australia there are hundreds of examples of crowd-funded activities (with rewards-as-returns) that have happy outcomes and satisfied 'investors'.

This Submission primarily takes into account the needs of a new and emergent industry that enables community-owned ventures such as that described above to become "Business-As-Usual" activities and sit alongside the established parts of the economy.

Glossary

Issuer: The person(s) who may be otherwise thought of as the Founder(s)

Campaign: This is the explanation from Issuer to the "crowd" explaining what the opportunity is that they wish to have funded, how they would use the funds, and what return they hope to provide back to Investors. This would usually include written and video contributions of content. A Campaign would run for a defined period of time. A successful Campaign would create a Crowd-Funded-Entity (CFE). Likewise, an unsuccessful Campaign would return funds to Investors and not go ahead as a CFE.

Issuer-Entity: The corporate entity used by the Issuer when attracting CSEF funding proposed in this Submission as a Crowd-Funded-Entity (CFE)

Crowd-Funded-Entity (CFE): As proposed within this Submission, the Crowd-Funded-Entity (CFE) would behave in a similar way to a Private Company (Pty Ltd), but would have a stapled-relationship to the Issuer and the "crowd" via a Single Purpose Investment Vehicle. This new type of entity would have the rights to generally solicit during the term of a Campaign. This type of entity is easily administered and closed in the likely event that the Campaign is unsuccessful at raising the funds it requires. It can easily convert to a traditional corporate structure like a Private Company or Public Company in the event it requires and / or raises capital in excess of $2million.

Crowd: This is generally defined as anyone, regardless of their relationship to the Issuer, regardless of the "Sophistication" of them as an Investor - in short, anyone who wishes to invest in an entity.

Crowd Sourced Equity Funding (CSEF): Term defined by CAMAC Discussion Paper to explain the process whereby the "crowd" risk their own money by becoming Investors into an idea, in the expectation of a financial return when that idea generates returns.

Investor: This refers to a singular individual that makes up the "crowd". This investor is likely to be legally "unsophisticated" or more commonly known as a "retail investor"

Single Purpose Investment Vehicle (SPIV) aka **"Investor-Entity"**: As proposed within this Submission, the Single Purpose Investment Vehicle would behave similarly to a Trust. It would have a stapled-relationship to the Issuer and the Crowd-Funded-Entity. This new type of entity would be limited to only a few defined activities such as pooling funds, receiving dividends and acquiring stock on behalf of the crowd in the Crowd-Funded-Entity. The Single Purpose Investment Vehicle is otherwise prohibited from engaging in commercial agreements like employing people, buying or selling goods.

Intermediary: Generally understood to be the website where Issuers and Investors engage in Crowd Sourced Equity Funding

Market-Licensed Intermediary (MLI): As proposed within this Submission, the Market-Licensed Intermediary would receive a conditional annual license from the Regulator. They would then be able to procure on behalf of Issuers suitable entities from the regulator to allow CSEF for the term of the Campaign. The principal role of a Market-Licensed Intermediary is to regulate, standardise and confine the practices of Issuers through processes agreed industry-wide that reduce risk to the Investors. In recognition of their services they are entitled to fees. The Market-Licensed Intermediary would host the Campaigns of Issuers online and would be unable to give financial advice of any Campaign listed.

The Regulator: Australian Securities Investment Commission

Convert: In this Submission we use the term "convert" to describe the process whereby a CFE becomes a more traditional Private Company (Pty Ltd) or Public Company (Ltd). The process of converting "graduates" the CFE from the legislative environment of CSEF and into more established framework.

Constitution: In this Submission this terms is used to describe the replaceable and non-replaceable elements that form the operating rules for the Crowd Funded Entity including its ability to have Investors dilute Issuers over time with unreturned dividends buying further capital. Where this is the case the Constitution clearly provides the premium and dilution methodology. In turn, the CFE Constitution informs the creation of SPIV and SPIV Charter.

(SPIV) Charter: In this Submission the term is used to describe the operating rules for the SPIV. These rules govern Members rights including their preferences if these were collected. It references the stapled CFE that it is attached to when created.

SPIV appointed Officer: In this Submission the term describes a volunteer Investor (via the SPIV) that will join the CFE as an unpaid Officer, representing (in person) the will of the Members with respect to the Charter of the SPIV.

CFE-SPIV Application: The Application is completed by the Issuer, lodged by the Intermediary including fees to ASIC who, as the Regulator, will issue a set of stapled CFE-SPIV entities. These will have impacts on the Constitution and Charter and direct what goes into the Plain Language Offer and Campaign.

Plain Language Offer: This Submission proposes that all Campaigns should carry a Plain Language Offer explaining key elements of the deal. This should act as a digital cover-sheet to any marketing materials and contain basic information including price, valuation and what proportion of SPIV returns are distributed to Investors as Dividends or used to buy additional capital from the Issuer.

CSEF Education: This Submission proposes that all Registered Investors be channeled through CSEF Education regardless of the MLI they are investing through. This would alert would-be Investors about inherent risks with CSEF and be presented as an online course that Investors would have to acknowledge and Accept before progressing.

Regime: This Submission proposes an entire or holistic solution seeking to change or create many things simultaneously. To be implemented in a singular way – as opposed to incrementally changing existing laws and entities. This effort and structure is referred to as the Regime

Returns: For the Purpose of this Submissions returns includes dividend and / or capital returns to investors in an operating business or sale-of-equity envirnment.

Q1 In principle, should any provision be made in the corporation's legislation to accommodate or facilitate CSEF. If so, why, if not, why?

Accommodating CSEF

The very short answer is yes, provisions should be made to accommodate Crowd Sourced Equity Funding. This Submission constructs the case that new and appropriate legislation catering for CSEF needs to be created.

Legally-speaking this might be achieved as a new Chapter of the Corporations Act – if that is sufficient. Or perhaps the better approach is to create a new Act covering the proposed Regime suggested in this Submission.

The approach we outline illustrates the beneficial impacts of CSEF on the broader economy, focuses exclusively on new business (Small to Medium Enterprises are the largest employer group in the country) and provides greatest clarity around what Crowd Sourced Equity Funding is, and can be.

To administer and govern the interactions between Issuer and Investors we suggest Intermediaries be required to have a Market License granted by the Regulator and updated annually.

Why Crowd Sourced Equity Funding

Liberating "small increments of investment by large numbers of people" is a way to unlock more economic activity that currently is prevented in the economy by well-intentioned existing legislation for existing structures that are used to attract investment and operate in the economy.

These ideas were established pre the Digital Economy and that is ok, but the Digital Economy can't be ignored in terms of impact on consumer behaviour and connectivity. But, this is not about educating you about the Digital Economy.

Many other countries have adopted CSEF ideas and provided air-space and legal clarification for this emerging investment industry. With the benefit of other's experiences, Australia can learn and leap ahead of the pack, thus avoiding some mistakes our trading partners have encountered.

10 Reasons Why CSEF

1. Stimulates economic activity
2. Stimulates small business growth
3. Stimulates jobs
4. Reduces costs of establishing a small businesses
5. Reduces business failure by pre-establishing demand
6. Taps "Innovative Australia"
7. Brings Australia to parity or ahead of foreign competitors
8. Brings our tech start-ups to parity with others globally
9. Assists local communities to co-own local infrastructure
10. Promotes "community and cooperation" on and offline

The market-led desire for CSEF is demonstrated locally by the growth of similar rewards-based platforms, like Pozible www.pozible.com - the biggest. The desire to engage in financial instruments similar to what CSEF would enable, can be seen in the debt products already made available through Peer2Peer schemes including Society One, i-Grin and Lending-hub and less successful rewards-based platforms like Start Some Good http://startsomegood.com/

KICKSTARTER

Crowd-funding Is Already A Force

Crowd-funding Changes Existing Markets

Type	Then	Now
Crowd Sourced Equity Funding - ?	ASSOB	Market Licensed Intermediaries
Peer2Peer Loans – Lending Hub	Informal Unsecured Loans	Lending Hub, Society One
Rewards (Pledge) Based Funding - Pozible	Pre-Paid Orders	Kickstarter, Indigogo, Pozible
Event Crowdfunding	Event Promoters Pre-Selling tickets	Crowder
Donations from Public - Philanthropy	Charity and NFP sending donor letters	iPledge, GoFundRaise

Globally, the implementation of CSEF by our economic peers – the US, UK, Canada and NZ – should encourage CSEF legislators in Australia. This CSEF funding model is becoming a legitimate investment activity within the economies of major trading partners, but not yet in Australia.

This investment market is in its infancy, but has huge potential. Australia is a laggard in this crowd funding market and really has to play catch up to ensure we don't miss opportunities, which other economies will gain.

Who already has CSEF in place

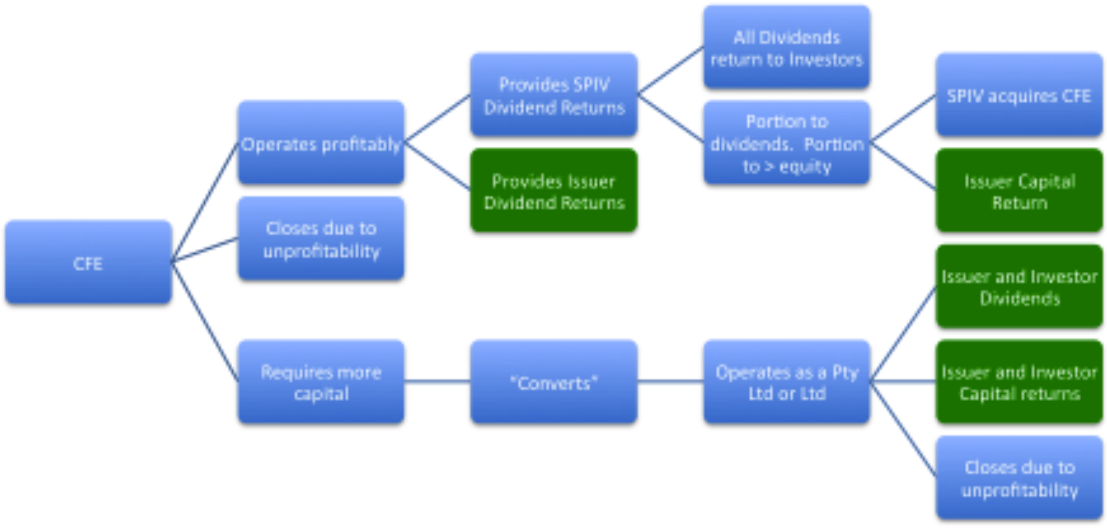
USA UK New Zealand

Italy Canada

Six Investor Incentives

1. Financial return through dividends
2. Financial return through capital sale
3. Experience of "my business"
4. Experience of co-operating with others
5. Fun of following a venture
6. Ability to invest in things they care about

Issuer Incentives in CSEF



Australia Missing Out

By not having a developed Crowd Sourced Equity Funding structure there are obvious detrimental outcomes.

One of the most obvious is the "brain drain" that is likely from within our Australian hi-tech, start-up community. It is common for software businesses to sell online and operate internationally from inception. Any entrepreneur considering a venture in this space would be encouraged to legislative environments that easily facilitated CSEF investment in their seedling of an idea.

This potentially makes the start-up scene of New Zealand more attractive than that of Australia let alone the start-up scenes in Asian, US and UK jurisdictions, which already are benefiting from CSEF legislation and outcomes. Equally compelling as the "brain drain" risk is the opportunity for building resilient local economies.

CSEF could potentially offer local communities a vehicle for pooling investment in shared local infrastructure. This would be economically rational where they are cheaper to consume and manage the closer they are to the point of production such as energy, food, water, waste and education projects.

Given most dwellings are occupied and mortgaged it is a fair assumption that these crowds are committed to local groups by virtue of it being "home". This group may have 20+ year mortgages and so 5+ year returns and pay back periods are not off-putting.

Were CSEF legislation drafted with this stakeholder group in mind then there are many local community groups seeking to co-fund and consume these essential services. This would provide local social and environmental benefits, but at its core is a cost-saving.

Politically we are all signed up to Regional Development and local economic benefits. We also know aligning the interests of these stakeholders has the capacity to influence how their communities and futures can be i.e safer, greener, happier – all highly motivating reasons.

However, the economic stimulation is the greatest motivator when considering this sector at scale.

If we accept there are reduced costs for buying local Energy, Food, Water, Waste and Education (5 Project types).

If we accept there at least 1000 communities in Australia that have ~10,000-people (1000 Communities)

If they all engage in 1 of the 5 types of project you have created 1000 small businesses (if they engage in all you have created 5000 small businesses).

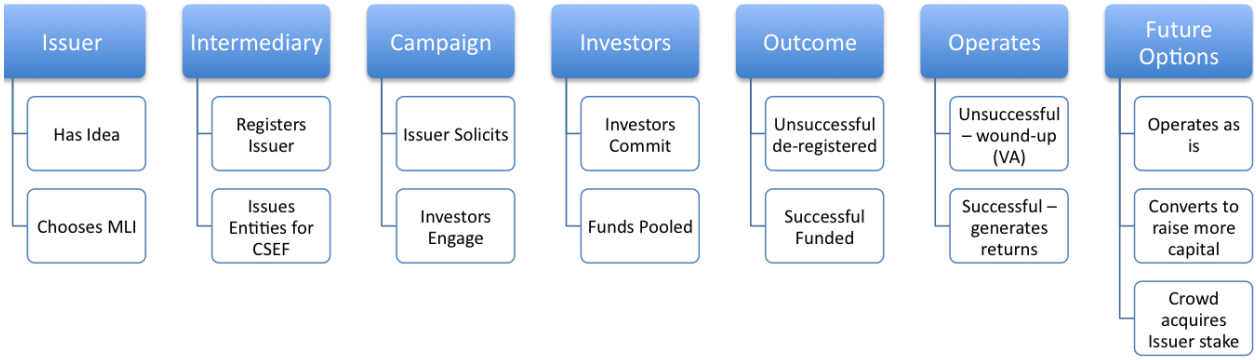
If each business seeks to engage 10% of a community as CSEF Investors and expects the average contribution to be $1000 then each business would have attracted $1 million in start-up capital.

This locally established capital would give stability to a new venture and the 90% of the community who were not CSEF Investors might still be a great customer base – considering the product the locals are selling is cheaper, greener and local, many sales barriers are reduced.

It is easy to imagine these 1000 small local-businesses being more sustainable investments than say $1000 put into a "tech startup".

Australia should introduce a CSEF Regime similar or exactly the same as proposed in this Submission or we miss out on creating a better "tech start-up" environment and a better local environment.

A New Chapter in The Corporations Act or a Fresh Act?



We submit that two new types of entity need to be created for CSEF – one akin to a Pty Ltd for the Issuer and one akin to a Beneficial Trust for the pooling of Investors. (As detailed later)

By writing specific legislation as either a new Chapter of the Corporations Act or as a Fresh Act is required to regulate these new types of entity. This new legislation would also consider the Market Licensed Intermediaries facilitating trade between the new entities.

Australia can avoid affecting existing Private Companies, Public Companies and other traditional entities when it introduces CSEF by creating this new Regime. It would be a case of trying to fit a square peg in a round hole if we simply tried to insert Digital Economy models into pre-Digital Economy legislation.

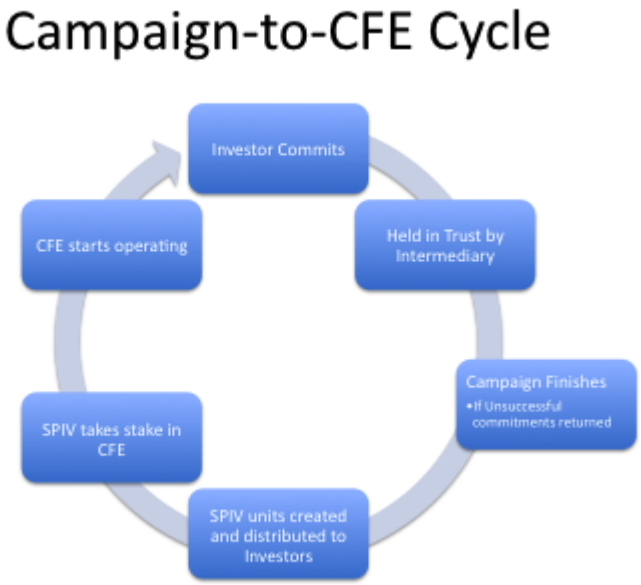
In other words we can avoid wholesale disruption of the current economy by drafting specifically for CSEF.

Legislative errors can more easily be wound-back and absolute clarity can be provided about the role CSEF plays in the broader Australian context i.e it is for new businesses.

In essence, the CSEF Regime we propose is limited to new businesses only (with small capital requirements and all listed on the known Intermediaries) and cannot be applied to existing businesses.

This also minimises possible ambiguity for existing businesses. If the CSEF format that is adopted in Australia operates as 'exemptions', or is available to their entity type (Private Company) existing small business may get confused by their eligibility.

Introducing this new legislative and operational paradigm – what we define as the Regime - requires diligent and creative preparation, but we contend that it is worth the investment of time and intellect.



Leave Good Enough Alone

The Australian economy is the envy of the world and it would not be prudent to create legislation that affects existing businesses or the entity types in use such as Private and Public Companies or Managed Investment Schemes.

If existing legislation is adjusted to include general solicitation or shareholder caps in Private Companies are extended, then these options are opened up across the board of existing and new companies; scale of impact is increased, but so too is the risk of fraud.

Any broad-based changes to Private Company structures would require existing businesses to consider what structure suits them best. This leads to providing professional advice and so AFSL advisors, lawyers and accountants would be supportive of this.

However getting lot's of Professionals (and their associated licenses, insurances and wages) increases the requirements for regulation that in turn would result in higher costs for all parties making it prohibitive for the pre-money enterprises that CSEF should focus on.

Do Not Change These Things

The Public Company structure is necessarily onerous and only available to businesses with established capital sources that can sustain the Regulatory overhead and associated expenses.

The Public Company (Ltd) structure is not suitable for CSEF and therefore should not be touched.

The Private company (Pty Ltd) structure is not appropriate either because of non-employee shareholder caps and other provisions like the 20/12 and solicitation rules. As argued above it would be unwise to alter these well-established rules because then CSEF is opened to existing businesses and not just applicable to new businesses.

CSEF should be applicable and available to the inventor of an innovative retail solution they want to bring to market. CSEF should not be something every general store now in operation will be faced with when they next meet their accountant (if they do).

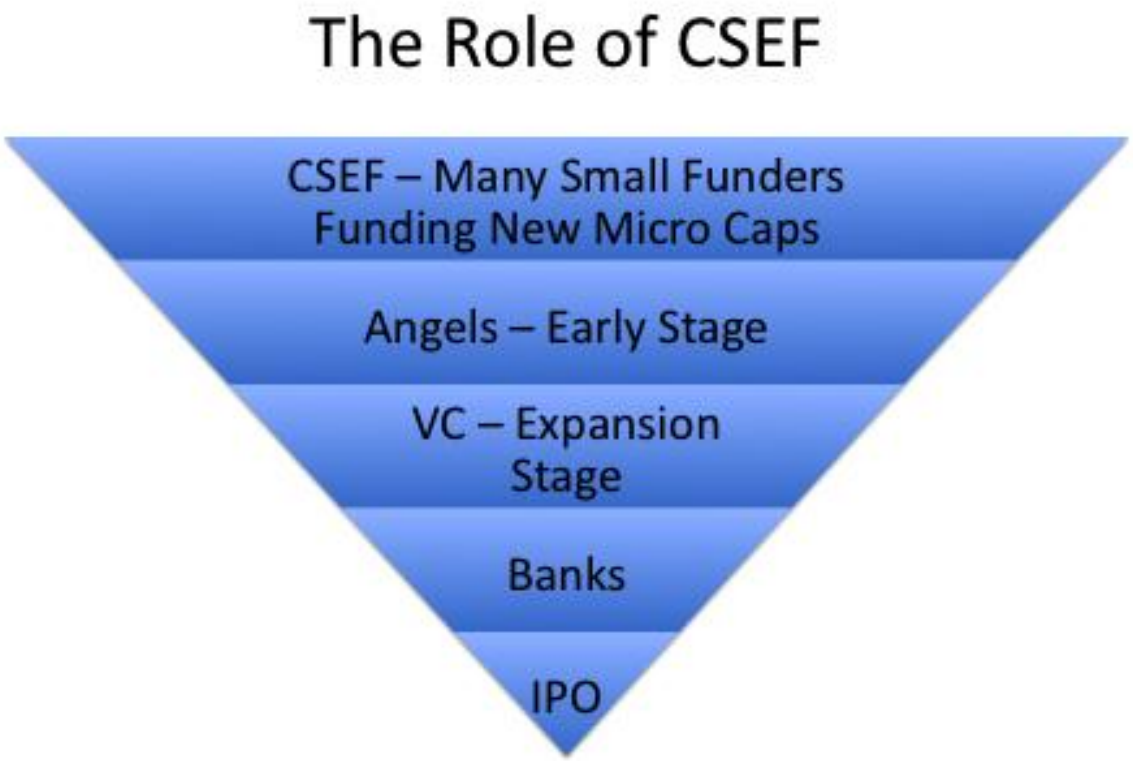
The Managed Investment Scheme for pooling multiple shareholders suffers from being too onerous for seed-stage businesses and is akin to Public Company compliance. Managed Investment Schemes also suffer from reputational issues that CSEF industry would want to avoid.

These Managed Investment Schemes may also engage in employment and make commercial contracts. In the context of CSEF any entity that "pooled" or aggregated the crowd into an entity for the purpose of taking the crowd's stake in the share register, would sensibly be restricted to the status of a holding vehicle and should not be able to employ or participate in commercial contracts. Managed Investment Scheme legislation is inappropriate in the CSEF context.

Integrating New CSEF Legislation with Existing Legislation

In this Submission we argue that the Regime for CSEF we suggest, can be considered a "funnel", "start-up" or "Seed-stage" environment only. The CSEF-derived businesses would be "graduated" if / when they exceeded capital requirement levels to either Private or Public Companies as appropriate and then would be subject to the already established legal framework.

Closing a CSEF-derived business would work in the same way as it currently does i.e via administration and/or liquidation processes followed by de-registration.



How it works with Investment classes

- CSEF is for <$2million and New Ventures

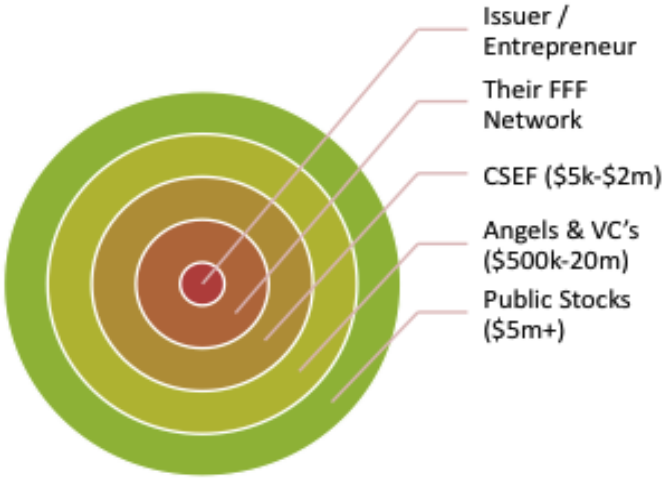
Properly constructed original CSEF legislation should feed into rather than merge or become part of existing legislation.

For seed-stage funding, which is CSEF's natural home, small increments of funding by large numbers of people is an idea whose time has come.

Once a "feed-in" paradigm for legislation and operations of the market is adopted it is easily understood how an entity could integrate with existing economic norms and -

a) Close if uneconomical, or
b) Graduate to a Public or Private Company if requiring further capital for growth

Scale of Funding

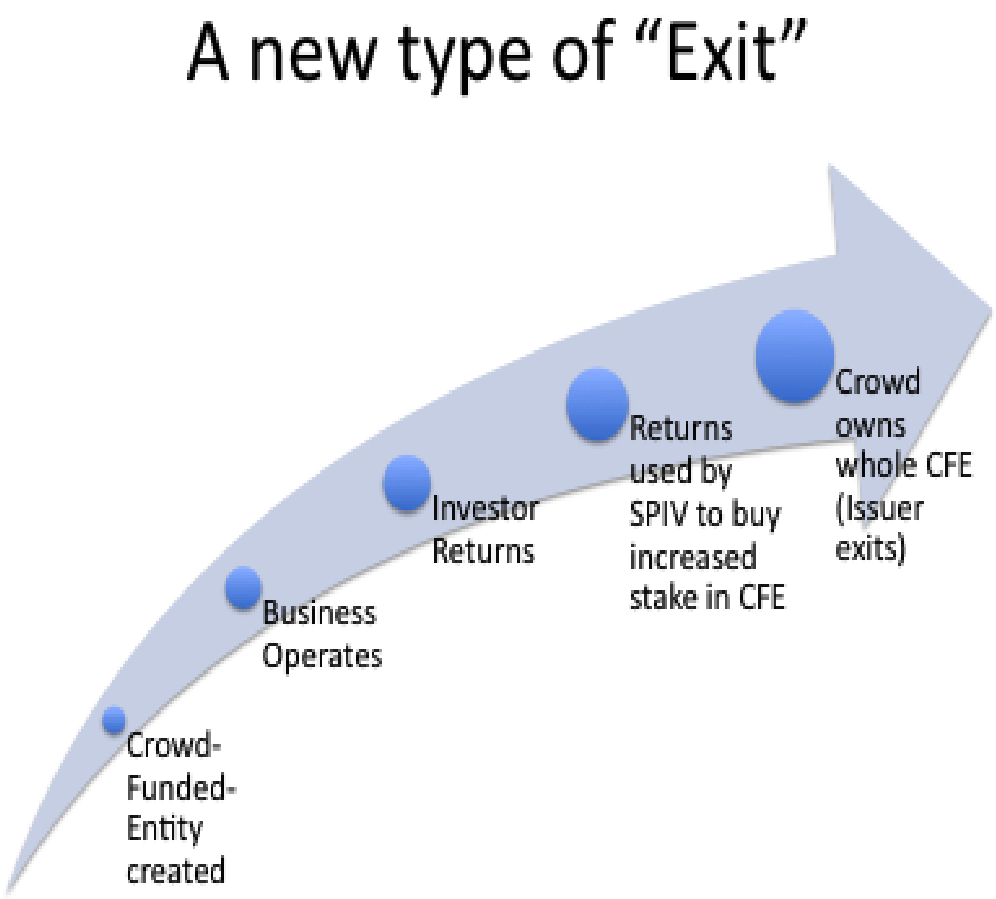


Less apparent at first is the new "exit" option available to Issuers (the entrepreneurs, innovators etc) that CSEF allows. Usually an entrepreneur can only profitably exit via trade-sale or public listing. CSEF legislation pertaining to the new Issuer entity and Investor entity can allow (if well constructed (before legislation is released)) a new category of exit.

In certain conditions, the proposed Regime would allow the "crowd" (Investors) to buy out the Issuer's remaining stake in the CSEF-derived business. This might be particularly appealing to local infrastructure businesses where the community wants to literally and metaphorically own the project resulting in gradual transfer of equity in a CSEF-derived business from the Issuer to the Investors.

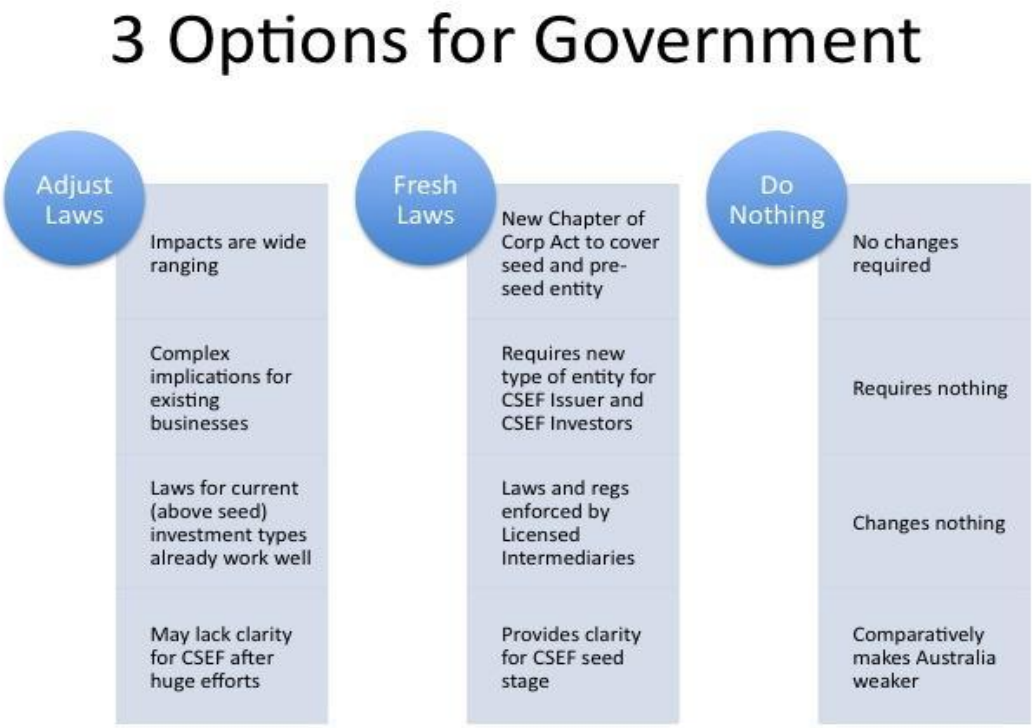
This can create huge economic certainty for projects with a 5-year plus life span. There is increased security when you start a project knowing that if your backers are your customers and happy, they will ultimately be who (collectively) would buy it from you and at what price they will pay for this.

This could encourage a plethora of local-level community investment. Simultaneously it will allow managed-funds that typically have 5-10 year life cycles the opportunity to align with crowds in a way where a buyer and exit price is understood before committing entry funds.



Q 2 Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or
(ii) confine CSEF to sophisticated, experienced and professional Investors? If so, what, if any, change should be made to the test of a sophisticated Investor in this context, or
(iii) adopt some other approach (such as discussed in Section 7.3)



(i) Take the form of some variation of the small scale offering exemption and/or

The small scale offering exemption should be kept in place for small scale offers (CSEF is large-scale). For large-scale funding such as CSEF as we see it in practice, a new Chapter within the Corporations Act is needed or a separate Act.

The CSEF context proposed in this Submission includes a paradigm where it is only for new businesses and works in parallel with new entity types and principally based in and on the digital economy. All expansion of the current exemptions really only work with a business that has existing revenue (i.e is not new) and is already a Pty Ltd or unlisted Public (Ltd) company structure. So this submission argues to leave the existing legislation in place for its specific purposes.

The current exemption is too onerous and an unfair cost imposition on the new investment-industry of CSEF. So if the current exemption were to be used in any way it would have to be extended in a way that impacted the broader legislation we would seek not to disrupt.

Never-mind that this would give the incumbent a great advantage in transforming from a “matching service” for small-scale offers into the only player for large scale offers. Something that was never intended when the exemption was made.

Notwithstanding the above reasons to dismiss changing the current small-scale exemption the issues with the current exemption include:

1. The exemption as it currently stands allows unlimited Accredited and Overseas Investors, but allows only 20 un-accredited Local Investors. As per Q1, CSEF would benefit local Australian communities if introduced and this part of the exemption would have to change for CSEF to be effective for a large stakeholder group.

2. The exemption basically doesn't allow for public solicitation (despite ASSOB claims), as this is only available under certain circumstances within the portal / website of the offer-board and / or potentially to people with a maximum one-degree of separation. The crowd in crowd-sourced is self-enforcing and self-evident; it requires people beyond a degree of separation to be approached.

3. The exemption as it stands still practically funnels investment ultimately into a Limited (Ltd) company structure with Disclosure Documentation required by all public listed and unlisted companies. Seed stage and low capital-intensive businesses requiring between $20k and $500k – would find this untenable. This current exemption has the effect of ruling out CSEF for Issuers unless they have a capital requirement in excess of $500k, which counter-intuitively would mean they would be of the size where conventional Angel investment networks are already operating making the CSEF legislation ineffective at freeing up the many small Investors and their associated economic activity.

4. The limited success of "Intermediaries" operating under the exemption should guide future CSEF legislation. The small-scale offer board (ASSOB) has helped 300 companies in nearly a decade and facilitated $135m in investments through the exemption.

Being the only entity using this exemption, ASSOB declares an average of only 14 Investors in most successful closes. This is correctly called a "small scale offer". It is not CSEF whereby thousands (a crowd) may wish to participate in ownership of a business or venture.

ASSOB or other match-making boards (if they exist) have a place in small-scale offers as evidenced by the statistics above, but crowd-funding and CSEF is a "feed-in" to this exemption and not a reason to extend the exemption. CSEF would work at less capital-intensive levels and for a different type of business – a new business.

Comparing the exemption ASSOB operates under with CSEF / crowdfunding as proposed in this Submission is generous. However, it may be technically accurate to call this Australia's first step towards CSEF. Humbly we submit it is not the direction to continue with when compared to fresh legislation with minimal impact on existing legislation and businesses operating in that framework.

Comparatively the pledge-based rewards platform Pozible has achieved much higher growth by tapping into the "crowd" in a similar way as this CSEF Submission proposes.

In conclusion, the exemption is not the priority because it's for "small-scale offers" where capital requirements would be in excess of $500k and would be accompanied by onerous ongoing governance requirements; this is assuming some rules were also relaxed making it practical to implement.

(Nor is it suggested that the current (Pty Ltd) company is a suitable vehicle with restrictions on 50 non-employee shareholders, 20/12 rules etc.

The priority must be to create specific CSEF Legislation either as new Chapter in the Corporations Act or as a separate Act to cover CSEF.

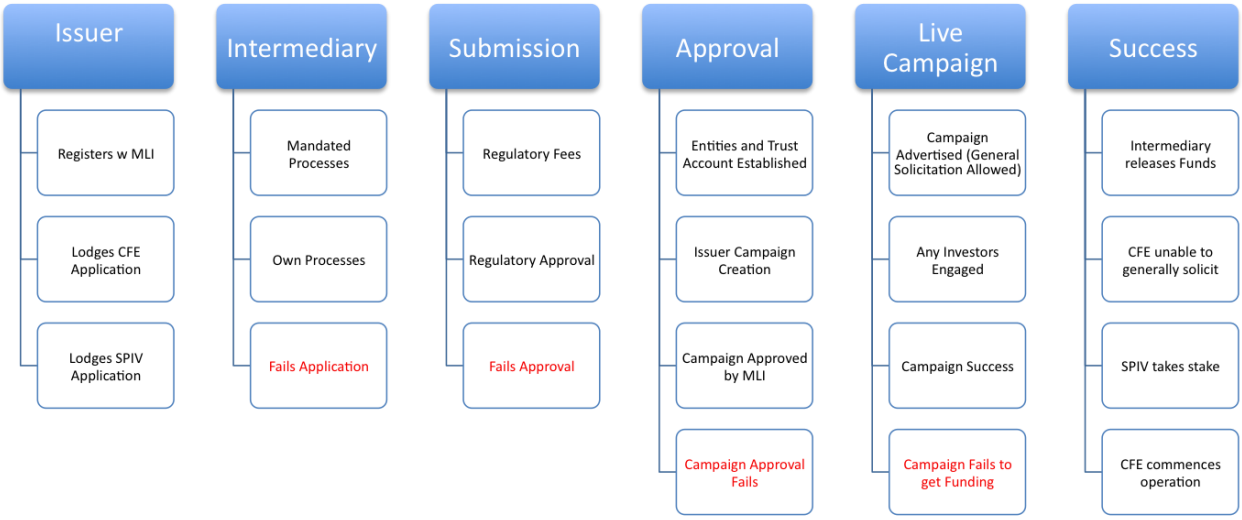
(ii) Confine CSEF to sophisticated, experienced and professional Investors? If so, what, if any, change should be made to the test of a sophisticated Investor in this context, or

As discussed above a set of new legislation would be preferred that allows crowd-funding instead of small scale offers.

In keeping with the idea of: many people investing small amounts – you would have to remove the Sophisticated Investor requirement in full for the proposed spirit of legislation to be enacted.

The legislation should include all unsophisticated Investors. Otherwise you severely impair the spirit of "crowd" when talking about crowd-funding.

Adopting the idea of this Submission - that a new type of Issuer entity be created and it specifically have the ability to generally solicit for the term of it's Campaign only – this is part one of the good policy framework we suggest. Part 2 is that this Issuer entity for the term of the Campaign should be able to approach any and all people regardless of sophistication or financial status for Investment. This would be inherent in adoption of good CSEF policy in our opinion.



As you can see from the diagram above, Investors would have a number of protections from fraudulent Issuers if the Regime we propose was accepted. Making this a less risky proposition than say a pledge-based crowd-funding campaign where only minimal safeguards are required in order to reduce friction and mass adoption.

Once the discussion is about Investing for a Return there must be some friction – in the form of Educating Investors, clearly explaining specific Offers and setting up the financial instruments needed to execute a commercial equity agreement.

This deeper knowledge of users and the process-rich method of crowd-funding suggested in this Submission, takes the risk down when compared with pledge-based crowdfunding. And there has been no fraud within Australian pledge-based Platforms[1].

[1] The author knows of none at least.

(iii) Adopt some other approach (such as discussed in Section 7.3)

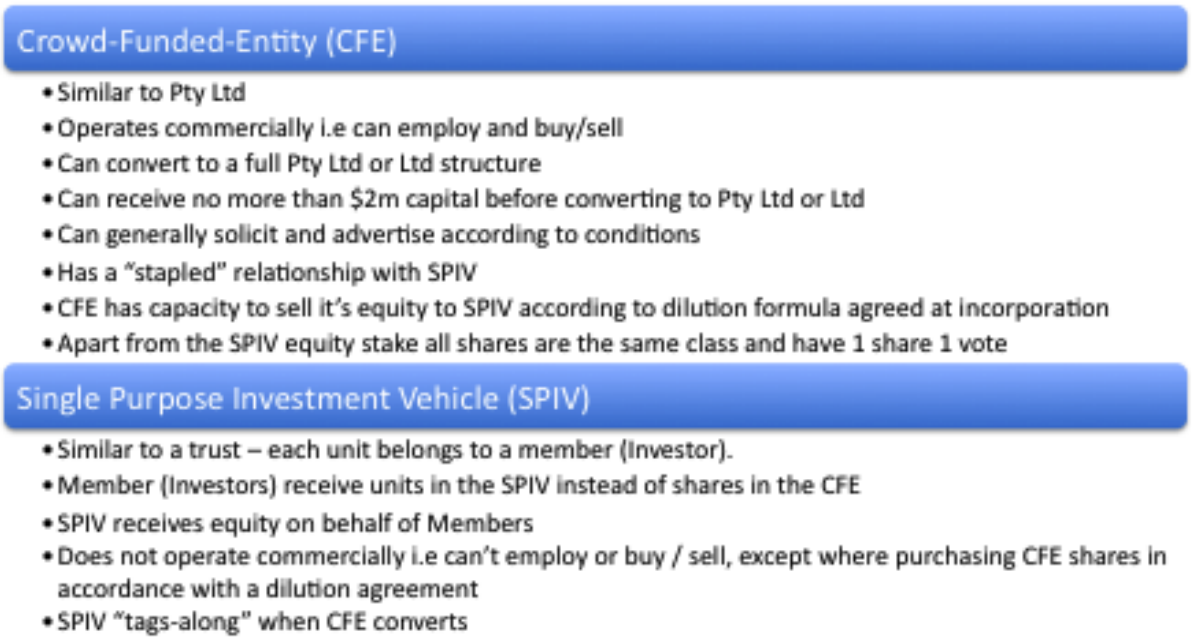
The nature of the accommodations this Submission seeks can be found throughout.

As a summary, we would suggest fresh legislation applicable to a new type of Issuer-entity (not a company Pty Ltd or Ltd and not a Managed Investment scheme) should include:

- A lift on the general solicitation rule allowing Issuer-entities to offer under clear terms to the public that their business idea is for sale under condition of meeting criteria set out by Intermediaries (the marketplace).
- A lift on the general solicitation rule allowing Issuer-entities to use any means they can afford or have legal access to in order to advertise their offer during the term of their offer. When they had not an offer listed on an Intermediary they could not generally solicit – what would they need to say any way.
- A lift on the rule of 20/12 – it doesn't belong in the world of CSEF – it is still probably suitable for existing private companies and should be left intact as per this Submission central theme.
- In accordance with this Submission the general solicitation rule is being relaxed only for new, pre-revenue business ideas for the period of their Offer on a Licensed Intermediary.
- To allow for the fullest effect of CSEF Legislation as proposed in this Submission do not qualify who is an Investor or part of the "crowd".
- A classless Investor is proposed because practically there would be no differentiation between Investors by level of sophistication as they will all buy through a new type of Investor entity if they invested in the Issue during the period of the Offer.
- If they invest after this point then they would be doing so when the entity has "graduated" to an existing business structure like a Private Company or Public Company.

Entity Type	Function	Features
Sole Trader	ABN: Contracting	Allows cheapest establishment of business. Treats all income as personal
Private Company	Pty Ltd: Private Company is most common structure used in economy	Treats income of business and individual separately. Shareholder caps and limits prevent being useful for CSEF
Public Company	Ltd. Public Company is for capital intensive businesses	Highly regulated and managed within well established framework. Not applicable for CSEF
Managed Investment Scheme (MIS)	MIS Aggregates Investors in investments that are capital intensive	Usually complex structures to allow tax offsets. Not applicable to small cap CSEF

Proposed Entity Features



A Regulatory, licensing and reporting structure for Intermediaries that facilitate CSEF, this structure should include:

- Clear disclosures to Investors by Issuers
- Processes that Issuers are required to undertake so that the Intermediaries are minimising risks – specifically of fraud (harm done by others) and
- Processes Investors are required to undertake so that Intermediaries are enforcing limits to investment size (harm done to self) commensurate with that Investor
- Intermediaries should have the capacity to share data and deny service to an individual that is attempting to break an annual cap imposed on investments in CSEF funded ventures.

To conclude, fresh CSEF legislation is required in order to do the market dynamics in such a way that the legislation meaningfully unlocks economic activity from many people, in lots of small capital-requiring businesses.

Q 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies
(ii) public companies
(iii) managed investment schemes. In considering (c), should the disclosure obligations of Issuers to Investors differ, in principle, if Investors are investing directly (as equity holders in the Issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

(i) Proprietary companies

Within the CSEF context as proposed by this Submission, the resulting Issuer entity would be a business that is similar to a private company as it stands today. However you would not need to change the existing legislation for Private Companies. In fact if you did you would be exposing all private companies to a change in their trading

(ii) Public companies

Given that CSEF context refers to seed-stage ideas and relatively small amounts of capital. You do not need to make any changes to the regulation of Public Companies. Instead as recommended by this Submission you would leave Public and Private company regulation intact and create fresh entities and legislation.

In light of the role and importance of large companies with their commensurate value on exchanges, it seems appropriate to leave public company governance (which is generally accepted as high quality) intact. If it aint broke don't fix it.

It would be anticipated that a successful CSEF venture would mature and "graduate" from the CSEF stage if requiring greater sums of capital from Investors. This capital may progress into established funding "funnels" usually occupied by Angels, VC, and Public Listing Options.

These further investment rounds and exit rounds can remain largely unaffected as CSEF is designed to un-tap economic activity in the start-up and local community resilience space, which is at the other end of the spectrum in terms of scale to the Public Company and the role it plays.

(iii) Managed investment schemes. In considering (c), should the disclosure obligations of Issuers to Investors differ, in principle, if Investors are investing directly (as equity holders in the Issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Taking the position of this Submission, whereby fresh legislation is drafted for the new type of Issuer-entity and new type of Investor-entity there would be no need to change the regulation governing Managed Investment Schemes.
The creation of an Investor-entity that aggregates CSEF Investors is explained later.

Q 4 What provision, if any, should be made for each of the following matters as they concern CSEF Issuers:

(i) types of Issuer: should there be restrictions on the classes of Issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')
(ii) types of permitted securities: what classes of securities of the Issuer should be able to be offered through CSEF
(iii) maximum funds that an Issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each Issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption
(iv) disclosure by the Issuer to Investors: what disclosures should Issuers have to provide to Investors
(v) controls on advertising by the Issuer: what controls, if any, should there be on advertising by an Issuer
(vi) liability of Issuers: in what circumstances should the Directors or controllers of the Issuer have liability in relation to CSEF. What defences to liability should apply
(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

This diagram is provided to help visualize the life-cycle of an operating Crowd-Funded Entity (CFE)

CSEF Australia Recommendation

A self contained Regulatory regime needs to be defined (even broadly) for it to be on the table and so included here is a method. There may be more appropriate methods than this develop. But this could work…

(i) Types of Issuer: should there be restrictions on the classes of Issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

This Submission argues that Issuers should all be "new" businesses and not existing (revenue generating) businesses.

This Submission would recommend that a new Issuer create a new Issuer-entity (perhaps called a 'Crowd-Funded Entity' or CFE) for any Campaign that wishes to raise Crowd Sourced Equity Funding.

The new Issuer-entity would list this on one of a few Market-Licensed Intermediaries and CSEF Investors would put their money into the new Issuer-entity via the Investor-entity (perhaps called the Single Purpose Investment Vehicle).

Aside from being new ventures, there should be a cap on the total funds a Crowd-Funded Entity can raise. Breaching that cap would cause the Crowd-Funded Entity to convert to a tradition Pty Ltd or Ltd form.

Issuers (Directors and Officers) should all be required to maintain at least permanent residency status and have some other form of ties to Australia, be it local assets or otherwise.

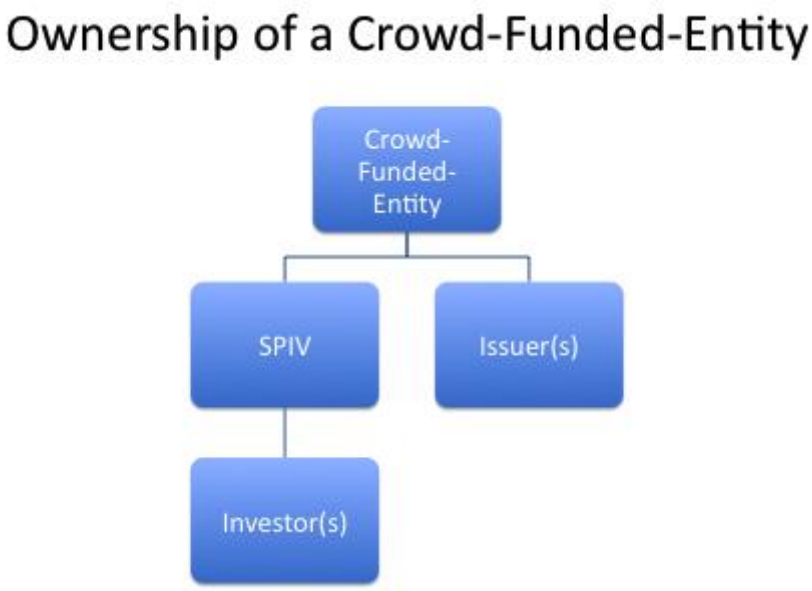
For CSEF we would argue there should be no other restrictions on the Issuer.

Naturally however, this will become a place for seed-stage ideas rather than large-scale fund managers and investment companies who typically wouldn't bother with the small-scale nature of CSEF.

All Investors are encouraged to get professional advice before investing and must click that they have either a) done so or b) waive the right to do so and understand this risk. This is done using the Plain Language Offer described later.

(ii) Types of permitted securities: what classes of securities of the Issuer should be able to be offered through CSEF

This Submission argues that a new type of entity be created when the Issuer wishes to raise CSEF. This would have shareholders (if successful) that included the Founder (Issuer) and the crowd (Investors) via pooled ownership mechanism.



The Issuer and Their Crowd Funded Entity (CFE)

This new Issuer-Entity can be called a Crowd-Funded Entity. The Issuer is essentially the Founder (or entrepreneur) and is granted equity (Security) in this CFE for coming up with the initiative. This Founder shareholding is complete with voting rights, dividend rights, capital rights etc (similar to a share in a private company Pty Ltd).

The Issuer would determine how much of the Equity in the CFE is available to the SPIV based on the funds being sought and raised.

The CFE would have sections of replaceable and non-replaceable "constitution" that is modified according to set-up of the Campaign – again this is similar to a private company where the constitution of a shelf company can be amended or modified.

The CFE would have the ability to do business with external parties and employ staff etc – again similar to the familiar Private Company (Pty Ltd) model.

The CFE would have to register for GST and pay tax rates at the same level prescribed for Private Companies.

When applying for the new CFE type of an entity the Issuer would have to nominate if there Campaign will require the "stapled" SPIV to have the capacity to receive 100% of returns as dividends or if some of these returns will be used to dilute the Issuers stake in the CFE and transfer it to the Single Purpose Investment Vehicle (SPIV).

Stapled to each Crowd-Funded Entity (CFE) is a Single Purpose Investment Vehicle (SPIV).

An Issuer would therefore not give CSEF Investors a security in the CFE, instead the CSEF Investors would be given ownership within the SPIV.

A Crowd-Funded Entity (CFE) is a new entity and is created by the Regulator in accordance with an Application made by the Issuer and submitted through a Market-Licensed Intermediary (MLI). An Issuer creates a CFE when they wish to raise Crowd Sourced Equity Funding (CSEF).

The Issuers' CFE will become the commercial vehicle (if funded) that operates day-to-day like a Pty Ltd. The CFE offers equity via the Single Purpose Investment Vehicle (SPIV) to the "crowd" of Investors

The CFE is allowed to generally solicit, to anyone (regardless of sophistication) for any amount below say $500,000. Putting a cap on single Investor of $500,000 and of total capital raised of say $5m will keep this Regime limited (intentionally).

The CFE can solicit for funding, but in actuality the crowd funds will be held in Trust by the MLI until a Campaign is successful. (Unsuccessful Campaigns return Investor funds held in Trust to the Investors). At that point a Single Purpose Investment Vehicle (SPIV) makes the Investment on behalf of the Investors ("the crowd"). Then the CFE receives it's CSEF.

The CFE is run according to a Constitution that contains non-replaceable items that govern behaviour and replaceable parts that are determined by the Issuer when making an Application. The specific nature of the Application is reflected in the specific nature of the CFE Constitution. Moreover, the Constitution dictates to replaceable parts of the SPIV Charter (to be explained further later) and the Plain Language Offer (to be explained in detail later)

The CFE has disclosure and reporting obligations to the SPIV because the SPIV will have rights (equity) in the CFE. Notwithstanding the obligations on the CFE most CFE's will want an ongoing relationship with the crowd of Investors.

A CFE may be "closed" from further funding on any Market Licensed Intermediaries after receiving CSEF funding of no more than $5million.

A venture that is started as a CFE with a stapled SPIV that is seeking further funds in excess of $5m is like any other business and would need to "Convert" to the familiar Private or Public Company structures to seek Angel Funding or similar methods of financing according to their needs.

A CFE could according to the pre-agreement with the SPIV, be purchased by the SPIV for a pre-disclosed premium – turning full ownership of the CFE over to the SPIV. This provides a new (non-traditional) exit mechanism for the Issuer (entrepreneur) who created the CFE.

As a new type of Investment CFE's could be perfect for "Big Capital" and "Little Capital" partnership. A CFE opens CSEF to matched-funding opportunities with governments and large managed funds – generating a new "loop" in the economic system.

A CFE can generally solicit as long as they declare they are a CFE in their advertising. The CFE can only generally solicit for the term of their Campaign.

A CFE can not raise CSEF funding directly only via a SPIV and only via a Market Licensed Intermediary.

A CFE can have more than one Issuer allowing Founders and Angel Investors to align before the CSEF raise as long as disclosed - or after the CSEF raise, as long as the type of security does not diminish the SPIV rights or dis-proportionally. The simple solution would be to have funders of the CFE with the same security as the Issuer (Founder)

A CFE otherwise works like a private company (Pty Ltd) and should be able to easily convert to this more traditional business structure should its needs change.

The Issuer and The Single Purpose Investment Vehicle (SPIV)

A SPIV has securities similar to a Unit Trust whereby Investors are treated as Members and receive the benefits of dividends and capital growth of their units.

Investors would receive units within the SPIV according to the amount of funds they invest.

These securities would have no voting rights individually available to Investors, but would collectively provide a volunteer SPIV nominated Officer to the CFE who represents the SPIV interests. This is similar to the role of the Trustee.

A SPIV would be restricted from doing business with external parties and could not employ staff for example.

The role of the SPIV nominated Officer (is similar to that of a "Trustee" for a Trust) would be unpaid and they would operate according to a prescribed Charter that includes reference to replaceable and non-replaceable sections of the constitution that the CFE was set up with. This Charter would include non-replaceable terms like 'acting in the best interest of the majority of SPIV unit-holders'.

Restricting the nominated Officer from anything but a volunteer that communicates the will of the Charter and preferences collected is designed to reduce overhead and allow frictionless delivery of "dividends" to the SPIV owners in the event of a dividend. Yet still capture that feeling of being a part of the decision making process of the CFE.

Capital return to the SPIV Investors would be tied only to a capital return in the CFE. This would remove any potential secondary market for SPIV Investors.

Practically the following steps would occur

1. An Issuer would join a Market Licensed Intermediary where they intend to raise CSEF
2. The Issuer would apply to the Regulator for an CFE-SPIV set of entities
3. In accordance with the nature of the Project an Issuer would make available in return for funds provided by the Investor a stake in the Single Purpose Investment Vehicle
4. This Single Purpose Investment Vehicle would pool then Investors funds and interest into one group and allocate an equivalent number of units as each Investor has paid for.
5. The SPIV would have a nominated, unpaid, representing "Officer" acting on the crowds behalf within the CFE.
6. Should a CFE be considering a decision that they want buy-in from the crowd on, then the Officer will give voice to the preferences of unit-holders on behalf of the SPIV.

(Binary digital polling methods can be used collect the preferences of individual CSEF Investors. Where the CSEF Investor does not partake in the polling then they in effect proxy their preference to the unpaid SPIV Officer)

Restricting the type of entities and investment options with CSEF to those described above provides low levels of complexity. This would enable these entities to carry on with their business with minimal transaction and other costs in the early stages, in addition to maintaining the creative, operational and other controls required to give fruition to the Campaign and Project Plan.

As long as adequate levels of disclosure were in place between CFE and SPIV then a fair balance between Issuers and Investors could be achieved, while minimising complexity, red tape, public and private costs simultaneously.

Notwithstanding the benefit of the simplicity described in the above model, this Submission makes a further recommendation: that under disclosed and prescribed circumstances a SPIV could acquire a greater share of ownership in the CFE.

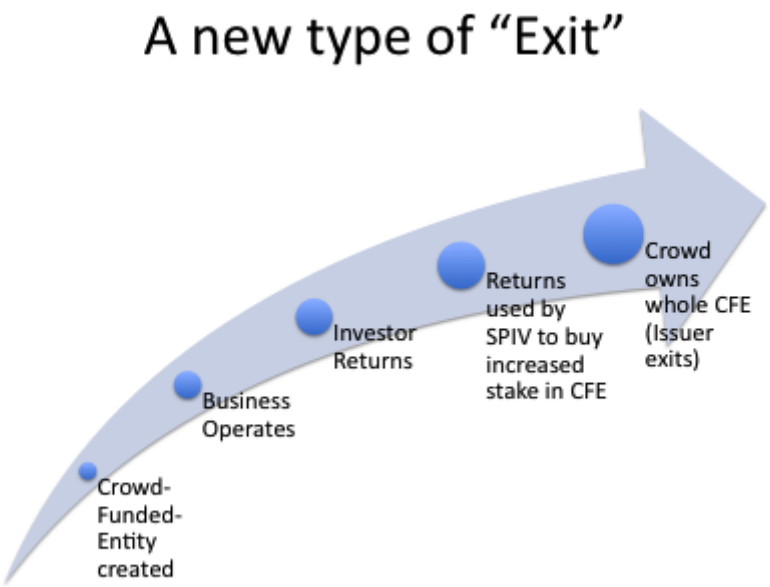
This would occur in the following way

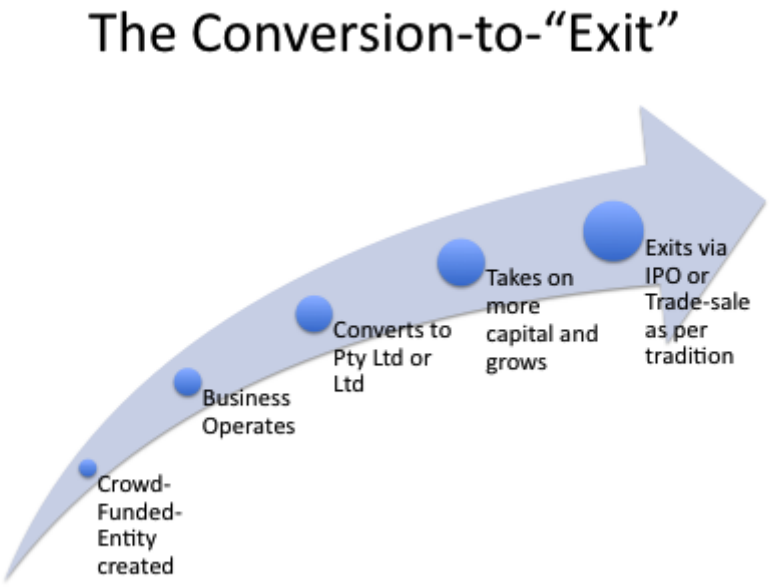
1. As the CFE operates like any other business, it generates returns to the Issuer (initiating person that is owner of the CFE) and the Investors who are pooled in the SPIV.
2. The SPIV instead of passing these "dividend" returns in full to the unit holders (individual Investors) of the SPIV would use part or all of these funds to buy more equity in the CFE.

(This is disclosed and the rates prescribed up front in the Project Plan so that Investors know what they are buying)

3. The Issuer (CFE) would then be selling equity in the CFE to the SPIV giving Investors in the SPIV a greater future return.
4. Over time the SPIV could acquire the entirety of the CFE equity and at this point the CFE would cease to have the Issuer as a stakeholder
5. It may be appropriate that once an agreed threshold of beneficial owners are actually SPIV unit holders then the CFE may be forced to "graduate" to a Private Company structure Pty Ltd or forced to graduate to an unlisted Public Company (Limited Ltd)

It may be appropriate that the CFE-SPIV twin set of entities be graduated from the low governance CSEF environment to a traditional governance and structure once either the threshold for Capital raised is breached or the threshold of SPIV ownership in the CFE is breached.





(iii) Maximum funds that an Issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each Issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

In light of the comments above, there should be a ceiling (somewhere below $5million). After all, once these entities have raised sufficient capital to grow to the next stage, there is no longer a desperate need to bridge a gap in seed stage funding that CSEF aims to bridge.

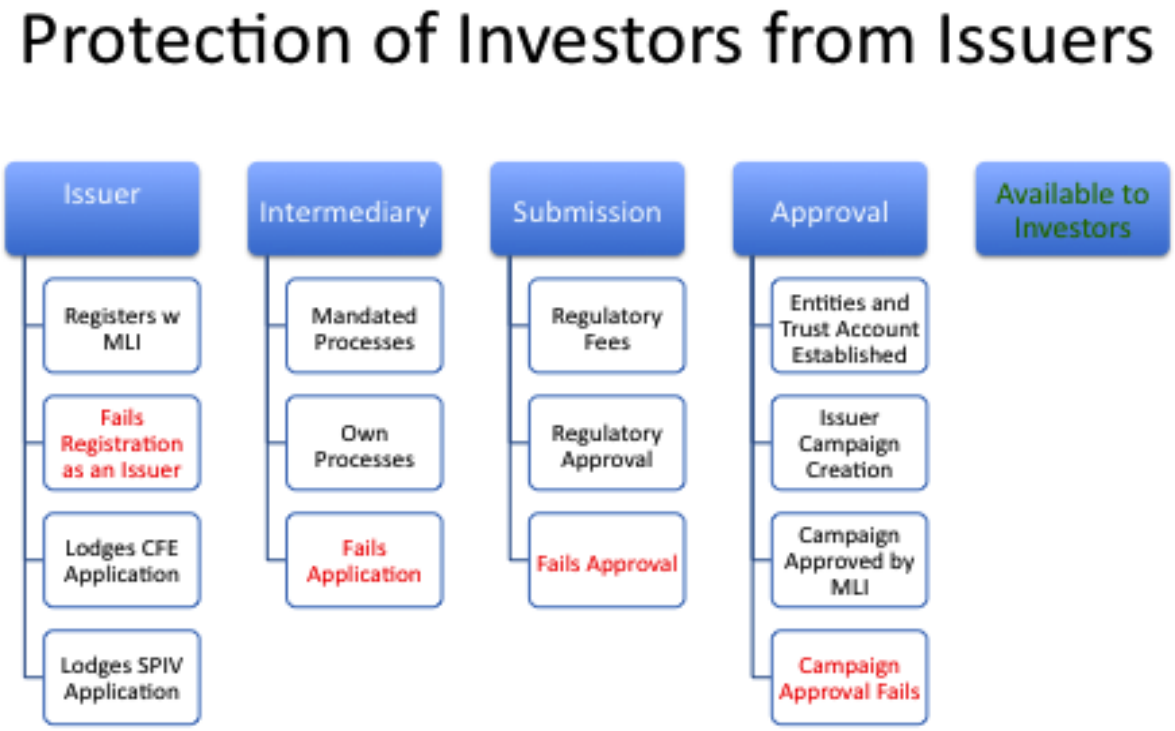
In addition, by that stage, the CFE should have a proven track record / passed "proof of concept", which would bring them to the size where other conventional sources of capital are likely to assist in taking them to the next level.

On one view, there is no real reason why the ceiling should be any different to that contained in s 708 of the Corporations Act 2001 (Cth) ("the Act") i.e $2million, given that this would be sufficient for the majority of start-ups to prove their concept on a small scale and retain sufficient equity to attract further capital.

However, on the other hand, we will surely see completely new innovations and business models, particularly in the areas of "local infrastructure" and "clean-tech". As such, it may be that a tiered system is put in place, whereby the ceiling is different for certain types of projects according to varying criteria to be assessed with reference to costs associated with proving the concept and perhaps the time and cost likely to be involved in breaking even and generating a profit.

To be accommodating we Recommend a maximum capital threshold of $5m although believe most of the activity will be in the region of $5k - $500k.

iv) Disclosure by the Issuer to Investors: what disclosures should Issuers have to provide to Investors



Given the matters raised particularly per (i) above, the Issuers should be required to register with a Market Licensed Intermediary. Thereby completing things like ID checks and processes that minimise fraud.

Once registered the Issuer can complete online forms that highlight and disclose the Campaign (Project Plan). This would include reference to capital being sought, SPIV levels of initial investment, SPIV acquisition costs of CFE equity as the business operates and threshold levels whereby the CFE-SPIV graduate to traditional means of governance and structure.

In addition to upfront disclosure the Issuer should be required to annually report to the Investors in the CFE and therefore to the unit holders in the SPIV.

The Issuers would then need to be subjected to certain levels of disclosure and diligence to the intermediaries, and the intermediaries would need to reach certain thresholds in conducting their own due diligence.

Both of these entities, and perhaps their Directors and officers could, for example, share joint and several liability to Investors with respect to misrepresentations, breaches of fiduciary duties and so on, and each could be liable to the other in turn. It may be that a new class of duties is created, as with those of Directors already set out in the applicable Act.

(v) Controls on issuing by the Issuer: what controls, if any, should there be on advertising by an Issuer

Considering the types of Issuers that can be expected to be playing in this market, in light of comments above, one would presume that general solicitation would be highly desirable, if not essential, at least for some types of campaigns

.

It must be borne in mind that, provided the types of Issuer are restricted as set out above, the Investors that will be attracted to this market will be small-scale retail Investors, typically looking to commit anywhere between a few dollars to a few thousand dollars only. In addition, those that are attracted to such an investment are typically not the sophisticated Investors within the meaning of the existing Act.

Further, the online portals of Market Licensed Intermediaries will not simply attract attention sitting idle. They should be entitled to advertise themselves also. However, advertising their own activities, without any specific mention of the projects with which they have listed and the particular investment opportunities they currently have, could prove useless and counterproductive to the industry, especially if generic advertising comes to be seen as spam.

There is nothing wrong with advertising at all. It is advertising and subsequent enticement without a fair balance between disclosure to Investors and practicality for Issuers that creates a problem. As such, if anything, the nature and extent of advertising could be regulated and only possible within the Campaign timeframe.

(vi) Liability of Issuers: in what circumstances should the Directors or controllers of the Issuer have liability in relation to CSEF. What defences to liability should apply

The idea that a sufficient breach attracts liability to repay the investment plus interest makes sense. For more serious offences, there should be larger civil penalty provisions, personal liability of Directors and other officers (perhaps enforceable by personal guarantees provided to the Regulatory on formation), and for the most egregious, maybe even as much as custodial sentences.

As to defences, considering the level the Issuers will be at, and the typical low-scale and low-risk nature of this market (considering that economic forces will see small investments only), the defences should be a little more lenient toward Issuers (and Intermediaries) for some of the more innocent offences (i.e. non-intentional and less serious breaches of fiduciary duties or disclosure rules). For example, something similar to a tailored mixture of the honest opinion and fair reporting defences to defamation might be appropriate, dependant obviously on the scale of loss done and set thresholds for scales of acceptable conduct, unsatisfactory conduct and professional misconduct, as most of the professions have. Of course much more limited for malicious offences such as misappropriation, fraud, misrepresentation (as opposed to negligence misrepresentation) and so on.

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

Again, in order to prevent harm to the public, Investors need sufficient disclosure to place them in a position where they understand the speculative nature of the investment and for them to treat it analogously to a term deposit, albeit with a risk of loss. Again, transaction and other costs are what are currently prohibitive to Issuers, so these must be minimised. Further, subject to the issue of voting rights, these entities will need a great degree of stability from Investors as they grow to the next level and "get off their training wheels". As such, there should probably be a ban, and in any event, considering the likely size of investments, there is probably no great reason to allow on-sales.

It may be that the CSEF Investors via the SPIV is permitted to buy more of the venture from CFE Issuer, subject to certain rules as declared in the Campaign. This will affect the price and an Issuers / Intermediary's additional disclosure and education obligations. But given it opens up a new succession model for businesses is worth it.

Of course, the CFE also has the ability to "convert" into a more traditional Pty Ltd or Ltd structure and then could have access to secondary markets within a completely different framework.

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

It is unclear what this question is asking because there are no existing Intermediaries for CSEF. Unless of course the question is implicitly suggesting that the current business (ASSOB) that operates a "business introduction and matching service" under ASIC class order (02/273) is an Intermediary for CSEF.

This Submission would challenge the definition of a "business introduction and matching service" being the same as a CSEF Intermediary in terms of large scale offers – of small sums – in new businesses usually requiring less than $500,000.

What we would recommend ultimately becomes a Market-Licensed Intermediary (MLI) and is expanded on in Q6.

A few similarities exist between ASSOB and our suggested Market-Licensed Intermediary (MLI). Both should:

- Be granted operational Licenses according to the Regulator
- Be unable to provide financial advice
- Be unable to show favour or discriminate between listed opportunities

In this Submission we argue that Market-Licensed Intermediaries (MLI's) when created have the following characteristics.

1. Provide the website or portal that CFE's (Issuers) place their Campaigns on and meet the crowd (Investors). Practically this means a website / portal is created for the purpose registering participants and facilitating CSEF.

2. These new MLI's should be Market-Licensed by the Regulator so they can become Market-Makers where CSEF can occur. They do not require traditional Financial Services legislation governing their operation (as argued previously fresh laws and legislation governing fresh entity types is recommended).

Financial Services Legislation (AFSL Licenses) as required by brokers etc requires obligations and in turn costs that stifle CSEF by making it cost prohibitive.

The best way for them to standardise and regulate that Intermediary environment would be through Licensing and renewal of License requirements. (Assuming new legislation, which is no guarantee).

None of this has anything to do with advice giving of a financial nature.

3. The ability to be granted a Market-License may depend on agreed minimum standards and renewal based on condition of these standards being adhered to by the Intermediary and all parties (Issuers and Investors) using that specific portal.

4. MLI's should provide the Regulator with confidence that no financial advice is being given by the Market-Maker – you don't see the ASX making recommendations on individual stocks ever.

5. The MLI's principle role is to reduce fraudulent activity through processes and this will be discussed more in our response to Question 6.

The Regulator should see the Intermediary as the place where Issuer and Investor engage and therefore the natural place to regulate and protect against the fraudulent activity they fear so much.

As a side note, every day hundreds of thousands of transactions take place including every reward-based crowdfunding platform where there are very clear rules set out in the Competition and Consumer Act 2010 (CTH) about what is right and wrong and repercussions.

The Competition and Consumer Act 2010 (CTH) also works for services and intangibles where people have no chance to assess in advance if the wedding planner, or concert promoter or cruise Director will deliver on the promises they made even though thousands of dollars are involved.

Q 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of Intermediary (also relevant to Question 5):
(a) should CSEF intermediaries be required to be registered/licensed in some manner
(b) what financial, human, technology and risk management capabilities should an Intermediary have for carrying out its role
(c) what fair, orderly and transparent processes must the Intermediary be required to have for its online platform
(d) should an Intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman
(ii) Intermediary matters related to Issuers: these matters include:
(a) what, if any, projects and/or Issuers should intermediaries not permit to raise funds through CSEF
(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on Issuers and their management
(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by Issuers
(d) to what extent should intermediaries be held liable for Investor losses resulting from misleading statements from Issuers made on their websites
(e) to what extent should intermediaries be held liable for Investor losses resulting from their websites being used to defraud Investors
(f) what possible conflict of interest/self-dealing situations may arise between Issuers and intermediaries (including intermediaries having a financial interest in an Issuer or being remunerated according to the amount of funds raised for Issuers through their funding portal), and how these situations might best be dealt with
(g) what controls should be placed on Issuers having access to funds raised through a CSEF portal
(iii) Intermediary matters related to Investors: these matters include:
(a) what, if any, screening or vetting should intermediaries conduct on Investors
(b) what risk and other disclosures should intermediaries be required to make to Investors
(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached
(d) what controls should be placed on intermediaries offering investment advice to Investors
(e) should controls be placed on intermediaries soliciting transactions on their websites
(f) what controls should there be on intermediaries holding or managing Investor funds
(g) what facilities should intermediaries be required to provide to allow Investors to communicate with Issuers and with each other
(h) what disclosure should be made to Investors about being able to make complaints against the Intermediary, and the Intermediary's liability insurance in respect of the role as an Intermediary
(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance Investor protection

(iv) any other matter?

(i) Permitted types of Intermediary (also relevant to Question 5):

The Market-Licensed Intermediary is registered with ASIC and has ongoing reporting obligations to ASIC. In addition, something similar to the Italian approach should be required. For example, one requirement could be that the Directors of an Intermediary have not been convicted of an offences involving dishonesty, much like existing requirements in various professions in Australia. If security is to be provided for enforceability in the event of a breach (discussed elsewhere), there might be minimum requirements involving this, perhaps personal guarantees and minimum levels of financial performance.

As with Issuers there might be requirements that MLI's are Constitutional corporations and their Directors and Officers have other links tying them to Australia. There might also be licensing and other requirements to adhere to (discussed below).

Market-Licensed Intermediaries (MLI's)

- Licensed Intermediaries provide the "board" on, which SPV's list and meet the crowd
- Licensed by Regulator, renewal based on Conditions
- Licensed Intermediaries provide no advice and reduce fraudulent activity through processes
- Intermediaries role
  - Vetting and qualifying Registered Users (Investors, Issuers)
  - Submitting to regulator Applications fit for assessment for new Entities
  - Counting statistics for use in various ways
  - Ensuring Plain Language Offerings and CSEF Education processes for Investors
  - Ensuring SPV-SPIV reporting obligations are met and enforceability capacity where not
  - "Close-outs" for SPV's that "graduate" from CSEF qualification
  - The means of imposing government limits on Investors
  - Funding the Ombudsman (should that be required) and
  - Ultimately (perhaps) the role of 'tax collector'.

(a) Should CSEF intermediaries be required to be registered/licensed in some manner?

Yes. This Submission recommends an annual licensing Regime. The process of obtaining a license would ensure that the holder understands the relevant laws and regulations governing the industry, only applicants with suitable qualifications could apply, that ongoing reporting obligations are complied with and so forth.

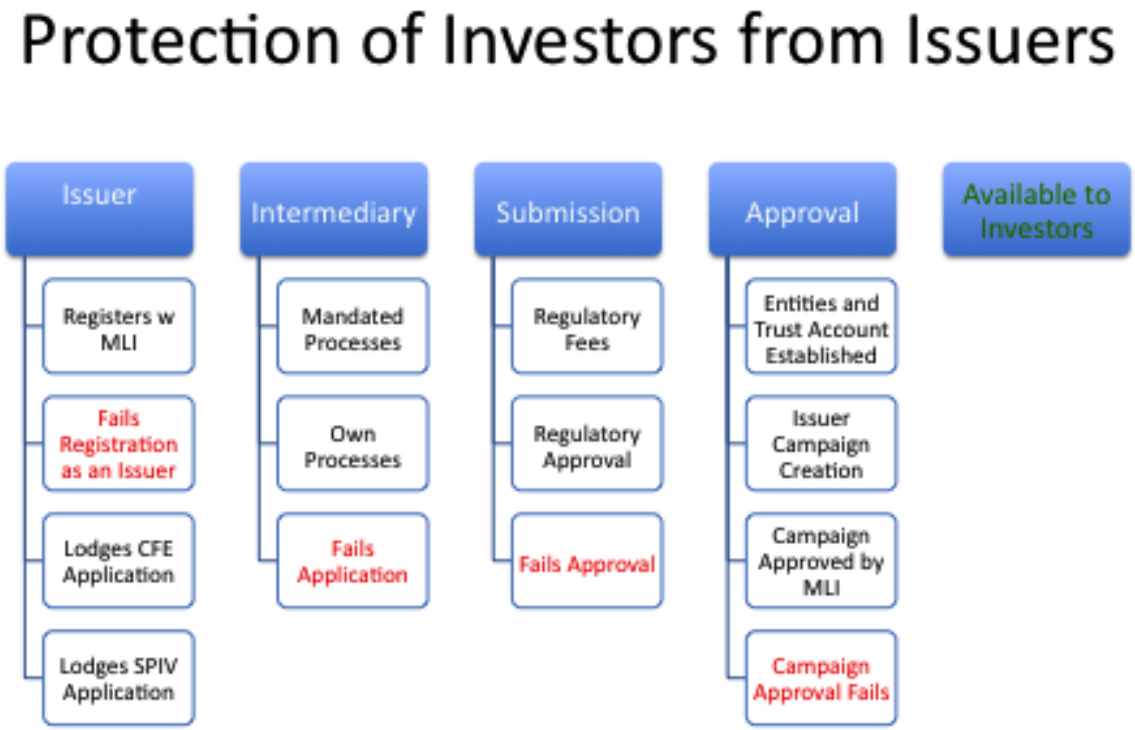
(b) What financial, human, technology and risk management capabilities should an Intermediary have for carrying out its role?

In order to be conducive to the establishment and growth of the industry whilst simultaneously maintaining harmony between it and the other conventional financial markets, the requirements should not be too stringent. However, the licensing process should require the holder to undertake a short course along the lines discussed in the preceding response, and it may be that two key Officers of the Intermediary hold sufficient qualifications, such as a bachelor's degree, in two or more of several areas, including law, economics, finance, accounting and so forth. There might be a subjective aspect for the Regulator to consider, such as the length and breadth of experience of the applicant.

(c) What fair, orderly and transparent processes must the Intermediary be required to have for its online platform

Registrations and Applications

All Issuers and Investors must become Registered Users - whereby the Market Licensed Intermediary gathers 100 points of ID and user account information required for creation of documents related to the CSEF Investment. This information will include Tax File Numbers, Home Addresses, Contact Details etc it will also include links to the Registered User's Social Media Accounts (where selected by the Registered User). All players in the system are then "known".



The MLI requires Issuers to complete an Application for CFE-SPIV entities - that are required to raise CSEF.

The Application documents require the Issuer to consider their Campaign and Offer, prior to launch. This focused questioning can be done online and the resulting answers can insert / delete replaceable elements of the following

1. The responses within an Application can cause replaceable language to be inserted / deleted / quantified into the Crowd-Funded Entity (CFE) Constitution
2. The responses within an Application can cause replaceable language to be inserted / deleted / quantified into the SPIV Charter.
3. The responses within an Application can cause replaceable language to be inserted / deleted / quantified into the Plain Language Offer that describes the deal to would-be Investors.

The Application can be reviewed by many Registered Users prior to lodging an Application

Plain Language Offer

Example 1: Plain Language Offer

- Campaign Name: Clovelly Food Syndicate
- Seeking: $150,000
- Offering: 50% of CFE to SPIV Investors
- Price Per Unit: $1500
- Unit equivalent in beneficial ownership: = 0.1% equivalent in CFE
- SPIV-to-CFE Purchase with Returns: Yes
- Ratio of Dividend: 50:50
- Capital Premium: 200%
- For each $1000 in Returns = $500 in dividends and purchase of of $500 more capital
- For each $1000 Beneficial Ownership Increase = .01875%

Example 2: Plain Language Offer

- Campaign Name: Coogee Food Syndicate
- Seeking: $150,000
- Offering: 50% of CFE to SPIV Investors
- Price Per Unit: $1500
- Unit equivalent in beneficial ownership: = 0.1% equivalent in CFE
- SPIV-to-CFE Purchase with Returns: No
- Ratio of Dividend: 100:00
- Capital Premium: n/a
- $1000 in Returns = $1000 in dividends and purchase of $0 more capital
- $1000 in Return, Beneficial Ownership Increase = 0%

Processes like these are relatively easy online and will enable all parties to correctly create CFE-SPIV application to the Regulator.

This will channel Issuers through all the considerations of their Campaign ahead of going 'live' with marketing and with attracting Investor funds.

The Registration of all Investors with each MLI should mean they are channelled through content about the inherent risks in CSEF vis-à-vis conventional securities and markets – regardless of which MLI they choose to invest with. This would be referred to as CSEF Education and include general warnings like the high probability that a CFE will not make a financial return and Investors are risking their money.

Then, prior to being able to invest in the SPIV an Investor must be taken through the specific deal by using the Plain Language Offer as a cover-sheet to any Campaign and associated marketing materials.

This Plain Language Offer being used as a cover-sheet allows Campaigns to be compared without reference to marketing materials. You can also advise Investors to seek independent Professional advice.

This disclosure method (Plain Language Offer) allows Investors the opportunity of calculating risk/reward on each deal they enter into. This would appear on-screen in a way similar to a software license and Investors would have to actively click they understand and accept the terms and conditions of the specific investment in order to progress.

The Regulator can enforce industry standardisation of both the general CSEF information (upon registration) and the way specific deals must express their terms and conditions (deal-by-deal) by insisting on clear documentation that MLI's must use. Thereby offering parity between deals offered on any of the MLI's.

Any savvy Intermediary might establish an online personal, confidential and secure portal enabling Investors to log in and view this information as relates to all of their investments, much like what is offered at least by retail industry superannuation funds. It may be that this, or an alternative mechanism that achieves the same or substantially similar purposes, becomes a requirement of registration of the Intermediary.

It should be borne in mind that intermediaries will have duties in protecting the privacy of personal information of Investors and Issuers. Between the ideas discussed in response to the other questions herein, and the usual disclosures required, for example, by privacy legislation, such as published policies regarding the collection, use and dissemination of personal information, not much else can or should be required.

(d) Should an Intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

Consideration must be given to the creation of CSEF Ombudsman – much like the TIO for telecommunications – this could be funded by a levy on all MLI's. However, the cost of running the Ombudsman may add a great degree of transaction and Regulatory costs, which may in turn hamper the establishment and growth of the industry.

In addition, no other investment market appears to have blanket recourse to such avenues. It is also important to note that, typically, for the reasons discussed elsewhere herein, it is likely that the majority of Investors will be less experienced and sophisticated, not only regarding

investments, but possibly also in matters of finance and law. That being so, to enable such a system might be to encourage unnecessary refereeing of misguided disputes. It may be that a balance can be struck, for example whereby Investors can refer matters concerning a failure to disclose to ASIC, or misrepresentations to Fair Trading NSW (or equivalent), even with minimum levels of investment in dispute required.

(ii) Intermediary matters related to Issuers: these matters include:

(a) what, if any, projects and/or Issuers should intermediaries not permit to raise funds through CSEF

Generally speaking, there should not be any restrictions on the types of Campaign able to raise funds through CSEF as long as they are new businesses and not seeking capital in excess of proposed limits.

(b) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on Issuers and their management

The Regulator could reduce uncertainty and risk by requiring Issuers and their management to be subject to Registration approval by MLI and then for Applications to be made to the Regulatory when creating the CFE-SPIV entities, as discussed elsewhere herein.

This would further reduce the risk of fraud, human error and so on. It could be achieved, for example, by way of digital statutory declarations and cross-checking accompanying completed Application forms.

(c) What preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by Issuers

As all the businesses would be new the due diligence is with the Issuer not the business – since the business will not have operated yet.

Similarly, control could stay with the Regulator through a periodical re-issuing of licenses. The onus could be put back onto the Issuer by also requiring them to disclose any material changes to the facts stated in their application forms as and when they occur.

(d) To what extent should intermediaries be held liable for Investor losses resulting from misleading statements from Issuers made on their websites

Joint and several (but perhaps not personal) liability, with the Issuer as discussed herein, might be suitable where the Intermediary is negligent, has breached a fiduciary duty or has fallen short of satisfying themselves, through independent means prior to accepting the Issuer's Campaign.

The MLI's should ensure through processes that material facts required to be disclosed to Investors and / or the matters, which must be disclosed to the Regulatory as part of the Application for registration process (discussed elsewhere herein). However, falling short of such

an event, an Intermediary cannot and should not be held responsible for the actions of another entity, particular where the Intermediary itself may be the victim of a fraud.

(e) to what extent should intermediaries be held liable for Investor losses resulting from their websites being used to defraud Investors

See answer to the preceding question.

(f) what possible conflict of interest/self-dealing situations may arise between Issuers and Intermediaries (including intermediaries having a financial interest in an Issuer or being remunerated according to the amount of funds raised for Issuers through their funding portal), and how these situations might best be dealt with

In response to the other questions, we have discussed various ideas, including the introduction of joint and several liability for Issuers and Intermediaries in relation to a failure to disclose or misrepresentation, specific duties of Directors and SPIV appointed Officers, personal guarantees and enforceable security, mandatory matters to be disclosed and reported on an ongoing basis (including the steps taken by an Intermediary to satisfy itself independently of an Issuer's claims) and so forth.

As such, there is no reason why such penalties could not be used in a targeted manner to also eradicate conflicts of interest. Considering that, in most cases, the Intermediary's consideration will be linked to the amount of capital raised and / or the performance of an Issuer, as opposed to a simple fee for time, if only due to the financial nature of Issuers participating in the market, to ban commissions or other performance-based incentives would probably be to doom the industry from the outset.

(g) what controls should be placed on Issuers having access to funds raised through a CSEF portal

As suggested elsewhere, the Intermediary should hold in Trust (similar to normal escow arrangements) the funds as they accumulate from investors. These would be released back to Investors if a target was not reached to launch the CFE (The Campaign was Unsuccessful). If the target was reached and the Campaign was Successful then the Trust would release funds to the CFE enabling the SPIV to take its stake.

(iii) Intermediary matters related to Investors: these matters include:
(a) what, if any, screening or vetting should intermediaries conduct on Investors

None of the qualifications required to achieve Sophisticated Status would be required. To qualify, we have already discussed the idea herein that Investors are required to run through a short internet-based module outlining the terms and conditions of the investment, the matters required to be disclosed, the risks and so forth. There will also be personal information collected by the Intermediary as a matter of necessity, from which the Intermediary can determine whether the investment would be permissible. Apart from this, and particularly given this is concerned with relatively minor investments, anything else might be excessive.

(b) What risk and other disclosures should intermediaries be required to make to Investors

See answers to previous questions herein

(c) What measures should intermediaries be required to make to ensure that any investment limits are not breached?

This issue could be dealt with quite simply. For example, the Investor might be required to submit to at least 100 points of identification upon Registration. This would enable cross-referencing against all other investments the particular Investor holds in other MLI's were MLI's allowed to share such information.

(d) What controls should be placed on intermediaries offering investment advice to Investors

To ensure independence and market integrity and to avoid being required to hold an AFSL License, all Market Licensed Intermediaries should never be allowed to offer or provide investment advice to Investors at all. If they are to be subject to a Market Licensing regime, this would be an ongoing condition of their Market License. They should always provide disclaimers and qualifications, with a recommendation that the Investor should seek the opinion of a financial or tax advisor, much like the common practice in other professions.

(e) Should controls be placed on Intermediaries soliciting transactions on their websites

No controls should stop the Intermediary offering its service as an Intermediary. However, as previously discussed in this Proposal the Intermediary cannot have preferences or give favouritism to the Campaigns on their site. Which means no 'staff picks', "What Is Hot" , "What is trending" to be used either in advertising externally or within the portal.

Likewise the Intermediary must not provide pro-active suggestions (aka Amazon) like 'you might like this…' or like Facebook 'Your friend liked this check it out'.

Registered Investors however should be able to set alerts to be advised when something that matches pre-defined criteria of interest to that Investor is made live.

(f) What controls should there be on intermediaries holding or managing Investor funds

For the protection of Investors, a relationship of trust or fiduciary should be established and maintained. No matter what the precise nature of the sum in question, Investor funds should be held on trust unless and until released to the Issuer. A regime should be put in place for the operation of trust accounts, much like those currently used in the legal profession, for example. Investor funds should then only be released to Issuers at such point in time when all requirements have been met. For example, as discussed elsewhere herein, if a minimum amount of investment is required to be received or pledged, whether or not making provision for cooling off periods or otherwise, it might be a breach of trust to release funds to Issuers until that amount has been reached, time limits for the exercise of Investor rights have closed and Investors have been notified. Funds should only be able to be returned to Investors in the event that the investment will not proceed, and Intermediaries would only ever receive consideration from Issuers once all requirements have been met.

(g) What facilities should intermediaries be required to provide to allow Investors to communicate with Issuers and with each other

In line with this Submission a CFE can generally solicit for the duration of a Campaign. An Intermediary may allow that a Campaign page operated by the Issuer be used for the purpose of updating the Campaign.

Committed Investors would be in contact with Issuers via Social Media and such during the life of the Campaign and hopefully have a good on-going business venture.

According the Proposals made in this Submission. The SPIV appointed Officer and use of digital polling of SPIV members (Investors) can be used to gauge the preference (not vote as it would apply to shareholders) of members in relation to the CFE and its operation and strategy.

This could be communicated on or off the MLI. To manage it – perhaps on the MLI website is best.

(h) What disclosure should be made to Investors about being able to make complaints against the Intermediary, and the Intermediary's liability insurance in respect of the role as an Intermediary

The extent of this disclosure should be no greater than with any other industry or profession. Investors should be informed of the fact that they can make a complaint and to whom, for example if intermediaries are subject to an as yet created CSEF Ombudsman.

Investors should also know about Fair Trading NSW (and equivalents), ASIC / the ACCC and so on, whether or not they have adequate insurance (which might be a requirement to their registration and operation) and whether their liability is limited by any professional standards legislation scheme.

It is the proposal of this Submission that the Insurance requirements of MLI be substantially relaxed as it would be better as discussed elsewhere if this Submission if the MLI did not have an AFSL License and did not offer advice.

(i) What disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

The MLI's should be required to clearly articulate the fees (upfront, commissions or ongoing) that it takes for it's services. This will quickly provide price-parity between all MLI's and most of the operational-parity is achieved by adherence of the MLI's to License conditions granted to it by the Regulator.

(j) What, if any, additional services should intermediaries provide to enhance Investor protection

Adding too much to the work required of intermediaries will change the economic dynamics of their relationship with Issuers. The more bespoke work required, the more consideration they will expect, and be entitled to receive. The more consideration they are entitled to receive, the less affordable their services are to Issuers and / or the more Investor funds required that go towards this end, rather than the ultimate purpose of the issuing entity. This is likely to dampen the establishment and progress of the industry.

Provided the Intermediary complies with disclosure requirements and ongoing reporting obligations (discussed elsewhere), and has some form of mechanism in place to respond to Investor questions without going so far as to provide financial advice (discussed elsewhere), there should be no further obligations imposed on intermediaries.

Question 7 In the CSEF context, what provision, if any, should be made for Investors to be made aware of:

(i) the differences between share and debt securities
(ii) the difference between legal and beneficial interests in shares
(iii) any classes of shares in the Issuer and its implications for Investors. A related question is whether disclosure, alone, would suffice.

(i) The differences between share and debt securities

This Submission recommend we see all CSEF Investors holding stakes via a SPIV.

Notwithstanding It makes sense that all Market-Licensed Intermediaries (MLI's) have to provide to registered Investors a cache of documents, disclosure and education about general CSEF offers. This information would include differences between CSEF and their SPIV Investments and those of other security types (debts and equities). These differences include such things as voting, rights of sale and other specifics.

It would be the recommendation of this Submission that the Regulator mandate all Market Licensed Intermediaries so that they provide standard information prior to allowing would-be Investors to become actual SPIV Investors.

Moreover we recommend that each CSEF offer should be easily compared:

- How much is the CFE trying to raise?
- What are the funds to be used for?
- How much does a SPIV unit cost?
- How much of a Project is held by the Issuer and the Investors in this CFE-SPIV?
- How much does the Issuer project this deal will be worth?
- Does the CFE imagine an exit to a normal company structure because of furture capital requirements?
- Does the CFE plan to have the SPIV buy-in further in the future?
- At what premium will the SPIV buy the CFE?
- If the SPIV is buying out the Issuer from the CFE, what sort of return is the Issuer going to receive in total?
- If the SPIV is buying out the CFE what is the rate of dilution? How long will it take?

- Are there any relevant threshold points?

If this were upfront it could ensure all players – Issuers, Intermediaries and Investors - had the opportunity to understand what they are participating in at a broad level and make the industry accountable to Licensing requirements of the Regulator.

Subject to differences between Issued opportunities and subject to Intermediaries and their different business models, it would be possible and advisable that any particular deal should describe in Plain Language Offers what it is in regards to; security type, voting, rights of sale etc

This could be mandated as part of Licensing the MLI's and thus provide impetus for Issuers to list and disclose the Offer in Plain Language that is easily understood by "retail investors" / "Crowd".

This would be in the spirit of clear labelling. Declaring contents of a deal and labelling on the coversheet (behind which sits an Issuers various marketing materials for their Campaign) Perhaps this could use a standard table of Terms/"Ingredients" as suggested elsewhere in this Submission.

It may be possible to say give a band of CFE-SPIV classes a risk-rating or warnings where appropriate.

You could even go further with maturity of the industry. As an illustrative example, there may be a "healthy heart tick" of approval that deal Issuers seek to attach to their Campaign in the same way food labelling often seeks 3rd party endorsement of Origin, Organic status, GM status or such.

Alerting would-be Investors to risks generally upon sign-up with a MLI and detailing to Investors committing to a deal about specific risks via the Plain Language Offering acting as coversheet to the Campaign provides clear disclosure processes and is a good thing and should be a conditional requirement to the ongoing Licensing of Intermediaries.

Therefore, in answering the specific question: should the differences between share and debt securities be advised to Investors – Yes. But this Submission recommend we see all CSEF Investors holding stakes via a SPIV.

(ii) The difference between legal and beneficial interests in shares

Should the differences between legal and beneficial interests in shares be disclosed to Investors – Yes. Again in this Submission we propose that it's clear to all CSEF Investors that they are beneficial owners via the SPIV.

Another disclosure required by all Issuers for the benefit of all Investors is the difference in type of share issued to

- The CSEF Investor (held within the SPIV) when compared with

- Normal share classes that are usually attributed to Issuers (Founders),
- Or later stage (post CSEF-Investors) Investors that are pre-committed using some sort of match-funding scheme

Match Funding

This match-funding could happen when / if certain goals are reached and Government at any level - Local, State or Federal - could reasonably promote (public-private) investment for desirable industries i.e local energy / food / waste projects. Already government bodies match funding with the crowd on pledge-based sites for various arts and cultural outcomes. Why not in Crowd Sourced Equity Funding.
This may not be limited to just Governement funding. For instance, say a clean tech fund with a 10-year lifecycle wanted to match a years worth of clean tech projects that are crowd funded with the proviso that the SPIV buys out the clean tech investment funds at the same time as the Issuer according to pre-published dilution schedule based on returns of dividends to the SPIV. This would provide fund managers with a known buyer and known premium over the 10 years of a typical clean tech fund.

As CSEF is generally for seed-stage funding the complexity of share rosters should not be high. The real issue is in making the shareholding disclosure obvious prior and upon investment, as the business is probably not operational until after the CSEF funding is completed.

In line with normal annual reporting to shareholders CSEF-derived businesses would report changes to the share register and any issuance of new capital. This would be communicated to CSEF Investors for marketing purposes and for the proper governance of the entity going forward.

An issue raised by Angel Investors and VC Investors with CSEF appears to be making sure that if they come in after an initial CSEF raise that they can operate the business with as little friction between and from the many small Investors that make up the round. CSEF should encourage not discourage later rounds of funding and again this may be achieved through the use of stapled trusts to beneficially hold the interest for all CSEF participants. If this structure is used then it should be correctly labelled as described earlier.

Managing the relationship a business has with CSEF-shareholders after the funding round has been completed should not be the role of the Intermediary, but should be pursuant to existing reporting norms for all private and public companies that need to prepare accounts for tax purposes at least annually.

In most cases, the crowd would be kept upto date by the Issuer as the crowd is analogous to a marketing vehicle for the Issuer.

Q 8 What provision, if any, should be made for each of the following matters as they concern CSEF Investors:

(i) permitted types of Investor: should there be any limitations on who may be a CSEF Investor
(ii) threshold sophisticated Investor involvement (Italy only): should there be a requirement that sophisticated Investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other Investors
(iii) maximum funds that each Investor can contribute: should there be some form of cap on the funds that an Investor can invest. In this context, there are a number of possible approaches under Issuer linked caps and under Investor linked caps
(iv) risk acknowledgement by the Investor: should an Investor be required to acknowledge the risks involved in CSEF
(v) cooling off rights: should an Investor have some right of withdrawal after accepting a CSEF offer
(vi) subsequent withdrawal rights (Italy only): should an Investor have some further withdrawal right subsequent to the offer
(vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF
(viii) reporting: what ongoing reporting should be made by the Intermediary and/or Issuers to Investors in regards to their investment
(ix) losses: what recourse should Investors have in relation to losses resulting from inadequate disclosure
(x) remedies: what remedies should Investor have in relation to losses results from poor management of the enterprise they invest in

(i) permitted types of Investor: should there be any limitations on who may be a CSEF Investor

Not at all. The central tenant and the whole premise of the CSEF idea is to enable small levels of capital raising from a large number of persons. Provided a sufficient balance is struck whereby the least sophisticated Investors are in an adequate position to understand the inherent risks, then there is no need to restrict such offerings to anyone else who will naturally be better equipped to do so in any event.

(ii) threshold sophisticated Investor involvement (Italy only): should there be a requirement that sophisticated Investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other Investors

While the logic behind the Italian approach in this regard is apparent, this should not be a general requirement for several reasons. The first is that, as the CAMAC paper itself discusses, the types of Investors we expect to see participating in this market will generally be more susceptible to representations, or generally more impressionable, if only owing to the small scale of their investments and the economic and demographic factors that will be typical as a result.

An Investor who invests without such an Investor leading by example is more likely to have considered the investment in greater detail, and the need for such issuing entities to secure such an Investor may prove prohibitive. After all, when talking typically of relatively small investment requirements, if the Issuer was in a position to achieve this, in all likelihood, it would not be operating in this market.

On the other hand, such Investors may be prepared to take a gamble with a small investment they could write off without much harm, which in effect would mean their involvement in that particular investment does nothing more than send false signals to the market, potentially to the detriment of the majority of (smaller retail) Investors.

(iii) maximum funds that each Investor can contribute: should there be some form of cap on the funds that an Investor can invest. In this context, there are a number of possible approaches under Issuer linked caps and under Investor linked caps

Generally speaking, the market should be as liberal as possible. However, there is of course a legitimate need to protect a new class of Investors in a new market of lower disclosure. There is also a great concern for fraud and other losses accruing from ill-prepared Issuers, but of course, the concern is with some, not all, investments, and should not be a bar to the industry in general.

It is the proposal of this Submission that the US example – limiting the monetary amount that an Investor may invest in each CSEF Issuer in one year – seems to strike the right balance.

This Submission recommends no more than $500k per Investor per Issuer and no more than $5m in a single year by an Investor. This is in line with each CFE having a Capital Fundraising threshold of $5m.

For obvious reasons, such an approach would limit the risks to Investors, encourage diversity in their portfolios, promote competition (for performance and disclosure) among Issuers and intermediaries, and encourage and allow for maximum participation in (thereby enabling the greatest utility derivation from) the industry as a whole, when compared to any of the other options discussed.

(iv) risk acknowledgement by the Investor: should an Investor be required to acknowledge the risks involved in CSEF

Yes. Online acceptance of terms and conditions is the first place to start. Such mechanisms would serve to make the Investor stop and actually think about what they are doing, and to assist them in overcoming indecisiveness at an earlier stage prior to making their decision to invest. In addition, it would serve to protect genuine and honest Issuers and intermediaries. Moreover, this could reduce the costs associated with regulation and enforcement to a great degree in the long run, for obvious reasons.

It may be that a more sophisticated approach to the online “click a button” type of acceptance is mandated, whereby Investors must complete an online questionnaire or tutorial specifically designed to require thought and considered responses. This could be one of the functions of intermediaries – to develop, implement, assess and report.

Generally speaking the MLI's should be advocating that before an individual invests they make sure they have consulted with a Professional Accountant or similar.

(v) Cooling off rights: should an Investor have some right of withdrawal after accepting a CSEF offer

No. Put simply, this is not conducive to this market at all. Investors will typically be more indecisive, having much less experience than sophisticated Investors, and therefore such an option is likely to invite and encourage withdrawals.

The Intermediary will instead hold all SPIV funds in Trust until it is clear that the Campaign has met or exceeded the required minimum capital being sought for the CFE to go ahead. Should it not go ahead then the Investors funds (held in Trust by the Intermediary) will be returned (less fees if applicable).

(vi) subsequent withdrawal rights (Italy only): should an Investor have some further withdrawal right subsequent to the offer

No as this becomes a secondary market and that's not advisable

(vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF

Yes. Generally, Investors via the SPIV have no right to sell as proposed in this Submission.

(viii) Reporting: what ongoing reporting should be made by the Intermediary and/or Issuers to Investors in regards to their investment

As discussed above, it is generally desirable for Issuers to fulfill reporting functions to Investors in a similar manner to the way Private Companies report to shareholders.

In addition to this, what would be more useful is if the short-term business plan and targets were disclosed, to some extent, to be used as a benchmark for Investors to track the progress of their investment. Obviously commercially sensitive information would need to be protected, but it may be that certain high-level information could be published, and progress monitored and measured against goals at various intervals of time.

These updates could post within a Registered Users account within each MLI.

(ix) losses: what recourse should Investors have in relation to losses resulting from inadequate disclosure

There are several remedies for inadequate disclosure we have discussed herein including Liability and or civic penalties.

(x) remedies: what remedies should Investor have in relation to losses results from poor management of the enterprise they invest in

We have discussed above the idea that Issuers and intermediaries should be liable to repay an investment plus interest in the event of certain (mis)conduct, and that Directors or other officers might be personally liable and may have to provide enforceable security to the Regulator for this purpose.

There does not appear to be any reason why Investors should have redress in relation to poor management. Poor management is too prevalent and subjective to be basis for refunding investment.

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained Regulatory regime for CSEF?

Square peg, round hole

The answer to this question will vary depending on who is making the Submission. This Submission poses the idea that it is right to make fresh legislation to govern CSEF. This will mean more work by the Regulator and industry initially but will be a better, clearer, smarter move than legislative creep.

The analogy is that we shouldn't force a square peg into a round hole. The current legislation is deficient (as explained earlier) and so the job is not just to change that legislation that works well for its purposes. Instead it is to create legislation fit for new purposes. This is why we should make fresh legislation in one go and not change existing legislation that works.

The evidence of those internationally making incremental adjustment doesn't support the argument for incremental legislation. The US has phased in 3 Regulatory sets of changes in JOBS Acts Chapter I, II, III. This is making money for lawyers and not being as effective as it could be.

A clearer set of new rules for new businesses provides greater efficiency in the market when compared with US when it comes to CSEF. We can learn from our foreign competitors and trading partners and avoid their mistakes.

The obvious drawback of incremental adjustment is that it forces platforms (Intermediaries) Issuers and Investors to have a changing landscape during infancy. Some settling in of the changes just made are unsettled with further changes. This reduces confidence in this investment class because the question of doubt of the Regulatory environment keeps shifting.

A less obvious issue with incorporating changes to existing Regulatory regimes as governed by the Corporations Act is that it will allow existing businesses to change their current structures. If we make fresh legislation for CSEF and aim CSEF only at newly created vehicles within that Regime then everyone who is currently in the market stays in the game rules that they entered into already.

Lets look at an example. If CSEF legislation is made through relaxing or extending provisions of the current Corporations Act, then all private companies (Pty Ltd's) have something new to consider i.e are they eligible for CSEF structures and fundraising.

That's a massive, massive impact on the broader economy. If legislation is made just for new companies that wish to use CSEF in their "birthing" then the rest of the economy motors on unaffected and not distracted from their core business.

Taking the example further, there may be structures like co-ops that currently operate in a well-governed regime. If you create CSEF legislation within the existing regime, these co-ops may try and "bulk-up balance sheets" and "create scale" by using CSEF to fund expansion. CSEF is not for expansion capital it is the home of seed capital.

The transition of co-ops moving into a CSEF context would reduce the co-ops reporting requirements and raise a risk that wasn't even there before. Let alone the risk to existing co-op members that a co-op enters into if it intends taking their capital mixing it with CSEF Investors and embarking on ambitious business plans.

So as to prevent upheaval with the introduction of incremental changes, legislation would provide only for new businesses that start their first day within a fresh Regulatory framework. Existing businesses would have to be excluded.

Details of the Regime

A self contained Regulatory regime needs to be defined (even broadly) for it to be on the table and so included here is a method. There may be more appropriate methods than this develop. But this could work…

Firstly you need to create two types of new entity.

Entity 1. Entity for Issuers - This is called a Crowd-Funded Entity (CFE)

A Crowd-Funded Entity (CFE) is a new entity and is created by the Regulator in accordance with an Application made by the Issuer and submitted through a Market-Licensed Intermediary (MLI). An Issuer creates a CFE when they wish to raise Crowd Sourced Equity Funding (CSEF).

The Issuers' CFE will become the commercial vehicle (if funded) that operates day-to-day like a Pty Ltd. The CFE offers equity via the Single Purpose Investment Vehicle (SPIV) to the "crowd" of Investors

The CFE is allowed to generally solicit, to anyone (regardless of sophistication) for any amount below say $500,000.

The CFE can solicit for funding, but in actuality the crowd funds will be held in Trust by the MLI until a Campaign is successful. (Unsuccessful Campaigns return Investor funds held in Trust to the Investors). At that point a Single Purpose Investment Vehicle (SPIV) makes the Investment on behalf of the Investors ("the crowd"). Then the CFE receives it's CSEF.

The CFE is run according to a Constitution that contains non-replaceable items that govern behaviour and replaceable parts that are determined by the Issuer when making an Application. The specific nature of the Application is reflected in the specific nature of the CFE Constitution.

Moreover, the Constitution dictates to replaceable parts of the SPIV Charter (to be explained further later) and the Plain Language Offer (to be explained in detail later)

The CFE has disclosure and reporting obligations to the SPIV because the SPIV will have rights (equity) in the CFE. Notwithstanding the obligations on the CFE most CFE's will want an ongoing relationship with the crowd of Investors.

A CFE may be "closed" from further funding on any Market Licensed Intermediaries after receiving CSEF funding of no more than $5million.

A venture that is started as a CFE with a stapled SPIV that is seeking further funds in excess of $5m is like any other business and would need to "Convert" to the familiar Private or Public Company structures to seek Angel Funding or similar methods of financing according to their needs.

A CFE could according to the pre-agreement with the SPIV be purchased by the SPIV for a pre-disclosed premium – turning full ownership of the CFE over to the SPIV. This provides a new (non-traditional) exit mechanism for the Issuer (entrepreneur) who created the CFE.

As a new type of Investment CFE's could be perfect for "Big Capital" and "Little Capital" partnership. A CFE opens CSEF to matched-funding opportunities with governments and large managed funds – generating a new "loop" in the economic system.

A CFE can generally solicit as long as they declare they are a CFE in their advertising. The CFE can only generally solicit for the term of their Campaign.

A CFE can not raise CSEF funding directly only via a SPIV and only via a Market Licensed Intermediary.

A CFE can have more than one Issuer allowing Founders and Angel Investors to align before the CSEF raise as long as disclosed - or after the CSEF raise, as long as the type of security does not diminish the SPIV rights or dis-proportionally. The simple solution would be to have funders of the CFE with the same security as the Issuer (Founder)

A CFE otherwise works like a private company (Pty Ltd) and should be able to easily convert to this more traditional business structure should its needs change.

Entity 2. Entity for Investors - This is called the Single Purpose Investment Vehicle (SPIV)

A SPIV can have unlimited numbers of "shareholders" or Members – although these people would probably be unit holders in something akin to a Beneficial Trust. The role of the SPIV is exclusively to hold the many Members (Investors) beneficial interests.

A SPIV cannot employ or engage in any commercial agreement aside from the agreement with the CFE, but this may include a trigger that allows the SPIV to assume greater and eventually full ownership of the CFE under certain pre-agreed circumstances

A SPIV will be governed based on the SPIV Charter that was created by non-replaceable parts that look at rules of operation including the way people cast preferences (not “votes”) and replaceable parts that were chosen when the Issuer made Application for the CFE.

A SPIV may poll its members for their preference regarding a decision the CFE intends to make. This preference collection system would be digital and binary. Based on a majority of units preferences the SPIV would take a position and its proportional equity in the CFE and would vote accordingly.

A SPIV would have a volunteer (or be provided a professional one in the absence of a volunteer) who would be known as the SPIV appointed Officer. They would personally represent the SPIV Charter and SPIV within the CFE decision making.

A SPIV is open to all CSEF Investors regardless of “sophistication” status

A SPIV cannot have a single Investor, must be plural, otherwise it is not a crowd.

A SPIV is otherwise like a Trust where it vests returns in full to the members i.e the people who tipped in funds (unless otherwise disclosed and pre-agreed prior to CSEF funding where it may use Returns to buy additional equity from the Issuer)

The CFE-SPIV is a Set of “stapled” Entities

A CFE cannot raise CSEF funding directly only via a SPIV and only via a Market Licensed Intermediary.

The CFE-SPIV-Plain Language Offer are all created by the Issuer when establishing their CSEF Campaign within a Market Licensed Intermediary. The Application for the CFE-SPIV (if approved) causes the CFE and SPIV to be created by the Regulator and then to the Issuer.

The use of CFE-SPIV structures is particularly useful for local community projects where an Issuer (local entrepreneur) may initiate the project and then sell the project to the local community that uses it and who are also SPIV members.

The use of CFE-SPIV entities would be no hindrance to start-ups seeking later rounds of funding as they grow, as the later-round of Investors can buy directly into the CFE (as if it were a private Pty Ltd company) and the SPIV carries the CSEF-raised portion on behalf of the SPIV members.

The use of the CFE-SPIV set of entities is confined to new businesses. However, forming the Regulatory environment for these new entities must make it easy for the CFE to convert to a traditional private or public company.

Next would be required new legislation to govern the entity rights and wrongs in detail and make these form the basis of the CFE Constitution and the SPIV Charter.

Market Licensed Intermediaries

The fresh legislation would establish and conditionally License Intermediaries to manage the CSEF Market(s).

To manage the market and enforce the new laws for new entities you'll need a Market-Maker or Market Licensed Intermediary (MLI) with the following characteristics:

Market Licensed Intermediaries (MLI's) provide the online portal on, which CFE's list and meet the crowd who invests in them.

MLI's are Licensed by the Regulator (ASIC), and the License renewal is based on Conditions

Market Licensed Intermediaries (MLI's) provide no advice and reduce fraudulent activity through processes that manage the interaction of Issuers and Investors

The MLI's role includes but is not limited to:

MLI's are naturally the place for vetting out fraudulent Issuer and qualifying any Project listed as "fit for CSEF"

MLI's would be used for counting statistics for use in various ways by the Regulator or the MLI

MLI's are useful agents in ensuring CFE-SPIV reporting obligations are met and have an may have an enforceable capacity (although that would be best achieved legislation and process clarity) where these are not being met. Holding the MLI financially liable for this makes it in their best interest to do a good job as does the annual License renewal.

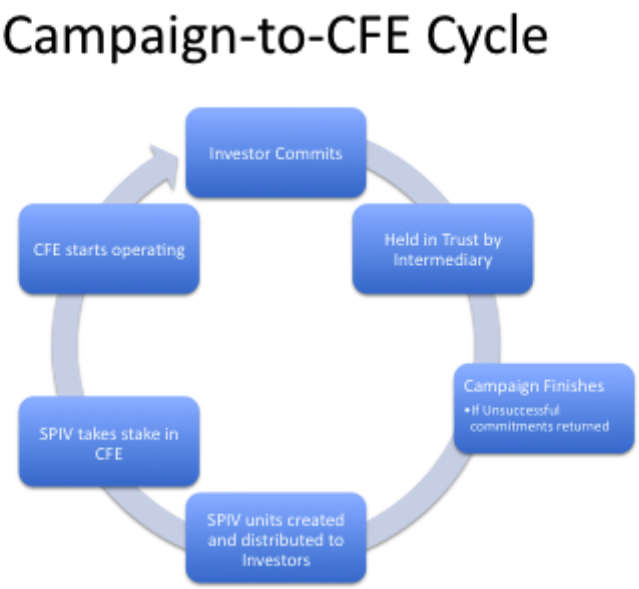
MLI's are the centre for "Close-outs" for CFE's that commercially fail and need to be directed into Administration or for those that are successful and need to "convert" from CSEF qualification to another more traditional structure like a Private Company or a Public Company.

MLI's would have the means of imposing government limits on Investors and Issuers if they shared Registered User data about Investments made by Investors.

MLI's ultimately could play the role of 'tax collector' if taxation of this investment class were sought.

In order for these fresh laws to integrate with the existing laws of the Corporations Act you must consider the process of either drafting a new Chapter in the Corporations Act or a New Act.

The Top Level Process



1. Issuer creates CFE-SPIV
2. CFE-SPIV campaign is listed on MLI and then advertised
3. Investor invests in SPIV
4. SPIV gives funds to CFE,
5. CFE gives equity to SPIV

Then,

1. CFE operates like Pty Ltd returning funds to owners - or
2. CFE graduates structure (to Pty Ltd or Ltd) and carries on with SPIV as shareholder polling the interests of the crowd. (n CFE can change to Pty Ltd of Ltd so long as it is without diminution of SPIV rights) - or
3. SPIV can purchase the CFE on certain triggers for dilution disclosed at the point of funding

Whilst the above processes may seem tiresome on paper – they are actually feasible ideas and quite simple. Simplicity is key to clarity and clarity rather than favouritism is what is needed for CSEF to be a good economic force liberating time and capital.

At the risk of repeating our Submission points, the fundamental reason to not make incremental changes to existing legislation and within existing legislation as mere “exemptions” is that it DOES NOT make the rest of the economy simpler. Because existing business can participate in already established frameworks and must be excluded from this new framework, which is for seed-stage funding.

Make It Simple, Make It Local

Legislators need to view CSEF only within a start-up context. However, they should not limit their imaginations to tech start-ups, which are notoriously high-risk, high-return and high profile.

Instead they should look to see how community groups and local economic groups will use fresh CSEF legislation to co-own local infrastructure that provides services close to the point of production. This sort of local economic stimulus is low risk / low return and is more often a facilitator of cheaper and better services for Investors who are also consumers of the product (Customers of the business).

As an example, you can imagine many 10,000-person-communities (call it a suburb) where 1000-people (10%) within that community, might be willing to invest $1000 each into a local Energy project for capture, storage and distribution of solar energy locally. The combined $1m from the CSEF raised allows the community to build something that not only will the 1000 Investors use but so would the remaining 90% of their neighbours if it were to exist. Each community may want a number of projects specific to their local area for other industries like: Food, Education, Energy, Water, Waste, Social Services.

Local communities would (if given fresh the regime proposed in this Submission) have the means of creating these pieces of infrastructure. These infrastructure projects inherently have a close point of production and consumption and are cheaper than alternatives purchased outside the community.

These are the sorts of business models that the UK is seeing emerge in addition to the high tech start ups. The US in the meantime has not seen growth in this local economic sector despite the JOBS Act being inspired in part by this local infrastructure ideal.

3 Potential CSEF outcomes

1. Do nothing – favoured by those who believe that if it ain't broke don't fix it. They rightly point out that the Australian economy is the envy of the world - or
2. Make incremental (retarded) changes within existing framework. Causing confusion across large parts of the established business environment. - or
3. Do it right with a fresh regime allowable only for new businesses.

This includes

- 2 new entity types specific to new CSEF businesses – one for Issuers and one for Investors
- New laws governing these types of entity which mirror a private company (Pty Ltd) and "stapled" trust.
- For only these new entities you would relax laws on solicitation to Investors and the sophistication of those Investors.
- A new Market Licensed Intermediary would enforce processes that govern the market behaviour.
- The special entities purposefully can "graduate" and convert to other structures for further funding rounds or exit options that are newly created by the crowd such as

dilution of the Issuer by the crowd ownership vehicle over time - a community buy-out, as it were.

Question 10 What, if any, other matters which come within the scope of this review might be considered?

What relaxation of the Sophisticated Investor status will mean?
What relaxation for start-ups on the rule of general solicitation will mean?
The Insurance Policy if CSEF is wrong for Australia?

What relaxation of the Sophisticated Investor status will mean?

An Ombudsman

When we allow retail Investors to commit funds to projects with a real risk that they may not see a return on these funds you have to consider creating an Ombudsman, similar to the TIO. Perhaps funded by the Market Licensed Intermediaries or government Regulator or both through a levy on funds raised.

This CSEF Ombudsman will make changes to the processes Intermediaries enforce on Issuers and Investors based on what does and doesn't work at reducing risk and improving performance of CSEF-derived entities.

Caps

Simple things like ensuring that Investors and Issuers abide by any mandated caps on Investors and intake of capital respectively (a CFE should convert if it takes in more than $5m) make sense.

Plain Language Offers

As does plain language product labelling what we call Plain Language Offers. When dealing with unsophisticated Mum and Dad investors the industry should be forced to call a spade a spade. Complexity hides stuff. CSEF should be simple, cheap and effective because of the combination of processes and the "crowd".

Generally speaking the amounts invested will be small and all Investors should be given buyer beware information about CSEF Offers and Specific Information on each Issue to make sure they can make informed decisions.

However, the more complex the regulation makes it (for example incrementally changing things or allowing existing market participation) the further from the goal we take CSEF and therefore the less efficient it will be at creating economic stimulus through the creation of new enterprises.

What relaxation for start-ups on the rule of general solicitation will mean?

These new businesses (CFE's) are seedling ideas and if they are to be funded they need to be advertised within the platforms at a minimum. However, the desirable outcome is that any CFE

can advertise on any medium to anyone within the time frame of their Issue as long as they clearly state they are a CFE.

Allowing CSEF-born start-ups to generally solicit only during their period of a Campaign means you won't encourage existing businesses that may otherwise want the right to generally solicit. Once the Issue is full or the timeline expires for a Campaign, then the CFE will no longer have the right to continually generally solicit.

If a business wished to continually generally solicit then they should be a Public Company with associated IPO and Product Disclosure.

CFE advertising in this space will get more creative - for better or for worse - and that will allow those that do it well to draw more attention and probably funds than someone that does it badly.

However, when someone arrives at a Campaign the landing page must be the Plain Language Offer that acts as a cover-sheet requiring the Investor to click and accept before moving into greater detail.

Moreover, it becomes a statement for the company soliciting funds about who and how they advertise. Their Investor advertising and communication, which under CSEF conditions is much expanded, becomes the "brand" for that business/entity.

If we had "free for all" solicitation in Australia for all companies (if say you relaxed the provision within the current regime and allowed everyone to solicit) it would probably add more junk mail to already full inboxes.

The Insurance Policy if CSEF is wrong for Australia?

This Submission is promoting a Regime of fresh legislation, for fresh companies, with fresh entity types and fresh Intermediaries. This has an inbuilt "insurance" mechanism if the resulting behaviour is unacceptable. It can be easily un-done.

If however, the government does CSEF in increments and within the current regime, if it is ever in the position of winding back CSEF legislation it would be much harder and much more expensive to un-do.

RE: regulatory regime for crowd sourced equity funding

Thank you for the opportunity to respond to the discussion paper on crowd sourced equity funding (CSEF).

My role as NSW Small Business Commissioner is to advocate on behalf of and support small business by:

- Providing dispute resolution services;
- Delivering quality business advice through the Small Biz Connect program; and
- Speaking up for small business within government.

Small businesses represent 96 per cent of all businesses in NSW. There are an estimated 680,000 small businesses which employ nearly 50 per cent of the State's workforce.

Access to finance is a significant issue for start-ups and small businesses. According to Australian Bureau of Statistics data, access to finance is the number one barrier to innovation for Australian businesses and the third largest barrier to general business activity.[1]

Research carried out by Deloitte Access Economics estimates that about 10 percent of Australian SMEs – or around 200,000 businesses – have difficulties accessing finance.[2]

Furthermore, NSW Business Chamber survey results show that 30 percent of businesses surveyed perceived that they had missed an opportunity in the two years to July 2012 due to a lack of credit, and 50 percent of those who had loans applications rejected reported that it significantly constrained their growth.[3]

Moreover, NSW Business Chamber survey results indicated that 20 percent of businesses who had loans rejected had to lay off staff or saw their chances of bankruptcy significantly increase.

[1] ABS Catalogue 8167.0 - *Selected Characteristics of Australian Business, 2011-12*
[2] Deloitte Access Economics and Professor Marc Cowling for the NSW Business Chamber, *Small Business Access to Finance*, 2013, p.7
[3] Deloitte Access Economics and Professor Marc Cowling for the NSW Business Chamber, *Small Business Access to Finance*, 2013, p.9

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Given the importance of start-ups and small businesses to the overall economy, difficulty in accessing finance thus has the potential to significantly curtail economic growth, investment and employment.

I believe that CSEF has the potential to be a valuable complementary source of capital to the traditional providers in the market, offering finance to businesses currently struggling to source investment.

CSEF is a relatively new and evolving form of capital raising. Broadly, it refers to schemes through which a business seeks to raise funding, particularly early-stage funding, through offering debt or equity interests in the business to investors online. Businesses seeking to raise capital through CSEF typically advertise online through a crowd funding platform website, which serves as an intermediary between investors and the business.

CSEF is currently possible under the existing Small Scale Offerings of Managed Investment and Other Prescribed Financial Products Exemption (Section 1012E of the *Corporations Act 2001*). However, in order for CSEF to fully develop in Australia, some changes to the regulatory regime are required.

A key priority should be to cultivate CSEF as a vehicle for economic growth and innovation, with appropriate protection for investors, without creating excessive compliance and administrative burdens for businesses.

To this end, I believe that the following points are essential components of an optimal regulatory regime for CSEF in Australia (these are expanded on in the table on page 4 of this submission):

- Businesses should be allowed to raise up to $5 million per annum through CSEF;
- Crowdsourced equity funding offerings should be permitted to be advertised, albeit in a limited fashion;
- Unaccredited investors should be permitted to participate in crowdsourced equity funding offerings;
- Proprietory limited firms should be permitted to make crowdsourced equity funding offerings;
- There should be no restrictions on the type of issuer, in contrast to the situation in Italy for example, where CSEF is limited to “innovative start-ups”;
- There should be no ban on secondary markets;
- Attempts should be made to educate investors in order to minimise risk;

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- The restriction on the number of investors should be raised from the current 20 in any 12 month period, contained in the small scale personal offers exemption, to 100;
- There should be a 10 day cooling off period;
- A transparent, mandatory code of conduct should be established; and
- Research on CSEF (and crowdfunding generally) should be encouraged.

I also advocate that a new, standalone legislative regime for the regulation of CSEF in Australia should be implemented.

However, irrespective of which option for the regulatory arrangements for CSEF is adopted by CAMAC, it is essential that excessive compliance and administrative costs are not imposed. For example, onerous licensing requirements for intermediaries and excessive disclosure requirements for companies utilising CSEF would be counter-productive and must not be imposed.

This is as important as the actual architecture of the regulatory arrangements adopted, such as broadening the current small scale personal offers exemption or a standalone structure.

Should you wish to discuss any of the issues raised in this submission further please contact Adam Spivakovsky, Senior Policy Adviser, on (02) 8222 4833.

Yours sincerely,

Yasmin King
NSW Small Business Commissioner

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Question	Commentary	NSW Small Business Commissioner's recommendation
Question 1 In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?	In principle, provision should be made in the corporations legislation to facilitate and foster CSEF. As stated on the first two pages of this submission, access to finance is a significant issue for start-ups and small businesses. According to Australian Bureau of Statistics data, access to finance is the number one barrier to innovation for Australian businesses and the third largest barrier to general business activity.[4] Research carried out by Deloitte Access Economics estimates that about 10 percent of Australian SMEs – or around 200,000 businesses – have difficulties accessing finance.[5] NSW Business Chamber survey results show that 30 percent of businesses surveyed perceived that they had missed an opportunity in the two years to July 2012 due to a lack of credit and 50 percent of those who had loans applications rejected reported that it significantly constrained their growth.[6] Moreover, NSW Business Chamber survey results indicated that 20 percent of businesses who had loans rejected had to lay off staff or	• In principle, provision should be made in the corporations legislation to facilitate and foster CSEF.

[4] ABS Catalogue 8167.0 - *Selected Characteristics of Australian Business, 2011-12*
[5] Deloitte Access Economics and Professor Marc Cowling for the NSW Business Chamber, *Small Business Access to Finance*, 2013, p.7
[6] Deloitte Access Economics and Professor Marc Cowling for the NSW Business Chamber, *Small Business Access to Finance*, 2013, p.9

Question	Commentary	NSW Small Business Commissioner's recommendation
	saw their chances of bankruptcy significantly increase. Given the importance of start-ups and small businesses to the overall economy, difficulty in accessing finance thus has the potential to curtail economic growth, investment and employment. Additionally, many small business owners borrow against the value of their homes in order to get their business off the ground. According to the Australian Bankers' Association and Council of Small Business Australia's report *Small Businesses: Access to Finance Report Year to March 2013*, an estimated 49,644 small businesses use their residential mortgage to fund their small business. With rates home ownership lower for Gen Y, this option may be less viable in future years, further constraining access to finance by start-ups and small businesses. In this context, equity crowdfunding has the potential to be a valuable complementary source of capital to the traditional providers in the market, offering finance to businesses currently struggling to source investment. One such cohort of businesses is those seeking investment in "equity gaps" where it is difficult to secure finance from traditional risk capital providers. Another is businesses that do not fit the high-risk, high-return profile served by many traditional risk finance providers.	

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Question	Commentary	NSW Small Business Commissioner's recommendation
	These businesses may not have the potential to deliver the exceptional returns that venture capitalists seek, however they may also be less risky and still provide significant value to the economy. While crowdfunding offers new investment opportunities to individuals and corporate investors, it also offers recipients of funding the ability to diversify their sources of funding. This lowers their funding risk and creates value for the system as a whole, again making the business less prone to funding shortages, therefore allowing them to better pool resources on significant business opportunities. Besides raising money, crowdfunding allows the project owner to gain feedback on some of the most critical parts of the product before its release into the public marketplace. For example, the project owner is able to gauge pricing information, demand for the product, feedback on how design might be improved, demographic information on potential buyers, precise information about market demands, and direct customer interaction. It can also lead to word-of-mouth recommendation and other social marketing. For the project owner, crowdfunding establishes a direct link between the business and the customer. Crowdfunding is an extremely effective way of gauging if their product or idea has a mass appeal. Even more important is the time in which the project owner is able to make this assessment; a two-month long crowdfunding campaign is a relatively fast turnaround for getting an idea off the ground.	

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Question	Commentary	NSW Small Business Commissioner's recommendation
	For project owners who experienced a successful crowdfunding campaign for their first round of financing, the aforementioned benefits can be extremely useful for a second round of financing from more traditional sources, such as venture capital or business angel investing, if this is necessary. For these reasons, CSEF in Australia should be supported and facilitated.	
Question 2 Should any such provision: (i) take the form of some variation of the small scale offering exemption and/or (ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or (iii) adopt some other approach	The fifth option outlined in the Discussion Paper involves the creation of a new, possibly standalone regime for the regulation of CSEF. This regime would provide benefits for CSEF including: • Clarity in the laws and regulations that apply specifically to CSEF; • The ability to make future specific regulatory changes to CSEF laws and avoid any adverse impacts on existing laws for other regulated financial products and securities; • The ability to control the activities of Australian CSEF investors, issuers and intermediaries and determine investor protection measures to be implemented between these parties; and • The ability to collect data on CSEF in Australia and allow for data analysis to measure risk, sector growth, and to allow for better informed and targeted law reform in this rapidly changing area.	• CAMAC should recommend to Government the creation of a new, possibly standalone legislative regime for the regulation of CSEF. • It is essential that excessive compliance and administrative costs are not imposed. • Unaccredited investors should be permitted to participate in crowdsourced equity funding offerings, provided an adequate framework to manage

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Question	Commentary	NSW Small Business Commissioner's recommendation
	I would therefore advocate that this is the option that CAMAC should recommend to Government. However, irrespective of which option for the regulatory arrangements for CSEF is adopted, is essential that excessive compliance and administrative costs are not imposed. For example, onerous licensing requirements for intermediaries and excessive disclosure requirements for companies utilising CSEF would be counter-productive and should not be imposed. This is of equal importance as the architecture of the regulatory arrangements, such as broadening the current small scale personal offers exemption or a self-contained statutory and compliance structure. Unaccredited investors should be permitted to participate in crowdsourced equity funding offerings. In other words, CSEF should not be restricted to professional or sophisticated investors. While platforms that only allow accredited investors to participate are a useful addition to the innovation system, they do not tap new pools of capital for investment in innovation. Allowing non-accredited investors to participate in CSEF will increase the total pool of funds available for borrowing by SMEs, and thus facilitate the diversification of funding options for businesses. However, unaccredited investors should be protected. This might	their risk is in place. • However, unaccredited investors should be protected. This might be achieved via a restriction that they only invest a certain percentage of their income in a given year through CSEF. There might be an exemption from this restriction for high net worth individuals. • Alternatively, a dollar limit upper threshold (for example $10,000), on investments by any one individual, could be applied to unaccredited investors. The final form the limit might take should be established in consultation with stakeholders.

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	be done via the implementation of a restriction that they only invest a certain percentage of their income in a given year through crowdsourced equity funding. There might be an exemption from this restriction for very high net worth individuals. For close relatives, a higher percentage might apply, as these often invest a greater amount than other investors and are not just driven by commercial considerations. Unaccredited investors should be required to provide a verified statement that they are only investing an amount below the specified threshold. It should not be up to intermediaries to enforce this requirement, as this would unnecessarily increase red tape for intermediaries. In other words, the onus should be on the unaccredited investor (or possibly the government regulator) to comply with this restriction. Alternatively, a dollar limit upper threshold (for example $10,000), on investments by any one individual, could be applied to unaccredited investors. The final form the limit might take should be established in consultation with stakeholders.	
Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of: (i) proprietary companies (ii) public companies (iii) managed investment schemes. In	Proprietary limited firms should be permitted to make crowdsourced equity funding offerings. However, there should be a higher level of investor protection for these firms. This is due to the fact that proprietary limited firms are not subject to less restrictions regarding account keeping, share transfers and consulting shareholders regarding the running of the	• Proprietory limited firms should be permitted to make crowdsourced equity funding offerings.

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considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?	business.	
Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers: (i) types of issuer: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups') (ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF (iii) maximum funds that an issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption	There should not be any restriction with regards to the classes of issuers permitted to utilise CSEF. For example, the Italian regulatory regime restricts CSEF to firms that are "innovative start-ups". Firms that are not in a fashionable niche still may have the capacity to generate innovation, employment and economic growth. There is also the problem of defining exactly which firms qualify under such criteria and which do not. I do not have a fixed view with regards to the types of securities that should be permitted, however small businesses sometimes find securities such as hybrid shares difficult to understand in regards to their obligations to the holders of these securities. Businesses should be allowed to raise up to $5 million per annum through CSEF. A lower ceiling, of for example $2 million, would be almost insufficient to make the exercise worthwhile for businesses. Moreover, ASIC already currently permits a limit of $5 million per offering in some circumstances (where a class order exemption is in place). There should not be a ban on secondary markets. I can see no	• There should not be restriction with regards to the classes of issuers permitted. • Businesses should be allowed to raise up to $5 million per annum through CSEF. • There should not be a ban on secondary markets. • Crowdsourced equity funding offerings should be permitted to be advertised, albeit in a limited fashion. • It is essential that disclosure and licensing requirements on

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(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors (v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer (vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply (vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities (viii) any other matter?	rationale why such a ban should be put in place. Disclosure obligations should be those currently obtaining under the Corporations Act. The existing legislation is adequate. It is essential that disclosure requirements on businesses do not become too onerous, as this has the potential to hamper the development of CSEF in Australia. It might be beneficial to require businesses to communicate with shareholders they have acquired through CSEF every few months or so, for example through bimonthly automated emails. Crowdsourced equity funding offerings should be permitted to be advertised, albeit in a limited fashion. I would advocate that advertising for CSEF be limited to portals/ intermediaries and trade journals (online or in print). CSEF offerings should not be advertised in the mainstream media, as this may attract investors who would not otherwise have invested in CSEF. These investors may be swayed by the advertising and may be more likely to have unrealistic expectations in relation to the potential risks and rewards of such investments. In relation to liability of directors, the existing provisions of the Corporations Act should apply.	businesses do not become too onerous, as this definitely has the potential to hamper the development of CSEF in Australia. • In relation to liability of directors, the existing provisions of the Corporations Act should apply.
Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to	Provided intermediaries are not giving financial advice, they should only be required to register with the relevant government regulator and not take out a financial services licence.	• Provided intermediaries are not giving financial advice, they should only

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intermediaries?	This reflects the current requirements under corporations law. I see no reason why this should be altered. Requiring intermediaries to take out for example a financial services licence would be a significant impost and this might hamper the development of CSEF in Australia. However, intermediaries should be subject to a mandatory, transparent code of conduct, which should be developed in consultation with industry. This code of conduct which should be clearly communicated to stakeholders and the broader public. The establishment of a code of conduct in the initial stage of CSEF in Australia will have a positive and stabilising input on the future of the industry. This might include the creation of transparent reporting guidelines and generic documentation. It should also address issues such as customer protection and contain reasonable and fair guidelines relating to the financial interest, exposure and diversification of funders and investees across multiple crowdfunding business models. This needs to provide guidance around fraud, risk explanations and potentially the testing of funders' knowledge. Customer identification is a key issue with both projects and funders; this includes know-your-customer, customer due diligence procedures and anti-money laundering aspects. The industry needs to create a relevant dialog and approval processes for best practices for customer due diligence.	be required to register with the relevant government regulator and not take out a financial services licence.

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Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries: (i) permitted types of intermediary (also relevant to Question 5): (a) should CSEF intermediaries be required to be registered/licensed in some manner (b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role (c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform (d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman (ii) intermediary matters related to issuers: these matters include: (a) what, if any, projects and/or issuers should intermediaries not	Intermediaries should be required to register with the relevant government regulator, and to abide by a transparent code of conduct which should be developed in consultation with industry (see comments at Question 5). However, it is essential that excessive compliance and administrative costs are not imposed. For example, onerous licensing requirements for intermediaries and excessive disclosure requirements for companies utilising CSEF would be counter productive and must not be imposed. As previously stated, intermediaries who do not provide financial advice should not be required to take out a financial service licence. This is preferable, as if intermediaries provide advice and therefore are required to be licensed, this will push up the costs involved in CSEF, for example due to the need for intermediaries to take out liability insurance. Intermediaries should be required to conduct reasonable due diligence with regards to the bona fides of firms seeking to attract funding through CSEF. For example, they should ensure that the issuer's lodgements are in order and up to date. Intermediaries should only be held liable for investor losses resulting from misleading statements from issues made on their websites / their websites being used to defraud investors if they have not performed reasonable due diligence on the business and / or have deliberately set out to mislead investors themselves. This is all that they can reasonably be expected to do. The mandatory	• Intermediaries should be required to register with the relevant government regulator, and to abide by a transparent code of conduct which should be developed. • However, it is essential that excessive compliance and administrative costs are not imposed. • Intermediaries should only be held liable for investor losses resulting from misleading statements from issues made on their websites / their websites being used to defraud investors if they have not performed reasonable due diligence on the business and / or have deliberately set out to mislead investors

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permit to raise funds through CSEF (b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management (c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers (d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites (e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors (f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with	code of conduct should be a guide in this regard. Intermediaries should be required to make disclosures with regards to risk and other disclosures as per the current requirements of the Corporations Law.	themselves. • Intermediaries should be required to make disclosures with regards to risk and other disclosures as per the current requirements of the Corporations Law.

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(g) what controls should be placed on issuers having access to funds raised through a CSEF portal (iii) intermediary matters related to investors: these matters include: (a) what, if any, screening or vetting should intermediaries conduct on investors (b) what risk and other disclosures should intermediaries be required to make to investors (c) what measures should intermediaries be required to make to ensure that any investment limits are not breached what controls should be placed on intermediaries offering investment advice to investors (e) should controls be placed on intermediaries soliciting transactions on their websites (f) what controls should there be on intermediaries holding or managing investor funds (g) what facilities should intermediaries be required to provide to allow investors to communicate with		

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issuers and with each other (h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary (i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised (j) what, if any, additional services should intermediaries provide to enhance investor protection (iv) any other matter?		
Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of: (i) the differences between share and debt securities (ii) the difference between legal and beneficial interests in shares (iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure,	Intermediaries and government regulators such as ASIC should have links to standardised educational topics on their websites. Another possibility is requiring investors to sign a document – either physically or electronically – stating that they have read material provided to them on these topics.	• Intermediaries and government regulators such as ASIC should have links to standardised educational topics on their websites.

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alone, would suffice.		
Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors: (i) permitted types of investor: should there be any limitations on who may be a CSEF investor (ii) threshold sophisticated investor involvement (Italy only): should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors (iii) maximum funds that each investor can contribute: should there be some form of cap on the funds that an investor can invest. In this context, there are a number of possible approaches under issuer linked caps and under investor linked caps (iv) risk acknowledgement by the investor: should an investor be required to acknowledge the risks involved in CSEF (v) cooling off rights: should an investor have some right of withdrawal	There should be no restrictions on permitted types of investors (see my comments in relation to Question 2). However, unaccredited investors should be protected via the implementation of a restriction that they only invest a certain percentage of their income in a given year through CSEF. This restriction might be waived for high net worth individuals. For close relatives, a higher percentage might apply, as these often invest a greater amount than other investors and are not just driven by commercial considerations. Unaccredited investors should be required to provide a verified statement that they are only investing an amount below the specified threshold. It should not be up to intermediaries to enforce this requirement, as this would unnecessarily increase red tape for intermediaries. In other words, the onus should be on the unaccredited investor to comply with this restriction. Alternatively, a dollar limit upper threshold (for example $10,000), on investments by any one individual, could be applied to unaccredited investors. The final form the limit might take should be established in consultation with stakeholders. There should not be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors. Sophisticated investors	• There should be no restrictions on permitted types of investors. • There should not be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors. • There should be a 10 day cooling off period. • After this 10 day cooling off period, investors should not have the option of withdrawing their investment. • A company's founders should not be permitted to sell their shares within a short timeframe of raising funds via CSEF. • Investors should be required to sign a

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after accepting a CSEF offer (vi) subsequent withdrawal rights (Italy only): should an investor have some further withdrawal right subsequent to the offer (vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF (viii) reporting: what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment (ix) losses: what recourse should investors have in relation to losses resulting from inadequate disclosure (x) remedies: what remedies should investor have in relation to losses results from poor management of the enterprise they invest in (xi) any other matter?	typically do not become involved in most businesses at the very early stages, unless the business has the potential to be very profitable and / or is technology-based. Implementing this restriction would therefore result in many businesses not receiving funding. Investors should be required to sign a document – either physically or electronically – acknowledging the risks involved in CSEF and that they understand the terms of their investment. This should be included in the mandatory code of conduct. There should be a 10 day cooling off period. This will foment public trust in the integrity of the regulatory environment for CSEF. However, after this 10 day period has elapsed, investors should not have the option of withdrawing their investment. This would be impractical, as after this cooling off period, the firm use these funds for purposes such as paying salaries, purchasing capital equipment etc, making a refund difficult. A company's founders should not be permitted to sell their shares within a short timeframe of raising funds via CSEF. This would leave investors "high and dry", having invested in an enterprise which now has no management. This should be the only restriction on the on-sale of securities acquired through CSEF. In relation to losses resulting from inadequate disclosure and remedies for losses due to poor management, these should be as per the current treatment of these issues in the Corporations Act.	document – either physically or electronically – acknowledging the risks involved in CSEF and that they understand the terms of their investment. • In relation to losses resulting from inadequate disclosure and remedies for losses due to poor management, these should be as per the current treatment of the issues in the Corporations Act.
Question 9 Should any	The fifth option posited by the Discussion paper involves the	• CAMAC should

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accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?	creation of a new, possibly standalone regime for the regulation of CSEF. As mentioned in my comments to Question 2, such a regime would provide benefits for CSEF including: • Clarity in the laws and regulations that apply specifically to CSEF; • The ability to make future specific regulatory changes to CSEF laws and avoid any adverse impacts on existing laws for other regulated financial products and securities; • The ability to control the activities of Australian CSEF investors, issuers and intermediaries and determine investor protection measures to be implemented between these parties; and • The ability to collect data on CSEF in Australia and allow for data analysis to measure risk, sector growth, and to allow for better informed and targeted law reform in this rapidly changing area. I would therefore advocate that this is the option that CAMAC should recommend to Government. However, irrespective of which option for the regulatory arrangements for CSEF is adopted by CAMAC, is essential that excessive compliance and administrative costs are not imposed. For example, onerous licensing requirements for intermediaries and excessive disclosure requirements for companies utilising CSEF would be counter-productive and must not be imposed.	recommend the adoption of a new standalone regime for the regulation of CSEF.

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	I regard this as being of equal importance as the actual architecture of the regulatory arrangements, such as broadening the current small scale personal offers exemption or a self-contained statutory and compliance structure. The key to effective crowd funding regulation is recognising that crowd funding investors are subject to a higher risk of issuer default because crowd funding issuers are generally not well established. Limiting the risk exposure for participants in CSEF is therefore a key priority. However, CSEF should be governed by different investor protection mechanisms compared to other regulated financial products and securities. A key priority should also be to cultivate CSEF as a vehicle for economic growth and innovation, with appropriate protection for investors, while minimising compliance obligations and liability risks for issuers.	

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Corporations and Markets Advisory Committee: consultation on crowd sourced equity funding

Community Sector Banking

Community Sector Banking is an innovative banking service which was launched in 2002 and specialises in providing banking and financial solutions to the not-for-profit sector across Australia. Community Sector Banking is a joint venture between Community 21, a company owned by not-for-profit organisations and Bendigo and Adelaide Bank Limited (BEN). Community Sector Banking seeks to improve and expand the movement and effectiveness of capital in support of not-for-profit activities, identify new streams of capital and maximise the sector's capacity to deliver positive community outcomes and social change. Currently Community Sector Banking provides financial services to over 7,500 not-for-profits. Given the sector's acknowledged role and effectiveness of delivering positive social activities and outcomes, any increased capital flowing to these activities will greatly enhance the national balance sheet. Also, given BEN's track record of building appropriate governance structures in partnership with communities across Australia to improve the health and wellbeing of each community, we believe we are in a strong position to develop an effective framework for investment through a Crowd Funding model directed to provide the flow of capital to such community and not-for-profit activities. While we continue to work through the development of our model and approach, we welcome the opportunity to provide our comments to ASIC as they formulate their views as to the appropriate regulatory structures that might apply to Crowd Funding.

The emergence of Crowd Funding in Australia presents considerable opportunities for the not-for-profit sector to improve their impact across Australian communities, helping to improve local economies and the effectiveness of not-for-profit activities. Any increased capital to the not-for-profit sector beyond the current philanthropic and government support would greatly enhance the impact of the sector's work in communities across Australia. While the primary focus of Crowd Funding to date has appears to have been on creative projects and seed funding, Community Sector Banking's model will focus on Crowd Sourced Funding (philanthropic, rewards based or debt/equity based) for a range of not-for-profit projects, social enterprises and community projects.

Its role then is one of facilitating positive social change by creating pathways for new capital through investment in a range of these projects to deliver enhanced social and economic change.

Whilst still in the development phase, the Community Sector Banking model is based on new economy thinking and is designed to stimulate and facilitate these new streams of capital thus providing citizens with a platform through which they can support and invest in projects which will benefit their communities and the broader Australian society.

As Crowd Funding matures in Australia and evolves from simple donation and rewards based funding platforms to incorporate peer to peer lending and equity based investment funding, there will be a requirement to build the regulatory framework that ensures that there is maximum transparency and protections for investors and appropriate payments systems gateways to protect the funds flow from investor through to investment. While acknowledging the special nature of these not-for-profit and community investments that we are looking to support and facilitate, we feel it is essential that the appropriate protections and transparency are required in a Crowd Funding model to ensure investors have confidence in the flow of capital and the effectiveness of their funding and investment support.

We encourage the current Australian Securities and Investment Commission review of the regulatory environment for Crowd Funding to take account of the potential benefits and impact Crowd Funding can have on the development of new capital flows for social infrastructure, social enterprise and community development.

Crowd Funding also presents a real opportunity to leverage Government and Philanthropic investments by adopting a matched funding model utilising crowd platforms, thus enhancing the funding available to support such important community supporting activities.

As stated, Community Sector Banking considers it is appropriate to have a robust regulatory environment, transparent payment systems and clear investor reporting responsibilities in any Crowd Funding structure. Combining a Bank payment gateway with a crowd platform, together with a strong connection with the not-for-profit sector and the individual projects, should enhance our proposition and the likely success of individual projects.

While there is genuine potential for community, social enterprise and for-benefit projects, facilitated through a Community Development Finance Institution like CSB, we believe our model may require special application or exemption from any proposed regulations that are adopted in relation to Crowd Sourced Equity Funding (CSEF) generally.

We believe investors, properly informed and engaged, will be able to discern the range of value (beyond pure financial) that will be created by applying such investment through the proposed CSB Crowd Funding model.

Investors through KIVA (www.kiva.org) for example in peer to peer loans often reinvest their investment into the next loan, much like a revolving fund or in fact a donation. Philanthropic venture capitalist using crowd platforms as a payment gateway or vehicle for change would benefit from appropriate transparency in project selection and progress, but if the regulatory costs become too high it will limit the impact and the effectiveness of Crowd Funding as a platform for change.

context

Before dealing with the specific questions raised in the Corporations and Markets Advisory Committee's Consultation on Crowd Sourced Equity Funding Discussion Paper, we feel that it is important to clarify our views regarding the nature of CSEF. In our view, the term CSEF is currently used to describe a number of very different and distinct concepts.

At one extreme, it refers to an activity which is akin to that undertaken in accordance with the existing Small Scale Offering Provisions (SSOPs) of the Act. Those who hold to this definition naturally see CSEF in practice as a means of extending the current activities to a wider audience, with a natural requirement to amend current restrictions on offer promotion, limits on raising amounts, and make allowances for larger numbers of investors. The view may be that the amounts to be raised in total fall within the $500,000 - $5m range, with individual investors being relatively sophisticated, and investing tens of thousands of dollars each (or more).

At the other end of the spectrum are those who view CSEF as being an extension of existing rewards based Crowd Funding systems – one which simply adds the ability to offer a financial return to those types of projects currently funded through this system. They see that the amounts to be raised nearly always less than $500,000, and very often are less than $100,000. They view the average investor as being relatively unsophisticated in an investment sense, likely to invest smaller amounts which may nonetheless represent a material exposure for them relative to their net worth.

At Community Sector Banking, we tend towards the latter definition, and this is the context in which we have responded in this document. We therefore focus on issues such as the efficient handling of large numbers of investors, of relatively small investments in private enterprises, and systems and disclosures necessary to inform and protect ordinary "retail" investors.

matters relating to issuers

Question 1	In principle, should any provision be made in the corporation's legislation to accommodate or facilitate CSEF? If so, why, if not, why?

A number of amendments have been made to the Act over the past 20 years to accommodate changes in the way that investors interact with issuers, not the least of which include the introduction of the Managed Investment Act, and the more recent FOFA regulations.

We see the current explosive growth in the Crowd Funding sector, and corresponding interest in the concept of CSEF to represent another paradigm shift in the way investors can interact with issuers. Further, evidence from overseas confirms that there is a growing demand amongst investors to participate in CSEF, and a near endless demand from small innovative businesses for the capital.

The Act currently makes general distinctions between public, private and small scale offerings. However, we believe that CSEF is fundamentally different as it represents a new category akin to "micro-scale" offerings. Logically, any new category of investment necessarily involved some legislative change in order to ensure efficient and effective operation of the particular investment market.

ASIC has released a number of statements regarding both Crowd Funding and CSEF, however to date, these have been general warnings without any material prescriptive guidance. This has created uncertainty in the market regarding the legality of not only CSEF,

but also simple rewards based Crowd Funding. As uncertainty is not conducive to an efficient operation of any market, we feel that it is appropriate for clear guidance to be issued, and believe that this must necessarily be accompanied by some legislative amendments.

Whether it be implemented via specific legislation, class order relief, or a combination of both, there is a clear need for:

1. a safe harbour for the operators of existing Crowd Funding platforms; and
2. clear guidelines for the operation of a CSEF platform.

With respect to (2) in particular, failure to provide a clear legislative framework will serve only to keep legitimate participants out of the market, whilst having little or no effect on investor led demand. This is a recipe for disaster, as it will simply leave the door open for less scrupulous operators and issuers to take advantage of investors under the auspices of inappropriate or ineffective legislation.

Question 2	Should any such provision: 1) take the form of some variation of the small scale offering exemption and/or 2) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or 3) adopt some other approach (such as discussed in Section 7.3, below).

We are firmly of the view that a simple amendment to the small scale offering provisions (SSOPs) is not sufficient to provide for the efficient functioning of the CSEF market (based on our interpretation of CSEF).

The existing SSOPs are essentially designed to facilitate capital raising in the $1m-$2m range (or up to $5m as a result of ASIC Class Order 02/273). Although it is possible to raise funds from an arbitrary number of investors using the various subsections in S.708, in practice, small-scale offerings generally attract a maximum of 20 investors.

This implies that the average investment size by an individual in a small-scale offering will be in the tens to hundreds of thousands of dollars, which is generally inappropriate for CSEF. Further, the SSOPs are structured around the concept that the investors are either professional/sophisticated, or have some other link to the investee that might allow them to make an informed decision despite the limited level of required disclosure.

By way of example, under CSEF, we believe that it is likely that an organisation that wishing to raise $250,000 might receive funds from up to 250 investors, each investing around $500-$2000. Unlike a small-scale offering, these investors are unlikely to be “sophisticated investors” or have any personal knowledge of, or connection with, the issuer.

We therefore have a situation where not only is there an order of magnitude difference in both the quantum of investment and number of investors, but also one in which the fundamental tenets of the SSOPs (sophistication or connection or knowledge outside of the otherwise limited disclosure) break down.

We therefore do not consider that the CSEF market can be efficiently or effectively regulated or accommodated merely through amendments to the existing SSOPs, or by limiting involvement to investors who satisfy a modified version of a sophisticated investor. [1]

As a consequence of the above, we therefore believe that the most efficient and preferred structure for the operation of a regulated CSEF platform will be through the existing MIS provisions (as suggested in S. 3.2.4 of the *Discussion Paper*) and we will generally provide answers in this context. Note that for consistency with this document we will continue to refer to the RE of the MIS as the "intermediary" and the ultimate investee companies as "issuers".

Question 3	In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of: 1) proprietary companies 2) public companies 3) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

As noted in the *Discussion Paper*, under the MIS structure, there are no specific changes required to the regulation of proprietary or public companies. However, with respect to the regulation of MIS, there will be a number of amendments or areas where relief is required.

Although it is feasible to operate a CSEF within the current definition of a financial assets MIS, we believe that there may be a benefit to introducing a new AFSL authorisation for the promotion and operation of a CSEF Platform. This would allow the introduction of specific regulatory guidelines and practice notes specific to the operation of the CSEF market under the same framework as applies to all other types of collective investments.

Specific issues that will need to be addressed include:

Liquidity: the MIS will be illiquid as defined in the Act (more than 20% invested in illiquid assets). However, individual asset pools may be liquid at various times, as will the general cash balances of investors prior to allocation to an issuer, or following the repayment of capital. Under current legislation, relief would be required to allow investor redemptions of these liquid amounts.

Allocation of shared costs: consideration needs to be given as to whether a system needs to be formalised for the sharing of general MIS overheads across asset pools.

Valuation/pricing: due to the nature of the issuers, it is highly unlikely that any accurate value can be placed on individual investments without significant analysis

[1] Note however that we are not suggesting that there is not an additional need to make some amendments to the existing SSOPs to extend the effectiveness of existing platforms such as the Australian Small Scale Offering Board (ASSOB). We merely believe that although such amendments will be useful in further bridging existing funding gaps, they will not be sufficient to allow the efficient operation of a broad based demand-let CSEF.

(incommensurate with the level of investment). This creates issues for the RE (in terms of its normal duties to report accurately to investors). The RE will need significant flexibility with respect to the way these items are reported to investors.

Auditing and Financial Reporting: the issues of both valuation and overheads flow into the processes of audit and annual/interim reporting. With respect to audit, it is impractical for an auditor to make an assessment of the value of an underlying investment. Provision needs to be made for auditors to be able to rely on whatever pricing methodology is adopted by the RE – that is to say, audit should be confined to an assessment of the flow of fund into and out of the trust account, and whether the MIS holds the appropriate issuer securities.

With respect to financial reporting, apart from the problems of valuing a portfolio of potentially thousands of private companies, the preparation of any report under current accounting standards is generally meaningless for investors who each hold interests in sub-asset pools. In short, the preparation of an accurate balance sheet and income statement is impossible, and nevertheless meaningless. We therefore suggest that a major component of any legislative amendments or relief should focus on ensuring that an RE (and its directors) are able to report in a sensible and meaningful manner to investors without incurring prohibitive audit, accounting or potential legal costs.

Ringfencing: the basic structure of a CSEF MIS would be based on issuing different classes of units in relation to different investments. Current legislation is not able to create an absolutely "perfect" system of asset ringfencing when dealing with issues that affect the MIS overall, relative to those that affect individual classes of unit holders. That is, there are some liabilities that can cross over the artificial boundaries in asset pools and some lack of clarity regarding the right of indemnification of an RE out of the assets of the MIS. A clear distinction between each of the discrete and mutually exclusive classes of units needs to be legislated in relation to SCEF in MIS to allow for ringfencing.

Communication: although there is provision in the current legislation for reports to be provided electronically, this cannot be made mandatory by the operator of a scheme. We suggest that due to the entirely "on-line" nature of the CSEF platform, there is no requirement for an intermediary to offer a hardcopy option. The alternatives would be either email or a login to an investor specific site.

Question 4	What provision, if any, should be made for each of the following matters as they concern CSEF issuers: 1) **types of issue**r: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups') 2) **types of permitted securities**: what classes of securities of the issuer should be able to be offered through CSEF 3) **maximum funds that an issuer may raise**: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption 4) **disclosure by the issuer to investors**: what disclosures should issuers

have to provide to investors

5) **controls on advertising by the issuer**: what controls, if any, should there be on advertising by an issuer
6) **liability of issuers**: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defenses to liability should apply
7) **ban on a secondary market**: should CSEF be limited to new issues, excluding on-selling of existing securities
8) **any other matter**?

Dealing with each item in turn:

1) **Issuer type:** we believe that all investees should be required to be corporation (public or private) and be registered for GST. This creates a consistence of regulation and draws a clear distinction between CSEF (which should be for a business purpose) and other forms of Crowd Funding (such as support for a personal project, cause or charity). It also allows, for example, the reporting requirements of the issuer to be linked to other normal business activities – quarterly reporting to the CSEF platform operator would be done at the same time (and including similar information) as a quarterly BAS, annual investor updates prepared and provided to the platform operator at the same time as the lodgement of company statements or tax return etc. This reduces the administrative burden on the issuers by incorporating the requirements into normal business reporting timelines.

2) **Security type:** we believe for simplicity of understanding, issuers should be limited to simple financial instruments – ordinary shares, simple preference shares and debt. Although in theory the interposition of an MIS with a professional Responsible Entity does allow more sophisticated instruments to be issued (as the actual investor would be the RE), the restriction to simple instruments encourages transparency and will avoid the need for complicated disclosure in a supplementary or Part 2 document.

3) **Maximum funds to be raised:** The market for small scale offerings is already serviced by existing platforms such as ASSOB (or others who avail themselves of the extensions to the SSOPs under CO 02/273) and other "angel" networks of sophisticated investors. A CSEF platform should aim to fill a funding gap and not be a mechanism for investees to avoid the rigour of these established systems. That is, it should provide access to funding at an earlier business stage, or where the quantum is not sufficient to justify the overheads or processes associated with (for example) ASSOB. As a result, we believe that a reasonable and practical limit to the amount that an issuer could raise should be in the order of $250,000 - $500,000.

4) **Issuer disclosure to Investors:** under the MIS structure, there are two layers of disclosure. The first is general information about CSEF investing and the MIS as well as all of the customary risk disclosures. This would naturally take the form of a Part 1 disclosure document - an "umbrella" PDS.

   This would then be accompanied by a Part 2 disclosure documents (effectively, a supplementary PDS) dealing with each individual issuer/issue. These would necessarily (for the purpose of clarity) be presented in a fairly standardised format and would contain information about each issuer (structure, ownership,

management & business description) and information on the investment proposition (the security type and their terms).

It is the responsibility of the intermediary (as the issuer of the umbrella and supplementary offer documents) to ensure that this information is factually correct, and it would not be unreasonable for the content of this section to be based on legislatively mandated disclosure requirements. However, these requirements must not be overly onerous or extensive – just the basic facts. Any requirement for detailed due diligence by the intermediary will create unsustainable operating overheads (given the relatively small size of each issue).

However, it is the very nature of Crowd Funding for there to be additional information as the key to any successful Crowd Funding or CSEF project is for the issuer to *create engagement with the public*. This is normally achieved via whatever means are appropriate to the project – additional information provided on a website, informative videos, social media updates etc – failure to provide this engaging content invariably results in a failed project/raising. Importantly, this information is *outside of the control of the intermediary*, and it must be absolutely clear that it does not form part of the offer document by reference – *even though some of the information might necessarily be included on "issuer additional information pages" prepared by the issuer but hosted on the intermediary site.*

Note that by "absolutely clear" we are not simply referring to an obligation being placed on the intermediary to put in relevant disclaimers, but rather than there be a standard form of disclaimer mandated, which if implemented will provide the intermediary with a clear legal standing and watertight defense against any action that might otherwise result from statements originating from the issuers.

5) **Advertising:** following on from the previous item, it is absolutely vital for issuers to be able to promote their projects. This may require some relaxation of the existing restrictions on advertising, or potentially an extension of the relief provided by CO 02/273.

6) **Issuer liability:** As under our proposal all issuers will be corporations and the issuer is raising funds from a single investor (the MIS), the liability of directors and officers of the issuer is already determined by the Act – that is, they control a private company that has made certain statements as part of a capital raising. Logically, the due diligence defense should apply. Fortunately, under the proposed MIS model, the issuer is dealing with an experienced Responsible Entity, as opposed to directly dealing with hundreds of investors.

7) **Secondary sales:** any investment made by the MIS in issuers should be for newly issued securities or instruments rather than the sale of shares by current owners. Secondary sales of units in the MIS are already sufficiently dealt by existing legislation (ie no established secondary market for the units, and the RE not permitted to operate a market).

matters related to intermediaries

Question 5	In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

We believe that the existing AFSL licensing requirements provide a suitable framework for CSEF intermediaries. Where the platform is operated using an MIS structure, the requirement would be that the entity is licensed to operate a financial asset MIS. Intermediary changes are covered further in Question 6 in addition to the aforementioned AFSL authorisation recommendation for CSEF providers.

Should the decision be made to allow a CSEF platform to operate under a structure other than a unit trust MIS, it may be appropriate to create a new category of authorisation to "operate a CSEF platform or scheme".

We do not consider that it is necessary to require licensing of those platforms that only offering rewards or presales. However in the absence of the appropriate license, they would be principally responsible for ensuring that the projects they promote do not contain equity or financial instrument elements. This would continue the ongoing uncertainty for these operators, so it would be useful for any legislative amendments or class orders to provide a clearly defined safe harbour in which they can operate.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

1) **permitted types of intermediary** (also relevant to Question 5):
   a) should CSEF intermediaries be required to be registered/licensed in some manner
   b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role
   c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
   d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman.

2) **intermediary matters related to issuers:** these matters include:
   a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
   b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
   c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
   d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites
   e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with
g) what controls should be placed on issuers having access to funds raised through a CSEF portal.

3) **intermediary matters related to investors:** these matters include:
   a) what, if any, screening or vetting should intermediaries conduct on investors
   b) what risk and other disclosures should intermediaries be required to make to investors
   c) what measures should intermediaries be required to make to ensure that any investment limits are not breached
   d) what controls should be placed on intermediaries offering investment advice to investors
   e) should controls be placed on intermediaries soliciting transactions on their websites
   f) what controls should there be on intermediaries holding or managing investor funds
   g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other
   h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary
   i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised
   j) what, if any, additional services should intermediaries provide to enhance investor protection.

4) **any other matter**?

Dealing with each item in turn:

1) We believe that the existing AFSL requirements (for retail investors) should be applied to operators of CSEF platforms, including the normal requirements relating to experience, capacity, compliance and membership of a dispute resolution scheme. We note an External Dispute Resolution Scheme may require a higher annual premium for intermediary Crowd Funding providers given the potential for a high number of investors and the risk nature of the investment but consider it important to maintain this level of consumer protection.

2) We consider that a decision regarding whether a particular issuer be allowed to raise funds through an intermediary should be made by the intermediary, based on information at hand at the time, and on the assessment of the intermediary regarding the suitability of the issuer for their particular platform. Intermediaries have a commercial interest in maintaining their reputation, and a general responsibility for protecting investor interests, which suggests that this form of self-regulation should be effective.

The requirements for initial due diligence by the intermediary should be commensurate with the level of investment being sought by the issuer. There should be a basic requirement to confirm the legal status of the entity, its shareholding structure, directors, management and principal business. This would form the basis of a Part II disclosure issued by the intermediary. Additional information required for existing businesses would include details of any legal action, and a copy of current financials statements signed off by a qualified accountant.

Beyond that, any additional information should be supplied by the issuer, whose officers should sign a declaration to the effect that all information published by them with respect to the offer and the business is true and correct. In addition, as a high level risk mitigation policy, there should be a signed restriction on the use of funds raised to not be used by directors or their related parties in a personal capacity (that is, the use of funds is restricted from personal exertion income).

The provision of this sworn statement to the intermediary then clearly determines where any liability for investor losses lies – intermediaries are liable for any breakdown of their system, while issuers are principally liable for statements covered under their declaration. That is, by obtaining the statement, the intermediary can automatically afford itself of the due diligence defense.

Although it is possible for this type of system to be abused (such as intermediaries accepting statements that they know to be false), such abuse contravenes sufficient other sections of the Act for it to be a generally workable solution, given the size of individual issues and the nature of the issuers.

With respect to self-interest/dealing, the existing regulations in the Act relating to the conduct of Responsible Entities should apply to intermediaries. Further, the advantage of using an MIS structure is that it can create a disconnect between investing in the MIS and allocating funds to any particular issuer.

Finally, the provision of funds to issuers should be based on current Crowd Funding systems – funds are only provided once a minimum threshold is reached. This might be achieved by applying the usual PDS four-month time limit applicable to raising a minimum subscription amount to each underlying issuer.

Importantly, the ability for an investor to withdraw a pledge at any time prior to the issuer reaching their minimum subscription hurdle creates a natural “cooling off” period.

3) CSEF Platform Operators should not be required to undertake any specific screening of investors, other than those normally required of those investing in a conventional MIS – principally those associated with AML/CTF requirements. It should be noted however that even this requirement may be overly onerous for investors who only wish to invest small amounts of money. We would therefore suggest that in addition to being able to utilise the services of online services such as Veda, some consideration be given to requesting that AUSTRAC accept that, where funds are only ever received from an Australian bank account and paid back to that same bank account (with no capacity for the investor to specify any variation), the intermediary may be permitted to rely on the AML/CTF checks that have necessarily already been performed by the relevant bank. This would be subject to the approval of the

relevant bank and may require some amendment to privacy policies, however it is a cost effective and workable solution in the long term.

With respect to disclosures, other than those normally required for any retail MIS, there should be a set of specific Crowd Funding related warnings designed to highlight the high-risk nature of the investments, and suggesting a limitation on participation in the sector. With respect to SMSF investors, this limitation could be legislated and managed in much the same way as the in-house asset restrictions (through the audit process of the relevant SMSF). There should not however be any specific requirement for the CSEF Platform Operators to police these recommendations or limitations.

With respect to the offering of investment advice, solicitation/advertising and the holding of investors' funds, we believe that the existing AFSL/MIS restrictions and custodial requirements are appropriate and should be applied to the CSEF Operators without significant amendment.

This also extends to the requirement to have an appropriate complaints handling and dispute resolution system, as well as appropriate Professional Indemnity insurance. Likewise, the requirements regarding disclosure of financial interests should also apply.

matters relating to investors

Question 7	In the CSEF context, what provision, if any, should be made for investors to be made aware of: 1) the differences between share and debt securities 2) the difference between legal and beneficial interests in shares 3) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

These distinctions should form part of any governing document – be that the umbrella (Part 1) PDS under an MIS structure, or some other minimum disclosure requirement on the platform.

As to whether such disclosure is sufficient, the answer really depends on whether any restriction is placed on the types of securities that issuers can offer under the CSEF regulations. If these are limited to simple debt and equity investments, then the disclosure should suffice.

Question 8	What provision, if any, should be made for each of the following matters as they concern CSEF investors: 1) **permitted types of investor:** should there be any limitations on who may be a CSEF investor 2) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

3) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest. In this context, there are a number of possible approaches under Issuer linked caps and under Investor linked caps
4) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF
5) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer
6) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer
7) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF
8) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment
9) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure
10) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in
11) **any other matter**?

Note that our commentary below attempts to balance the protection of investors and the on-line nature of Crowd Funding platforms. On this basis and dealing with each item in turn:

1) As stated previously, we consider CSEF to be a mechanism for a broadening of the funding base for small or innovative Australian businesses. As such, there should be no limitation on the type of investor.

2) The theory that by requiring one "sophisticated" investor to participate might seem to provide extra protection to general public investors, but in reality, we believe it will do the opposite and create an undue level of complacency in non-sophisticated investors. Ostensibly, there are investors who are sophisticated by definition and those who are sophisticated in the plain English sense of the word as a result of experience and knowledge, but inevitably, those groups do not always overlap. As a consequence, the fact that someone meeting the current definition has invested does not therefore mean that they have conducted any significant or effective due diligence on the issuer.

3) We feel that a reasonable **limit** on a per investment basis should be $2,500 - $5,000, however we accept that this is based on our particular interpretation of the likely CSEF investor profile (as discussed at earlier in this paper) and that others may recommend higher values.

   Irrespective of the limit on individual issuers, we do not however think that it is appropriate for an intermediary to be responsible for policing whether investors have exceeded any particular limit with respect to their total exposure to CSEF. Rather, the disclosure document should clearly indicate that these are high-risk investments and only suitable for a portion of investable capital.

Nonetheless, it would be quite feasible to place a limit on total exposure to CSEF by a SMSF, as these entities are independently audited, and already deal with overall limits such as the in-house asset limitations.

4) Under an MIS or similar structure, a risk acknowledgement would be a necessary part of any application process.

5) As mentioned above, despite the fact that the underlying investments will be illiquid, provision could be made for a short cooling off period provided it is exercised prior to the closing of any raising. This mirrors the current operation of Crowd Funding sites where investors can cancel a pledge at any time prior to the campaign reaching its threshold target.

6) Subsequent withdrawal rights are impractical; however note our previous comments regarding a requirement to be able to allow redemption in relation to certain classes of units even when the MIS as a whole is by "illiquid" by definition.

7) Secondary sales (of investor interests in the MIS) will be covered under the current market-making restrictions as it applies to MIS. The RE intermediary will obviously be able to trade the underlying investments in accordance with the constituent issuer documents and the law.

8) We have made some mention above about the requirement for legislative changes or relief to statutory reporting and audit of the platform/MIS as a whole. With respect to meaningful reports to investors, there should be provision for an online issuer update area where the intermediary posts annual updates to the information contained in the Part II disclosure (such as changes to share structures, directors, management, etc), and also where reports produced by the issuer are published. We consider that it is reasonable for issuers to provide general quarterly updates, which may include the financial information that would normally be included in a BAS, as well as a general update. As the former may be sensitive, and option should be available for that information to only be accessible by the relevant investors.

9) Investors must have the usual recourse to the intermediary with respect to errors it makes in the operation of the CSEF platform or offer document. However, it must be made clear that they have no specific individual recourse to the intermediary in relation to items published by the issuer, and that where the intermediary has received an appropriate declaration from an issuer with respect to certain matters that do actually form part of the disclosure document, the intermediary is entitled to rely on that declaration as a clear due diligence defense. With respect to negligence, fraud or misleading and deceptive conduct on behalf of the issuer, the intermediary (as the actual legal investor) will have full legal rights of recovery. However, provision must be made for the intermediary to elect to not pursue action where it is uneconomic to do so.

10) Investors effectively have no direct rights against the issuers, other than a claim that the issuer's misrepresentations induced them to invest in the MIS. Given that the RE has the right to pursue the issuer under such circumstances and is arguably in a better position to make a cost benefit analysis of such action, it may even be desirable to remove the capacity of an individual investor to pursue issuers (especially given the quantum of individual investments).

Question 9	Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

Based on our comments in this submission, we would suggest that the necessary changes could be incorporated into the Act incrementally. Our preference for operating a CSEF Platform under the existing AFSL/MIS legislation (with amendment) suggests that a complete self-contained regime is not required at this time.

Question 10	What, if any, other matters which come within the scope of this review might be considered?

conclusion and next steps

The emergence of the CSEF market presents a unique opportunity to mobilize capital for a variety of new investments, however when mobilized for the support of investment in social infrastructure and development initiatives for the Australian Not for Profit sector they can produce some very valuable outcomes for the broader Australian community. The social investment market is unique in so far as success is measured on the basis of both financial performance and social outcomes, this unique distinction needs to be taken into consideration when framing the regulatory environment for CSEF.

Community Sector Banking believes that any CSEF framework will be greatly enhanced by the inclusion and support of the investments proposed under the CSB Crowd Funding framework, and a regulatory regime that provides investor engagement and transparency within an appropriate MIS structure will enhance the flow of capital to a range of new investments.

The CSEF systems will require clear guidelines for operators, investors and issuers alike. However, there are key components under the MIS, including issues of liquidity and ringfencing, as outlined earlier in this submission, that require further exploration, this would lead to greater clarity and operation efficiency.

Community Sector Banking is keen to work with the regulator to insure that the opportunities presented by CSEF can be developed whist ensuring that appropriate protection is provided to all stakeholders.

Community Sector Banking would welcome the opportunity to participate in further discussions and forums to assist in developing the CSEF market in Australia.

END

Australian Community Renewable Energy

CAMAC CSEF Submission

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Key Points

- The community energy sector in Australia has grown rapidly in recent years and shows promise to become a major contributor to local economic development and energy supply in Australia.
- This sector comprises a range of organisational forms, fundraising models and actors.
- A crowd-sourced approach to equity funding could address one of the major challenges facing the development of community energy projects in Australia - namely reducing ongoing administration costs. This has been identified in research as a key barrier to the sector's growth.
- This submission is made on behalf of the 15 undersigned community renewable energy projects and organisations.
- Currently, there are over 40 community energy projects in development with over 300 active project proponents. These projects are located across Australia in both urban and regional areas, with proponents of all ages and from a range of backgrounds. For the purpose of this submission, issuers are these community energy project proponents.
- Sophisticated investors have played an important role in initial projects, however, the sector would benefit most from a dedicated, pilot-scale regulatory framework that allows lots of small investors to participate in the investment and ownership of a number of community energy projects.
- If designed explicitly to foster investment in community energy, a dedicated CSEF framework would provide significant opportunity to grow this innovative new sector while continuing to protect investors from fraud and other risks.
- **We are not proposing wider reforms to the Corporations Act, but seeking an enabling framework to explicitly jump-start investment in community energy projects.**
- **We look forward to discussing the finer details of this framework during subsequent consultation.**

Introduction: About Community Energy and our interest in this Inquiry

A vibrant *community renewable energy* (or simply, *community energy*) sector has emerged in Australia, united by a desire to democratise, decentralise and decarbonise our energy production and distribution.

- Democratising our energy production will provide new, fair investment opportunities, empowering citizens and whole communities to become owners and decision-makers in their local energy supplies.
- Decentralising our energy supply will involve the installation of local energy generators, such as solar, wind, biogas and other renewable technologies appropriate for local production. This will drive local economic development, improve distribution efficiency and build resilience in terms of both electrical supply and the local economy.
- Decarbonising our energy supply will reduce our reliance on costly fossil fuels by replacing these with renewable energy, such as solar, wind and biomass, which continue to become only cheaper as the technology is more widely deployed over time.

Broadly, community energy projects fill a gap in energy production between household demand (up to 5 kilowatts) and commercial requirements (roughly above 100 kilowatts). However, many projects are considerably larger, particularly wind, where one or more turbines of between 1 and 3 megawatts per turbine may be installed to supply whole communities.

The community energy model is well established internationally, particularly in Germany, the UK and increasingly in the USA. In some jurisdictions, community energy is a significant contributor to the energy supply mix and also to the local economy. In Germany, for example, over 50% of all renewable energy generated comes from citizen and community owned sources.

There are between 40 and 70 community energy groups with projects in various stages of development in Australia. With almost all of these having been initiated within the last 12-24 months, the **importance of removing barriers to financing is becoming increasingly apparent.**

This recent explosion of projects indicates significant interest in this sector in Australia and shows the potential for community energy to become a major contributor to local economic development and overall energy supply, shadowing the experience in overseas jurisdictions.

US and UK Experience: Mosaic and Abundance

Mosaic is an online equity based crowdfunding platform in the US, established to connect solar projects with investors.

- To date, Mosaic has channelled over $5m into renewable energy projects, mostly on social housing projects in California and now further afield.
    - Mosaic demonstrates the huge appetite for community renewable energy investment. Within the first 24 hours of going live in January 2013, Mosaic's website raised more than $300 000, including over $200 000 for three loans for solar arrays on affordable housing complexes offering returns of 4.5%
- Rates of return for most of its projects are higher than US treasury bonds and are quite competitive with many other financial investment options for investors. Mosaic "didn't wait for the passage of JOBS act" because they were confident that there were enough interested investors to secure the financing of their projects.
- This suggests that 'getting out of the way' is an important role for government.
- The success of Mosaic is in its movement of energy investment away from generic, centrally controlled Renewable Energy Credits to a marketplace that is more satisfying for investors and more resilient.
- Mosaic conducts and collates some due diligence in their project appraisals. In line with SEC offerings.
- Until recently, renewable energy investment opportunities on Mosaic were open to all residents of California and New York State but were restricted to high profile investors from elsewhere within the USA.
- More information can be found at https://joinmosaic.com.

In the UK, **Abundance Generation** is the only green crowdfunding platform approved by the Financial Conduct Authority (FCA).

- Abundance aims to "link up communities and individuals with Renewable Energy Projects and make it possible for everyone to share in the benefits of clean energy production."
- Abundance Generation has successfully provided a platform for the financing of renewable energy projects, allowing investment from all UK residents over 18.
    - Abundance demonstrates a similar appetite for community energy investment, with one of their recent projects successfully raising £400,000 in less than one month, with investors contributing as little as £5 each.
- More information can be found at https://www.abundancegeneration.com/.

What outcomes are we seeking?

A stand-alone, pilot regulatory framework for equity crowdfunding of community energy

For most community energy projects in Australia, wide community engagement is a key objective. **The creation of investment and other participation opportunities for a large number of community members** to become owners or investors in renewable energy generators is seen by many as the ideal model for achieving the desired level of community engagement.

CSEF platforms represent an innovative mechanism for large numbers of community members to invest in community energy projects in such a way that minimises the administrative burden these projects face. However, for this to occur, changes to the current restrictions placed on CSEF would be required.

We are seeking further discussion on the creation of a stand-alone, pilot regulatory framework for community energy equity crowdfunding to show the potential for the sector in Australia. We look forward to discussing ways in which such a framework could be designed to further develop the community energy sector while still protecting investors from fraud and other risks.

Equitable access to investment opportunities, proportionate to financial capacity to absorb losses

Community energy projects allow everyday people from within a community to become owners of energy generators. More importantly, **the communal, local nature of many of projects - such as Hepburn Wind's embeddedness in the Daylesford area - means that project proponents and intermediary organisations are well placed to identify scams.** Knowledge-sharing between participants and support organisations can help to promote honesty in project development. Nevertheless, robust auditing and governance of projects should still be encouraged through standards developed specifically for the needs of the community energy sector.

A key role for the CSEF review should be to identify where existing protections for general investors serve to remove access to renewable energy investment opportunities. As an alternative, we advocate equitable access for all investor profiles, whereby exposure to risk can be mitigated by limiting investment proportionate to financial capacity to absorb likely losses.

We welcome discussion of a mechanism by which these protections can be provided. The "investor linked caps" being considered in New Zealand, USA and Canada look promising in this regard.

Opportunities for Peer-to-peer lending

New peer-to-peer lending businesses such as SocietyOne have developed platforms to collate and manage some project risks while still maintaining the social embeddedness of community lending. SocietyOne connects local businesses with customers through web and mobile platforms allowing fast and easy crowdfunding of capital, such as for new coffee machine financing from customers at a local cafe. There is tremendous scope for this approach within the community energy sector.

Direct responses to Questions posed in Section 7 of the Discussion Paper

Response to questions 1-3:

Our main priority is the development of a stand-alone, pilot regulatory framework for equity crowdfunding of community energy projects to show the potential for the sector in Australia. We want to avoid where possible wide-ranging changes to the regulation of existing companies where this could invite fraud. Therefore, in principle, we wish to avoid changes to the Corporations Act.

Response to questions 4-6:

Community energy project proponents have canvassed the option of applying for a jointly held AFSL. However, a suitably designed regulatory framework could accredit one or more intermediary organisations to act as a marketplace for projects and attract equity investment, and avoid the expense and administrative burden that is currently making equity funding unviable for the dispersed sector.

Renewable energy projects have high capital costs that could be hamstrung by restrictions on the size of investment and/or number of investors. For a pilot scale regulatory framework, we believe that ensuring a mix of sophisticated and other investors will be necessary to effectively fund solar PV projects in the range of 50-250 kilowatts and wind projects up to 6 megawatts in size.

Furthermore, we stress that restricting investment in a regulatory pilot to ‘sophisticated investors’ would not serve to guard against fraud as there is no demonstrable correlation between wealth and knowledge of energy systems, *per se.*

Organisations Supporting this Submission

Community Power Agency
Pingala - Community Renewables for Sydney, NSW
Backroad Connections Pty Ltd, Vic
Bendigo Sustainability Group, Vic
Embark, NSW
GV Community Energy, Murchison, Vic
LIVE, South Melbourne, Vic
Low Carbon Kimberley, WA
Melbourne Community Power, Vic
Pingala, Sydney, NSW
Ranges Energy Community Solar Cooperative, Vic
Renewable Energy Inner West, NSW
Repower Shoalhaven, NSW
SolarShare, ACT
Starfish Enterprises Network, NSW

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Feedback to

CAMAC Review into Crowd Sourced Equity Funding (CSEF)

1. Philanthropy Australia - Background and interest in CSEF

Philanthropy Australia is the national peak body for philanthropy and our members are trusts and foundations, families and individuals who want to make a difference through their own philanthropy and to encourage others to become philanthropists. Our mission is to lead an innovative, growing, influential and high performing philanthropic sector in Australia.

Impact investing is of growing interest in the philanthropic sector generally, and to many of our members, as a new and exciting strategy to assist them to achieve their charitable goals.

In line with its mission to grow philanthropy, Philanthropy Australia has an interest in ensuring that the Australian community is encouraged and supported to invest in both for profit organisations which have social/environmental goals in addition to their financial purpose, and to NFP organisations which have a business arm designed to generate profit that can be reinvested to support their charitable goals. By raising capital through online platforms, CSEF offers opportunities for concerned individuals to participate in impact investing in a small way and potentially provides a valuable source of capital for these companies and organisations working for the public benefit.

Given our remit, we only want to comment on CSEF for those organisations which have the intention of generating measurable social and environmental impact alongside a financial return, and not on start-up/innovative for profit organisations which don't necessarily have a broader social/environmental purpose. This is not in any way intended to suggest these other projects are less worthy, they are simply outside our ambit as philanthropy's peak body.

Having only become aware of the Review into CSEF in the last few days we have not had a chance to canvass the opinions of our membership on this complex issue. We therefore want to make a short general submission only at this stage, but register our interest in participating in any further opportunities there may be as part of the review process to discuss and debate the findings, options and proposed recommendations.

2. General comments on Discussion Paper

Two of Philanthropy Australia's principles in relation to public policy reform are very pertinent to consideration of the Review's key issue of whether there should be provision made in the corporations legislation to accommodate or facilitate CSEF and if so, what form this should take. These are that any relevant legislative reform should:

- Encourage the creation of incentives for giving and the removal of any impediments
- Ensure that the regulatory environment remains positive and that any regulatory changes are positive for the philanthropic sector and not overly complicated or onerous

Given these principles, it is Philanthropy Australia's view that the current legislation creates barriers for small organisations that could benefit from CSEF and provision should be made to accommodate and facilitate CSEF.

We would support the implementation of lighter touch regulation, on the basis that any regulatory regime introduced for CSEF should not have the unintended consequence of discouraging philanthropy. We would support further consideration of Options 2, 4 and 5 in the paper, rather than Options 1 and 3. In principle, there should not be limitations on who may be a CSEF investor, such as a threshold of sophisticated investor only involvement, for organisations raising finance for the provision of goods and services relating to the public benefit. Setting of appropriate maximum levels though we would agree is something that is worth of exploration.

Given the limited time it has had to consider the discussion paper, Philanthropy Australia does not wish to comment further on specific elements associated with each option. Regardless of the regulatory regime adopted, and given that this is an emerging and changing market, it will be important to build in a specified review date to consider whether the new regime is achieving its stated goals in relation to facilitating CSEF and whether there are unintended consequences flowing from it.

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Crowd sourced equity funding: Response to Discussion Paper

Thank you for the opportunity to respond to the Corporations and Markets Advisory Committee ('**CAMAC'**) Discussion Paper on crowd sourced equity funding ('**CSEF'**).

We strongly support the concept of CSEF as an avenue for both small businesses and social enterprises to access capital to support their growth. Our particular interest is in how CSEF can support social enterprises, which our response primarily discusses.

About Chuffed

Chuffed (www.chuffed.org) is Australia's first not-for-profit crowdfunding platform. It supports Australian not-for-profits and social enterprises to run engaging online crowdfunding campaigns to raise funds and build support for their ventures.

We are supported by our Founding Partner, The Telstra Foundation.

Several of the organisations that we support, fall under the category of 'social enterprises' – defined as businesses that trade for a social purpose. These businesses take several incorporation structures but the majority are owned and/or run by not-for-profit organisations (generally incorporated as Companies Limited by Guarantee or Incorporated Associations). Chuffed, itself, would be classified as a 'social enterprise' that is owned by a not-for-profit company limited by guarantee.

We believe that several of these social enterprises would benefit from access to crowdsourced funding from equity, equity-like and debt structures. Furthermore, from the investor-perspective, CSEF could direct a significant volume of capital into the social enterprise sector from investors who prefer to receive both a social and financial return on their investments.

Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?

We believe that explicit provisions should be made in the corporations legislation to accommodate CSEF. The current legislation does not make the

legality or illegality of CSEF clear which has prevented the growth of any significant CSEF sector in Australia.

CSEF would provide significant benefits not only to issuers looking to raise funds but also to investors looking to diversify their portfolio across a range of investments, particularly those looking for more 'impact investing' opportunities.

We believe that any adjustment to the legislation should balance:

- Managing the risk to investors through various regulatory mechanisms; with
- The reality that this form of raising funds is likely to involve a large number of small investments which likely do not represent a significant portion of any individual's net wealth; with
- The reality that this form of fundraising involves several social and community proof mechanisms which lead to very low levels of fraud

Question 2: Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

We believe there are several models that could facilitate the emergence of a CSEF market, of which a variation of the small scale offering exemption is an option. In order for this option to be viable, the variations will need to be implemented, which include but are not limited to: lifting the shareholder cap (passed 100 shareholders, preferably unlimited) and removing the ban on advertising.

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

We do not believe that there is reason to confine CSEF to sophisticated, experienced and professional investors. If the aim is to manage investor risk, better options are to place provisions on the type of information that must be made available to investors and through caps on the amount that an individual investor can invest.

We believe that any restrictions of this nature would severely limit the possibility of a community to support local social enterprises.

Question 5: In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

We believe that current obligations of intermediaries to ASIC provide sufficient protection for all parties involved. The addition of extra requirements such as financial services licensing would prove to be too high a regulatory burden for most CSEF intermediaries and would severely limit the intermediary market.

Question 6: What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of intermediary (also relevant to Question 5):

Intermediaries should be registered with ASIC as CSEF intermediaries but should not be required themselves to have any further financial services licensing. They should outline the processes that they use to handle funds for the different security types and whether they will be involved in the processing of any returns to investors.

They should have some mode of internal dispute resolution process, but this should be limited to the functioning of the platform only and not the performance of the investments.

(ii) intermediary matters related to issuers:

- We do not believe that there should be restrictions to the types of projects or issuers permitted to raised funds through CSEF. It may be appropriate to place a limit on total amount of capital raised per issuer so that very large scale capital raising does not attempt to circumvent appropriate current legislation in place.

- Intermediary platforms are not best placed to conduct due diligence on issuers. This should be done by a separate sponsor or reference who may be required to be licensed in a different manner.

- Issuers, not intermediaries, should be held liable for investor losses resulting from any misleading statements made by issuers on the website or by any fraudulent activity conducted by the issuer. This places the liability in the hands of the person most responsible for these actions. Appropriate legislation should make this liability clear particularly if the intermediary acts as a merchant receiving funds from investors, potentially placing it in a liable position from its bank's point of view.

- Intermediaries should be limited from themselves making investments into issuers that they host and prevented from hosting projects from issuers in which they have a commercial interest. This would potentially represent a conflict of interest. All approval processes conducted by the intermediary should be done as a neutral party at arm's length.

- Issuers should have the option of placing a minimum threshold for funds raised. If they do not reach this minimum threshold, funds should not be transferred from the investors (or intermediary) to the issuer. This threshold should be optional and set by the issuer with the processing managed by the intermediary.

(iii) intermediary matters related to investors

- It would not be economically feasible for intermediaries to screen or vet investors. Intermediaries should make reasonable attempts to ensure that the information about the investor that is provided is genuine information though.

- Intermediaries should be required to provide investors with a pro-forma risk disclosure about the nature of CSEF investments, the content of which could be stipulated in the legislation

- Intermediaries should limit any particular individual user on their platform to the appropriate limit per investment, and potentially across their platform. It would be impractical for intermediaries to check the total investments across all CSEF platforms unless this was provided in a centralized system.

- Intermediaries should not offer investment advice to investors unless they are otherwise licensed to do so.

- Intermediaries should be able to advertise their services as a CSEF platform and be able to showcase investment opportunities for the purpose of demonstrating what they do. The intermediary should also be able to offer advice to the issuer on how to advertise their offering.

- Intermediaries should be required to disclose all fees on any project page as well as as close to the point of transaction as possible in a simple format that clearly shows how much of their investment will go to the issuer and how much will go to the intermediary.

Question 8: What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) permitted types of investor: *should there be any limitations on who may be a CSEF investor*

We believe that there is no reason to limit who may be a CSEF investor. Any limitation would unduly restrict the ability of social enterprises to raise funds in their community.

(ii) threshold sophisticated investor involvement (Italy only): *should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors*

We do not believe a threshold requirement is necessary. This would unfairly bias against newer ideas that may not yet have any sophisticated investors such as several small businesses.

(iii) ***maximum funds that each investor can contribute:*** *should there be some form of cap on the funds that an investor can invest. In this context, there are a number of possible approaches under Issuer linked caps and under Investor linked caps*

We believe that a reasonable cap of $10,000-$20,000 per investor per offering should be placed. We do not believe that this should be linked to the income or net wealth of the investor as this would be impractical to monitor.

(iv) ***risk acknowledgement by the investor:*** *should an investor be required to acknowledge the risks involved in CSEF*

Yes, the investor should be required to acknowledge and understand the risks of investing via CSEF through agreeing to an online pro-forma risk statement.

We at Chuffed believe that CSEF has enormous potential to open up investments into not just the small business sector, but also into social enterprises who perform a critical role in our society. Setting up an appropriate regulatory structure for CSEF to operate is a critical first step in making CSEF a reality and we commend CAMAC on addressing this issue thoughtfully.

Prashan Paramanathan
CEO and Director, Chuffed
www.chuffed.org

SUBMISSION IN RESPONSE TO CAMAC DISCUSSION PAPER ON CROWD-FUNDING

We at Capital Potential are delighted to forward this submission and hope it contributes usefully to overall discussion on this important topic. We strongly believe that crowd funding and appropriate regulation thereof will be a key enabling component of Australia's overall national development strategy. We believe that our nation's future prosperity directly depends on how effectively we can both become a digital economy, and position ourselves to embrace the enormous opportunities brought about by economic transformation in Asia. We believe these two factors are interlinked and that crowd funding is a central component of the supportive and nurturing incubatory environment which Australian small and medium sized business requires to thrive. We applaud this timely initiative by CAMAC and welcome the opportunity to contribute further.

Chris Moore Simon Price James Hyles

Joint Managing Directors, Capital Potential

CONTENTS

1. The benefits and risks of online fundraising: response to CAMAC discussion.

We recognise that the CAMAC discussion paper needed to present a balanced outline of the pros and cons of crowd-funding. However, we believe there is a strong case for the potential economic utility of crowd-funding, and also that there are good reasons why crowd-funding appears especially applicable to the Australian economy and its financial system. In our view, these robust principles underlying the concept of crowd-funding were not always prominent in the CAMAC discussion.

In addition, the authors believe that some of the risks of crowd-funding cited in the CAMAC paper are not in fact borne-out by study of crowd-funding's actual practice in other economies.

In this section we attempt to articulate the broad economic case for the potential benefits crowd-funding can bring to the existing financial system.

1.1 Distinction between crowd-sourced equity and crowd-sourced debt funding.

The CAMAC paper makes clear that it is using the term "Crowd sourced equity funding (CSEF)" as a broad term to include both equity and debt (loan) capital raising. Whilst we understand the reasons for this generalisation, we believe that in practice it is useful to distinguish between crowd sourced debt funding (or crowd-lending) and crowd sourced equity funding (which we will refer to as crowd-investing).

The importance of the distinction lies in the very different risk profile for the investor. As the UK's FCA notes in its own discussion of crowd-funding, the failure rate amongst (UK) new business start-ups is between 50% and 70%. This inherent risk profile of equity investment in new business start-ups does suggest that crowd-investing may be appropriate only for relatively sophisticated and/or high net worth individuals, able to make such investments in the context of a larger overall portfolio.

In contrast, crowd-sourced *lending* to small or medium sized businesses looking for loan capital to finance investment or business expansion should in principle represent an investment with a far more manageable risk profile. A competent crowd-lending site, through a combination of some filtering for credit risk and a mechanism for allowing its investors to be diversified across multiple individual loans, should be able to ensure that the return its investors receive is relatively stable. Indeed, with the addition of some form of internal credit insurance or provision fund, a crowd-lending site should be able to deliver a product to its investors which resembles a bank deposit in terms of outcome (albeit not backed by deposit protection as a bank deposit would be). In the UK, crowd-lending is developing rapidly and has proved able to deliver a deposit-like outcome for its investors.

We therefore suggest that crowd-lending and crowd-investing represent very different offerings to investors, and will have different (if related) functions within the financial system and the broader economy. In the UK at least, successful sites to date have tended to focus on one or the other (either crowd lending or crowd-investing). At present in the UK, crowd-lending is a substantially larger phenomenon than crowd-investing: in 2012, loans made via crowd-lending amounted to £350m, whilst equity raised via crowd-investing was just £10m.

We believe that both crowd-lending and crowd-investing will have important roles to play in the Australian financial system. In the following sections we look separately at the case for crowd-investing (equity) and crowd-lending. We will use the term crowd-funding to refer collectively to crowd-lending and crowd-investing.

1.2 The economic case for Crowd-Sourced Equity Investing

In the existing financial system, equity funding for relatively small-scale new business start-ups often has to be found from 'friends and family'. Crowd-sourced equity funding is essentially just a means of broadening the network of "friends and family", by offering a service which matches potential investors with entrepeneurs or users of capital.

The potential economic role of such a service is very clear. Individual investors may already have appetite for investing a portion of their savings in start-up ventures, but may not currently have in their circle of "friends and family" any entrepeneurs looking for equity capital. Access to institutionalised venture capital funds is in practice restricted to ultra-high-net-worth individuals, a tiny segment of the population and a limited segment of the savings pool. It therefore seems likely that the existing financial system is failing to unlock a portion of the risk appetite latent in the savings pool.

Equally, it seems likely that the existing financial system may be failing to deliver sufficient equity-funding for viable but relatively small-scale new business ventures. The banks' role is to provide debt capital to established businesses, whilst venture capital firms are obliged to seek relatively large-scale investment opportunities.

By seeking to match potential individual investors with new businesses seeking equity funding, crowd-investing can deliver an improvement in the matching of supply and demand for risk capital in the economy – an improvement over what the current financial system is able to deliver. In principle, any improvement in the matching of supply and demand for risk capital ought to allow for higher business investment, with all the consequent broader benefits for the economy, employment etc.

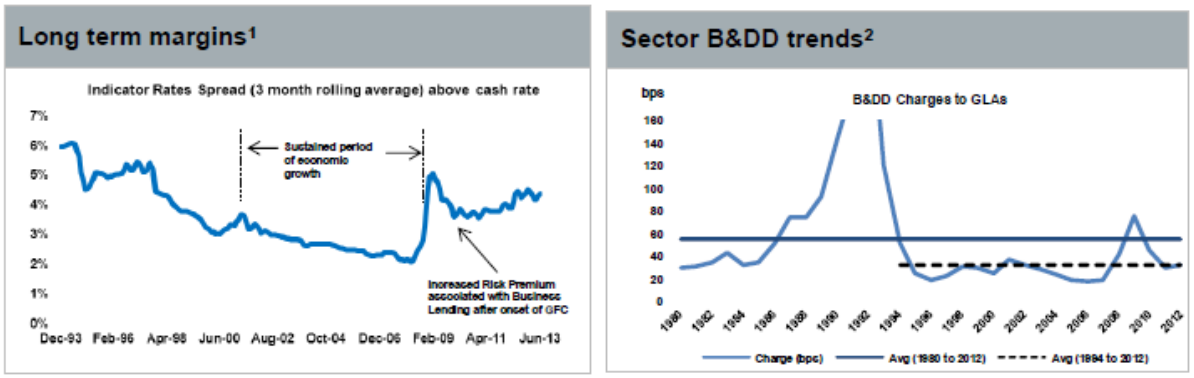
1.3 The economic case for Crowd-Sourced Lending to Businesses

Recycling of domestic savings into loan capital for business is supposed to be a primary function of the banking system. However, post the GFC, the banking systems of many developed economies stand accused of unduly restricting the supply of credit to business. There are a host of economic, regulatory and behavioural reasons why this accusation might be well founded, though it is one which is hard to prove.

We do not have anything specific to add to the debate on whether or not the Australian banking system is unnecessarily restricting the volume of credit supplied to the business sector. However, we believe it *is* possible to make direct observations about the Australian banks' *pricing* of credit and the interest spreads which the banks' are currently extracting from the household and business sectors. On a number of occasions the Australian banks have been accused of failing to pass on RBA rate cuts to borrowers, an accusation which it is easy to quantify and for which there is a wealth of evidence.

As just one example, we would like to cite the charts below taken from a June 2013 presentation by NAB, Australia's largest business lender, to a UBS conference. The chart on the left shows the asset spread which NAB has historically earned on business lending (ie the spread of the average lending rate over the RBA cash rate). Asset spreads are currently close to the historic highs seen in the aftermath of the early 1990's recession and during the GFC. Conversely, the chart on the right hand side shows bad and doubtful debts (ie credit losses) experienced by NAB on the same business lending over the same period. Clearly, credit losses are currently extremely benign, in fact close to the lowest levels seen during periods of sustained economic growth.

Lending spreads paid by Australian business borrowers vs loss rates experienced



Source: NAB

The fact that Australia's largest business lender is currently extracting historically high lending margins, despite an historically benign credit experience, is strong evidence of a market failure. The interest spread should in principle be mainly determined by the credit experience (low credit risk = low interest rate etc). It appears that the banks are extracting unwarranted supernormal profits (or economic rent) from the business sector. This represents a significant inefficiency in the functioning of the economy.

Crowd-lending is highly relevant to this inefficiency (which is not unique to Australia). In the US and especially in the UK, crowd-lending is starting to function as an effective disintermediary of the supernormal interest spreads which currently exist in the banking systems. Simply by directly matching savers (ie lenders), with business (or individual consumer) borrowers, crowd-lending sites have been able to deliver both a higher rate of interest for savers and a lower interest rate for borrowers. This process will reduce the economic rent extracted from the household and business sectors by oligopolistic banking systems. Lowering the cost of credit to business should in principle help to raise business investment, with all the consequent benefits to the economy, employment etc.

It is perhaps worth noting that the UK Government takes this point sufficiently seriously that it has provided government funds to directly aid the development of the crowd-lending sector in the UK[1].

[1] At the time of writing, the UK Government has provided £20m to Funding Circle and £10m to Zopa, to be used in financing loans to business.

2. Comments on some of the risk factors in crowd-funding raised in the CAMAC discussion.

We believe the above gives an outline case for the positive role in the economy that will be played by the growth of crowd-funding. In addition, in this section we would like to respond to some parts of the CAMAC discussion on the risks of crowd-funding.

2.1 There is little evidence that crowd-funding will deliver investments with a higher failure rate.

In section 2.1.4, "Risks of crowd sourced funding, Failure" (p.7), the CAMAC paper discusses whether the risk of an investment project's failure may be greater in the case of crowd funding than in the case of traditional forms of finance, because "in crowd sourced funding….the projects that are in fact funded are those that provide the participants with some psychological reward…..these projects are not funded according to their business and financial merits".

Whilst we understand why the authors of the report might consider this view, we think there is little evidence to support it. In fact there is some evidence for the *opposite* view, namely that the success rate of crowd-funded loans or equity investments may prove to be *better* than those achieved in the traditional financial system. For example, the longest-running crowd-lending site in the UK is Zopa, which was established in 2005. Though it is now expanding into SME lending, Zopa initially crowd-funded unsecured consumer loans (sometimes known as peer-to-peer lending). Since 2005, including the period through the GFC, the credit experience on consumer loans funded by Zopa has in fact been substantially *better* than that achieved by the major UK banks on their own consumer loan portfolios. Bad debts on Zopa's consumer loans have run at just 0.25% for the last three years[2]. This is quite remarkable, as received wisdom would say that a new entrant into a consumer loan market should typically suffer a credit experience *worse* than that of established players.

It is possible that the explanation for Zopa's excellent credit experience may partially lie in its initial screening process for borrowers – perhaps its loan portfolio is focused only on the better credit risks, whilst those of the major UK banks comprise a broader cross-section of consumer borrowers. Still, Zopa is only using publicly available credit data (Experian) to select borrowers – it did not start with the accumulated proprietary data which the banks have claimed gives them an underwriting advantage.

Another possible explanation for the excellent credit experience on Zopa's lending may simply be that of "moral suasion". Borrowers know that they are borrowing directly from peers rather than from a large financial institution. This may improve behavioural influence on default rates.

Crowd-funded lending to business is a more recent phenomenon in the UK and so its track record is too short to be statistically reliable. Nonetheless, the initial credit experience has been good, and certainly not worse than that experienced by the major UK banks.

Crowd sourced equity funding is still too small and recent a phenomenon in the UK to provide a meaningful comparison of success rates with those for institutionally financed ventures. However, our own survey of projects which have been successfully financed in the UK via crowd-investing does *not* suggest an investor base unwilling or unable to apply rational investment judgement.

In conclusion, at present there is some hard evidence that the crowd-funding process is capable of achieving an investment selection with a *better* success rate than that achieved by traditional financing methods. This is especially true with respect to crowd-lending.

[2] Source: Interview with Zopa CEO Giles Andrews, published in UK's Guardian newspaper, August 12th 2013.

2.2 Impact of crowd-investing on the traditional business model

In section 2.2.2 "Impact of CSEF on the traditional business model" (pp 9-10), the CAMAC paper describes CSEF as involving a "reversal of the traditional business cycle… (in which) public funding may be sought on the basis of future possibilities only, rather than on clear evidence of a viable business model in operation". The discussion then suggests that this "reversal" of the traditional business model "increases the risk of failure and loss to equity investors through CSEF".

In fact, current institutional forms of financing for new businesses, such as venture capital firms, very often finance new ventures before there is any demonstrable business model. Many well known and successful internet ventures have gone through several rounds of VC financing before any revenue has been generated.

Crowd-funding does not in fact "reverse" the traditional model for financing investment. What it does is simply provide a new mechanism for matching supply of with demand for capital (either debt or equity capital).

2.3 Crowd-investing participants: quality of issuers

In section 2.2.3 "The CSEF Participants, Issuers" (pp. 11), the CAMAC discussion suggests that the risk of "lack of managerial skill" on the part of issuers (and consequent increased risk of business failure) may be accentuated in the case of crowd due to its business model.

In fact, our own survey of the leading crowd-investment sites in the UK suggests a high degree of professionalism amongst issuers successfully raising finance. For example, Nicola Horlick, a well-known fund manager and entrepeneur in the UK, has successfully used crowd-investment to fund projects which would have also been likely to attract funding from more traditional sources.

We believe the evidence from the UK at least is that both crowd-investing and crowd-lending (to business) are in fact attracting a high quality of investment projects which are seeking to lower their cost of capital via use of crowd-funding. As argued in Section 1 above, lowering the cost of capital for business investment should be viewed as a primary economic benefit of crowd-funding.

2.4 Applicability of crowd funding in the Australian context

In section 3.1 (pp 17), the CAMAC paper discusses the potential for crowd funding in Australia. One line of argument made is that crowd funding in other jurisdictions (especially the US) is seen as a means of driving economic recovery from the GFC. CAMAC notes that "Australia's economy has fared reasonably well post the GFC in comparison with the USA and Europe and therefore it is less certain that CSEF will ever have an equivalent influence in Australia."

However, we have argued (Section 1 of this paper) that the real benefits of crowd funding lie in its potential to fundamentally improve the efficiency with which capital is recycled from household savings into business investment. This benefit is applicable to any economy, not just those which have suffered most in the aftermath of the GFC.

Moreover, we believe there are several aspects of the Australian financial system which suggest crowd-funding may be especially relevant. We discuss some of these below.

2.4.1 Potential for crowd-lending to disintermediate the banks' supernormal interest spreads

Firstly, as we argued in section 1, there is good evidence that Australia is among the number of developed economies (the UK is another example) in which an oligopolistic banking system appears to be extracting undue "economic rent" (high interest spreads) from the household and business sectors. Wherever this is the case, the potential benefits of crowd-lending are highly pertinent, as is already being demonstrated in the UK.

2.4.2 Potential role of Superannuation assets in supplying investor capital to crowd-funding sector

Secondly, the Superannuation system has created a relatively large and sophisticated retail investor base in comparison to many other developed economies[3], along with a large pool of readily investable assets. Superannuation assets amounted to $1.6tr as of June 2013, this amount is expected to grow to around $3.4tr over the next 10 years, driven by the increase in contribution rate from 9% to 12%.

Within this asset base, the fastest growing segment is self-managed superannuation funds (SMSF): assets in SMSF now amount to some $500bn[4]. The profile of SMSF members suggests a relatively sophisticated investor: SMSF members are older (76% over 50), with significantly higher average incomes and much larger super fund balances (average SMSF fund size $480k)[5].

Interestingly, SMSF funds currently have a very high allocation to cash (bank deposits): approximately 30%, or $150bn[6]. Given relatively low interest rates, it is difficult to see the investment rationale for such a high allocation to cash. There is potentially a powerful motivation for SMSF members (a relatively sophisticated investor group) to reallocate a portion of the cash in their super funds into crowd-lending directly to business. To quantify the obvious, each 1% of just that portion of SMSF funds currently dormant in cash represents a potential A$1.5bn supply of capital to the crowd funding sector.

2.4.2 Potential demand for capital through crowd funding

Borrowings by Australian business currently amount to around A$800bn, within which lending to small and medium-sized businesses is some A$240bn. A shift of just 4% of SME loans onto crowd-lending platforms would equate to roughly A$10bn of demand for capital.

In conclusion, we believe there are strong arguments suggesting that the economic benefits of crowd funding are especially applicable in the Australian context.

[3] See for example the discussion in "Funding Australia's Future: The Future Demand and Supply of Finance", published by the Australian Centre for Financial Studies.
[4] Source: RBA
[5] Source: RBA
[6] Source: RBA

3. Regulatory responses to crowd-funding in other jurisdictions – comment on broad principle

Among other countries, the US, Canada and Italy are developing a regulatory framework for crowd-funding which has many new provisions specific to the sector – for example specific limits on the amounts issuers may raise via crowd-funding or on the amounts individuals may invest. In contrast, the UK approach largely incorporates crowd funding into the existing regulatory framework for the financial system, with relatively minimal new regulation specific to crowd funding.

As we have argued through this paper, we believe that crowd funding's use of a website intermediary to match savers with users of capital should not alter the underlying principles of raising equity or debt capital. We believe this simple point should inform the regulatory approach to crowd-funding as far as possible, whilst of course respecting the need to protect consumers and to ensure stability of the financial system as a whole.

Specifically, we believe that restrictions on crowd funding relating to the business model of the issuer (as in Italy), or to amounts issuers may raise or individuals may invest (as in the US), or requirements on financial reporting which are specific to crowd-funded issuers (US) are all liable to create un-intended consequences or market distortions. In principle, existing laws relating to corporations and financial fraud will apply to crowd-funded activities as to other financial transactions, and these existing laws and regulations ought to be sufficient.

On this basis we believe that, amongst regulatory approaches taken in other jurisdictions to date, the UK approach offers the best broad model for Australia.

4. Responses to selected questions posed by CAMAC in Section 7 of its discussion paper

Hopefully, the broad principles outlined above, along with the case for the benefits of crowd funding argued previously, should themselves generate answers to many of the specific questions raised by the CAMAC discussion in its section 7.

In this section we offer our responses to some of these specific questions raised by CAMAC.

4.1 Overview

In considering what, if any, regulatory response might be made in Australia to crowd funding, the CAMAC discussion suggests a range of policy options (Section 7.1, pp 53):

Option 1: no regulatory change

Option 2: liberalising the small scale personal offers exemption from the fundraising provisions

Option 3: confining CSEF exemptions to offers to sophisticated, experienced or professional investors

Option 4: making targeted amendments to the existing regulatory structure for CSEF open to all investors

Option 5: creating a self-contained statutory and compliance structure for CSEF open to all investors.

The view of the authors of this submission amounts to a combination of options 2,3 and 4. Specifically, we would suggest the following outlines:

- That both crowd-lending and crowd-investing activities are deemed to fall under the regulatory jurisdiction of ASIC;
- That in order to facilitate proprietary companies being able to raise equity via crowd-investing, the current fund-raising restrictions on proprietary companies be liberalised (see further discussion in 4.1.1 below);
- That ASIC consider restricting the crowd-investing (equity) form of crowd-funding to sophisticated, experienced or professional investors;
- Conversely, we believe that the crowd-lending format (ie crowd-funded loans to business or consumer borrowers) should remain open to all retail investors; and
- Beyond the liberalisation of current restrictions on fund-raising, we do not believe there should be any new rules on financial reporting or any other new requirements specific to issuers raising capital via crowd-investing or crowd-lending. We believe that existing regulation surrounding proprietary companies is adequate in this respect.

4.1.1 Liberalisation of fundraising restrictions on proprietary companies – relevance to CSEF

We would envisage that Australian issuers potentially seeking to access crowd-invested equity capital would be proprietary rather than public companies. In both the US and the UK, the $ amounts of equity being raised on crowd-investing platforms by individual issuers are still extremely small in relation to the amounts raised by public companies on the public stock markets. In the UK, looking across the two largest crowd-investment sites (Seedrs and Crowdcube), the largest single capital raise to date appears to have been £600,000. Even in the US, the largest single crowd funded equity-raise to which we can find reference is one for US$10m, a still tiny amount in relation to a typical public market equity raise. In the UK, crowd-investment sites typically require that their issuers be registered as ‘private’ rather than ‘public’

companies. 'Private' companies as defined by UK corporate law are the near equivalent to 'proprietary' companies as defined under Australian corporate law.

In order that proprietary companies in Australia be able to access crowd-invested equity capital, we believe there will need to be some liberalisation of the current restrictions on proprietary companies ability to raise equity funds. Specifically, we believe that:

- the shareholder cap (restriction on total number of shareholders) should be removed; and that
- current restrictions on the size of equity offerings by proprietary companies should also be removed.

With regard to the shareholder cap, we note that in the UK, the Companies Act 1980 removed the limit on the number of shareholders in a private company.

4.2 Responses to specific questions raised by CAMAC discussion paper

Below we offer responses to the specific questions raised by CAMAC in Section 7 of its discussion paper.

> **Question 1** In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

Only insofar as the restrictions on fund-raising by proprietary companies should be liberalised, for the reasons argued above. We do not believe crowd funding requires any amendments to corporation law in other areas.

> **Question 2** Should any such provision:
>
> (i) take the form of some variation of the small scale offering exemption and/or
>
> (ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or
>
> (iii) adopt some other approach (such as discussed in Section 7.3, below).

(i) Yes, we believe the small-scale offering exemption should be further liberalised, as argued above.

(ii) We would suggest that crowd funding of *equity* investments in new business ventures (ie crowd-investing as we have narrowly used the term in this document) could be restricted to sophisticated, experienced or professional investors. However, we believe that crowd-*lending* to both business and consumer borrowers should remain open to all retail investors.

With regard to any potential change in the definition of sophisticated investor, we have no specific proposal. However, we would note that:

(a) the definition of sophisticated investor is somewhat more onerous (in terms of the absolute level of wealth) in Australia than it is in the UK ($2.5 million net worth or $250,000 gross annual

income in Australia vs £250,000 net worth or £100,000 gross annual income in the UK); and (b) in its latest consultation paper the FCA is proposing to also open CSEF to retail investors who are not sophisticated or high net worth but self-certify that they are either receiving investment advice on the CSEF investment from a regulated financial advisor or that their investment will be less than 10% of their investable assets. In the US, a leading crowd lending site, Lending Club, self-imposes a requirement that investors must have an annual gross income of at least $70,000 and a net worth of at least $70,000, or just a net worth of more than $250,000.

Question 3 In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

(ii) public companies

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

(i) We believe that the funding restrictions on proprietary companies should be liberalised for the reasons argued in 4.1.1 above. We do not believe crowd funding requires any other amendments to the regulation of proprietary companies.

(ii) We do not believe any change is necessary in respect of public companies. We would not envisage public companies to access crowd-funding in the medium term, and even if they did, we do not see that this would require any change to their regulation.

(iii) No, we do not believe any variation in disclosure obligations of issuers to investors is warranted by difference in the structure by which investors invest.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

(ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF

(iii) **maximum funds that an issuer may raise:** should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

(iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors

(v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer

(vi) **liability of issuers:** in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

(vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities

(viii) **any other matter?**

(i) No, we do not believe there should be any restriction on types of issuer permitted to employ crowd funding. Such restrictions seem to us unnecessarily proscriptive. We have argued that the benefit of crowd-funding lies in its potential to improve the efficiency with which capital is recycled from household savings into business investment. If this view is correct, then there is no need for regulators to take any view on the types of investment to which crowd-funding should allocate capital.

(ii) A restriction to straightforward equity or debt (loan) instruments is worth considering. This would help to ensure the crowd-funding sector remains an appropriate place for household savings.

(iii) We do not believe any maximum on the amount an issuer may raise is necessary. To date, sums raised by individual issuers through crowd-investing sites are still extremely small in the context of broader capital markets. There is no evidence that a limit is required or relevant.

(iv) We do not think there should be any additional disclosure requirements for issuers beyond those enshrined in existing law for proprietary companies. Note that some of the UK crowd-investing sites (eg Seedrs) set their own requirements which go beyond those of UK company law. However, this represents the websites acting as 'investor relations' managers for their issuers, and is not a regulatory requirement.

(v)

(vi) We do not believe that the use of crowd-funding should create any specific liability for issuers' directors or controllers beyond those already existing under current corporation legislation.

Question 5 In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

Crowd funding intermediaries should be licensed as intermediaries by ASIC. We believe that current licensing requirements would in principle enable ASIC to tailor the terms of licences specifically for crowd funnding intermediaries. ASIC should be able to do this in such a way that the crowd-funding sector is able to flourish. Licences for crowd-funding intermediaries could for example include some specification

as to how funds from investors are to be held prior to being passed on to issuers.

We believe that bringing crowd-funding within the authority of ASIC can help the sector to gain the confidence of the public.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) **permitted types of intermediary** (also relevant to Question 5):

- (a) should CSEF intermediaries be required to be registered/licensed in some manner
- (b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role
- (c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
- (d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

(ii) **intermediary matters related to issuers:** these matters include:

- (a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
- (b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
- (c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
- (d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites
- (e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors
- (f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with
- (g) what controls should be placed on issuers having access to funds raised through a CSEF portal

(iii) **intermediary matters related to investors:** these matters include:

- (a) what, if any, screening or vetting should intermediaries conduct on investors
- (b) what risk and other disclosures should intermediaries be required to make to investors
- (c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

(d) what controls should be placed on intermediaries offering investment advice to investors

(e) should controls be placed on intermediaries soliciting transactions on their websites

(f) what controls should there be on intermediaries holding or managing investor funds

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

(j) what, if any, additional services should intermediaries provide to enhance investor protection

(iv) **any other matter?**

(i) We believe crowd-funding intermediaries should be licensed by ASIC. The specific requirements for these licences would be a matter for ASIC, but we believe that ASIC should attempt to minimise the initial regulatory burden on the sector. ASIC could consider adopting a phasing-in of regulatory requirements (for example capital requirements) over a number of years, in order to give the sector a chance to achieve critical mass.

(ii) The requirements on intermediaries with respect to due diligence on issuers should be kept to a minimum. The principle of crowd-funding is a simple matching of investors with issuers. Resulting transactions are made directly between the investor and the issuer, at least in terms of the economic relationship. Therefore the intermediary cannot be held responsible for losses resulting in any way from investments made via its website.

This however, does not preclude intermediaries taking it upon themselves to make specific undertakings for investors. For example, an intermediary could undertake to ascertain that all issuers on their site are indeed correctly registered proprietary companies. In practice, existing crowd-funding sites in the US and UK do make such commitments, presumably in order to ensure that their platform is attractive to investors. Clearly, where intermediaries make specific commitments to investors, then they should be held to these commitments.

(iii) If the regulator chooses to restrict crowd-investing in equity to sophisticated, experienced or professional investors, then we believe that intermediary websites should only be required to have investors self-certify themselves as sophisticated investors.

Beyond this, we believe that simple risk disclosures, as outlined in response to Question 7 below, are a sufficient requirement.

We do not believe crowd-funding sites would want to offer investment advice as this would seem to run contrary to the spirit of the business model, and would presumably require separate licensing by ASIC for the provision of investment advice. ASIC might wish to specifically bar

crowd-funding intermediaries from also providing advice, though this could also be left implicit in the rules (ie provision of advice would simply require a separate license). However, we believe there is scope to provide access to insurance products which may be used to enhance protections for investors.

With regard to client funds, we believe it would be fair to make crowd-funding intermediaries subject to the same rules for holding or managing client funds as apply to other forms of financial intermediary in Australia.

Provision of facilities for communication between investors and issuers should be left up to intermediaries – no regulatory view is necessary on this point.

Crowd-funding intermediaries should be subject to the same requirements on fee disclosure as apply to other financial intermediaries in Australia.

Question 7 In the CSEF context, what provision, if any, should be made for investors to be made aware of:

(i) the differences between share and debt securities

(ii) the difference between legal and beneficial interests in shares

(iii) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

In principle we believe that crowd-funding sites should be under obligation to provide on their websites clear warnings as to the inherently risky nature of equity investment in start up-ventures. In the case of crowd-lending, we believe that it should be made clear to investors that their investments do not attract the same level of protection as applies to a bank deposit.

We believe these disclosures are sufficient.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) **permitted types of investor:** should there be any limitations on who may be a CSEF investor

(ii) **threshold sophisticated investor involvement (Italy only):** should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors

(iii) **maximum funds that each investor can contribute:** should there be some form of cap on the funds that an investor can invest**.** In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*

(iv) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF

(v) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer

(vi) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer

(vii) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF

(viii) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment

(ix) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure

(x) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

(xi) **any other matter?**

(i) As argued previously, we believe there may be a case for restricting crowd funded *equity* issuance to sophisticated, experienced or professional investors. However, we believe crowd-funded *lending* should be open to all investors

(ii) No.

(iii) We do not believe that there should be any limit on the amount investors may invest via crowd-funding.

(iv) Yes, investors should be required to acknowledge the risks inherent in crowd funding. This can easily be done by ensuring that investors have to acknowledge the warnings we referred to in our response to Question 7.

(v) A standard "cooling-off" period for investments may be warranted, at least in the case of equity investments. These should tie-in with any existing "cooling off" periods applying elsewhere in financial services regulations.

(vi) No.

(vii) No, there should not be any resale restrictions. In the case of crowd-lending, the capacity for investors to re-sell chunks of loan agreement is being very effectively used by the leading UK sites to replicate some of the liquidity provided by a bank deposit.

(viii) No, we do not believe there should be any new reporting requirements specific to issuers raising capital via crowd-funding.

(ix) There should be no recourse available to investors other than those that would already be available in the case of fraud or where a company breaks existing rules on financial reporting.

(x) There should be no new remedies made available to investors accessing crowd-funding beyond what would already be available to such investors under existing corporation legislation.

Question 9 Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

As argued above, we believe that crowd funding can be accommodated through incremental adjustment to the existing provisions in the Corporations Act (primarily a liberalisation of fundraising restrictions for proprietary companies). We do not believe that a fully self-contained regulatory regime for crowd funding is necessary.

Crowding the finance industry would be equitable for all: a submission to the Corporations and Markets Advisory Committee review on Crowd Sourced Equity Funding

Submitted by[*]
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[*] Note: All views and opinions expressed in this submission represent the personal views held by the authors. Nothing in this submission is intended to reflect the opinion of any group, entity or body which either author may be associated with or employed by. This is provided for the purposes of information only and does not constitute legal advice and must not be relied on as such.

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Crowd-Sourced Equity Funding

1. Introduction

Crowd-sourced equity funding (**CSEF**) is a novel method of raising capital by offering equity or debt to a large number of primarily retail investors through an online crowd funding platform.

Currently CSEF is effectively not available in Australia. For a proprietary company to employ CSEF would require advertising the sale of securities—which amounts to a prohibited 'public offer'—and then acquiring more than 50 non-employee shareholders, which is also prohibited.

In September of this year CAMAC undertook a preliminary review of CSEF in Australia and published a discussion paper outlining the possibilities for CSEF. In the discussion paper, CAMAC calls for submissions on: whether CSEF should be allowed in Australia, the nature of CSEF, and the changes that will be required to facilitate CSEF in the Australian market.

In our submission, we recommend that CSEF should be introduced in the Australian market. We suggest that Australia base their laws on the recently enacted American JOBS Act. The JOBS Act permits companies to raise up to $1 million through crowd sourced equity funding, through an authorised CSEF platform.

To facilitate this, we propose the following changes to the Corporations Act:

1. Create limited exemptions to requirements of the Corporations Act, that prohibit CSEF, ie. CSEF companies are able to have more than 50 non-employee shareholders provided that they hold shares through CSEF.

2. Add a new licensing regime similar to an AFSL for CSEF platforms to operate.

3. Create a regime for the operation of CSEF companies including limiting the amount of money that can be raised through CSEF and create a reporting regime for CSEF companies.

Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF?

The current system is inflexible and only allows limited crowd sourced funding for donation or reward. CSEF is currently unfeasible due to the limitations of our corporations law. Whilst legislative changes are relatively

2. What is CSEF and why should it be introduced?

2.1. Crowdfunding generally

Crowdfunding is a subset of **crowdsourcing**—which generally refers to where tasks are outsourced from a firm to the general public over the internet in the expectation that individuals will make a valuable contribution to the firm's production process at little or no cost to the firm.[1] **Crowdfunding** in particular refers to the process of soliciting funds from a large number of people using online tools.[2]

Crowdfunding has four main types: donation-based, reward-based, lending-based and equity-based.[3] **Donation-based** crowdfunding involves soliciting donations from funders for a cause they support. This has few complications as no rewards are promised in exchange for funds. Donations are generally given due to support for the idea behind the venture or the mission that it intends to carry out.[4]

Reward-based crowdfunding offers some form of non-financial benefit in return for investment—such as access to a new product, especially early or at a discount;[5] participation in a community; or some form of social status, such as being perceived as an 'early adopter'.[6]

Lending-based crowdfunding entails the issuance of debt or bonds in exchange for the investment. **Equity-based** crowdfunding, aka 'crowd-

[1] Paul Belleflamme, Thomas Lambert and Armin Schwienbacher, 'Crowdfunding: An Industrial Organization Perspective' (Paper presented at the Digital Business Models: Understanding Strategies, Paris, 25-6 June 2010),3.
[2] Blakeley C Davis and Justin W Webb, 'Crowd-Funding of Entrepreneurial Ventures: Getting the Right Combination of Signals' (2012) 32(3) *Frontiers of Entrepreneurship Research* 1, 4.
[3] See generally, Gerrit KC Ahlers et al, 'Signaling in Equity Crowdfunding' (SSRN working paper series 2161587, October 14, 2012), 6-7.
[4] Ajay Agrawi, Christian Catalini and Avi Goldfarb, 'Some Simple Economics of Crowdfunding' (Working Paper University of Toronto, June 1 2013), 15; Omar M Lehner, 'Crowdfunding social ventures: a model and research agenda' (2013) *Venture Capital*, 7.
[5] Agrawi et al, above n4, 14.
[6] Ibid, 15.

sourced equity funding' ('**CSEF**'), is a form of crowdfunding in which the funds are solicited by some form of venture in exchange for an equity stake in that venture.

Current Australian law makes it very difficult for either equity or lending-based crowdfunding to operate.[7] This submission will argue that it would be beneficial to facilitate both of these sorts of funding. These should be collectively referred to as 'crowd-sourced security funding', but for the sake of convenience, this submission will assume that both are encompassed by the term 'CSEF'.

2.2. Crowdfunding successes

Even without equity offerings, crowdfunding has been increasing the opportunities for startups both in Australia and globally. For example, San Fransisco-based games developer Double Fine Inc failed to raise traditional funding for a new video game, so turned to crowdfunding and raised over USD3 million from over 87,000 investors.[8]

The 'Pebble epaper watch' seems to have been the most successful crowdfunded venture yet. The watch's inventor, Eric Migicovsky, had raised USD 375,000 from angel investors, but was USD100,000 short of the amount required for a production run. On 11 April 2012, he turned to crowdfunding website Kickstarter to raise the additional funds. This crowdfunding was rewards-based—investors would receive one watch for each $120 donated. He raised the required capital in two hours, and eventually closed his campaign after 37 days, having raised over USD 10 million and committed to produce 85,000 watches.[9]

On Australian crowdfunding platform Pozible, Melbourne-based reality dress up game event Patient O raised $243,480 from crowdfunding in late 2012, and news website NewMatilda.com raised $175,838 to relaunch in 2010.[10]

What equity-based crowdfunding does exist in Australia has been predominantly through the Australian Small Scale Offerings Board ('**ASSOB**'), which has been offering a highly limited form of crowd-sourced equity funding since 2006. As of November 2013, it has raised $135 million.

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[7] 'Crowd sourced equity funding', (Discussion Paper No Corporations and Markets Advisory Committee, Commonwealth, September 2013), 17-29.
[8] Davis and Webb, above n2,, 7.
[9] Agrawi et al, above n4, 2-3.
[10] Alberto Colla and Terence Wong, 'Crowd funding — should Australia embrace the growing crowd?', *Keeping Good Companies (Governance Institute of Australia)*, April 2013, 154, 155.

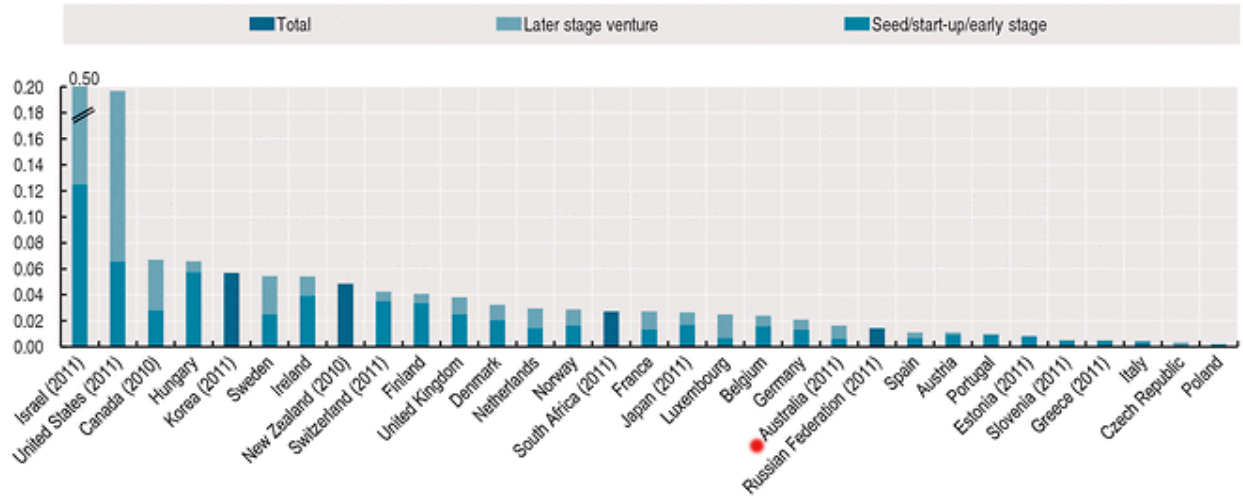
As of April 2012, when it had raised $125 million, it was the largest CSEF platform in the world.[11]

This success has been achieved in spite of the limitations placed on ASSOB by the Australian funding restrictions—which have compelled ASSOB to somewhat perversely solicit funding offerings from within companies' existing social networks rather than on the internet at large, and also imposes onerous disclosure requirements.[12]

The fact that Pozible and the ASSOB have both thrived even in Australia's adverse regulatory environment clearly indicates that crowdfunding has a future in this country. We can only imagine what would be possible if they did not have to face the barriers that have been inadvertently thrown in their path by a system which was not designed with crowdfunding in mind.

2.3. Crowdfunding and the flow of capital

It is well recognised in the economic literature that new ventures tend to struggle to raise capital in their early stages.[13] Raising capital is particularly hard in Australia, which ranks substantially below other OECD countries in terms of venture capital raised relative to GDP.



Venture capital as a proportion of GDP in OECD countries in 2011/12.[14]

[11] Ahlers, above n3, 11.
[12] *How Does ASSOB Work?*, <http://www.assob.com.au/entrepreneurs.asp?page=3>.
[13] Lehner, above n4, 4.; see generally, Andy Cosh, Douglas Cumming and Alan Hughes, 'Outside Enterpreneurial Capital' (2009) 119(540) *The Economic Journal* 1494; Armin Schwienbacher, 'A theoretical analysis of optimal financing strategies for different types of capital-constrained entrepreneurs' (2007) 22(753) *Journal of Business Venturing*.
[14] OECD, 'Access to finance: Venture capital', *Economics at a Glance* <http://www.oecd-ilibrary.org/sites/entrepreneur_aag-2013-en/06/03/g6-

Crowdfunding provides a means to address this issue by reducing the cost of investment in a number of ways.

First, the internet has reduced the cost of matching funders to entrepreneurs across distances and between social groups.[15]

Second, it is evident from the successes of non-security based forms of crowdfunding that small investors will donate money to ventures for no financial return. As outlined above, these donors derive non-pecuniary benefits from doing so. It follows that CSSF investors would be partially compensated through the provision of those same benefits. This would allow issuers to 'bundle' securities with these non-pecuniary rewards, and therefore reduce the expected return on investment and, consequently, lower the price of capital.[16]

For example, consider a hypothetical startup venture in an industry in which the expected return on investment is 10%. That startup has an innovative product which is well-suited to crowdfunding. Instead of delivering a 10% return to each investor, the venture could issue bonds at a 5% rate of return, bundled with the opportunity to be 'early adopters' of the product and the social benefits from being a part of the community of investors.

Social ventures in particular tend to have difficulty finding funding from traditional sources. These ventures struggle to convince funders of their competence and skill due to the disparities in the goals, terminology and organisational structures between the not-for-profit industry and the investment finance industry.[17] On the other hand, crowdfunding is inherently advantageous for not-for-profit companies over for-profit companies.[18] This result is intuitive as where people are giving money for a cause and not necessarily expecting a large return, they would be more likely to donate to a cause that is important to them.

9.html?contentType=&itemId=/content/chapter/entrepreneur_aag-2013-27-en&containerItemId=/content/serial/22266941&accessItemIds=/content/book/entrepreneur_aag-2013-en&mimeType=text/html>.

[15] Agrawi et al, above n4, 11.

[16] Ibid., 11-2.

[17] Lehner, above n4, 1.; note that 'social entrepreneurs' are generally more trustworthy than others— Ibid, 4.

[18] Belleflamme et al, above n1,21-8 attempts to explain this from a rational choice perspective.

It follows that CSEF for unsophisticated small investors might substantially increase the flow of capital to not-for-profit and social ventures, without detracting from existing finance.

2.4. Crowdsourcing through crowdfunding

Crowdfunding can reduce labour costs by allowing ventures to crowdsource various roles which would otherwise be required to be conducted by employees. For example, the response of the 'crowd' to a venture provides an indication its future success, and can serve as both market research and marketing.[19] The crowd can also provide input on the product design and the business plan.[20]

In one survey of crowdfunded ventures, 85% of respondents indicated that they engaged in crowdfunding partially as a means of gaining public attention, and 60% also did so to obtain feedback on their product or service.[21]

It is important to note that, whilst a potential source of valuable advice, the 'crowd' will be inherently noisy and volatile.[22] Also, lower disclosure requirements and a relative lack of experience from people outside the traditional business community engaging in entrepreneurial activities may cause crowdfunded ventures to be riskier than traditional investments.[23] The diffused nature of crowdfunding may also make it difficult for investors to hold the management to account.[24]

These risks are mitigated somewhat as the internet dramatically reduces the cost of shareholder coordination.[25] Online communities have already developed ways of gauging the prospective success of a crowdfunded venture. They follow the advice of other investors and external media outlets, and also pay attention to the apparent quality of the product, any discounts offered with the product, and the managerial experience within the startup's management.[26] Similarly, a vigilant 'crowd' of investors can be an excellent means for detecting fraud.[27] When added to the other benefits from crowdsourcing, this would no doubt outweigh the costs in some cases at least.

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[19] Agrawi et al, above n4, 12.; Lehner, above n4, 7.
[20] Agrawi et al, above n4, 13-4.
[21] Belleflamme et al, above n1,6.
[22] Agrawi et al, above n4, 17-8.
[23] Ibid., 19.
[24] Ibid., 21.
[25] Andrew A Schwartz, 'Crowdfunding Securities' (2013) 88(3) *Notre Dame Law Review* 1457, 1478.
[26] See generally, Davis and Webb, above n2,.
[27] See, Agrawi et al, above n4, 28.

Type of Crowdsourcing	Description
Participation of consumers in product development and configuration	Companies ask for comments and suggestions on current and future products
Product design	Companies ask to develop a whole new product from A to Z
Competitive bids on specifically defined tasks or problems	Companies ask to give a solution to unsolved problems
Permanent open calls	Companies ask for any new information or documentation
Community reporting	Same as before apart that the work is done by a known community instead
Product rating by consumers and consumer profiling	Companies ask for product reviews and opinions for other users to see
Customer-to-customer support	Companies ask customers to help other customers and use it for consumer knowledge and product design

Different sources of crowdsourcing[28]

2.5. A more equitable system

In the current financial environment, investment in non-publicly listed companies is the preserve of the most wealthy Australians. The costs associated with investing in securities generally bar all but wealthy financiers from investing in startup firms other than those owned by friends and family.[29] Consequently, traditional sources of finance favour people who live in industrial areas and have wealthy connections.[30]

Other factors also lock people from less wealthy areas out of financing. In areas with fewer bank branches, it is costly for banks to personally assess a venture's credit risk, meaning that the bank instead relies on standard risk profiling models, which are almost invariably biased against people from disadvantaged areas. The distance from bank branches may also limit individuals' awareness of their financial options, meaning that less credit is sought.[31] Additionally, people who live outside of traditional financial circles will often lack the 'social capital' to obtain financing.[32]

In other words, lower and middle class Australians are being shut out from investing in the next big success story.

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[28] Table source: Armin Schwienbacher and Benjamin Larralde, 'Crowdfunding of Small Entrepreneurial Ventures', *Handbook of Entrepreneurial Finance* (Oxford University Press, 2010) Version available at http://ssrn.com/abstract=1699183, 6.
[29] *Cf,* Schwartz, above n25, 1474.
[30] Ibid, 1468.
[31] Lisa T Alexander, 'Cyberfinancing for Economic Justice' (2013) 4 *William & Mary Business Law Revie* 309, 319.
[32] Ibid., 320.

This is a substantial loss to Australia. It is a loss for the startups that stand to benefit from additional investment; it is a loss for the potential investors, who are denied the returns that their investments would bring; and it is a loss to all society as the system prevents discretionary income from being put to productive use.

Crowdfunding has the potential to change this. Online funding platforms substantially reduce the cost of matching ventures to investors.[33] The most significant implication of this is geographic—in general, crowdfunders tend to be located further from entrepreneurs than traditional funding sources.[34] Accordingly, crowdfunded ventures are less dependant on their physical location and preexisting social circles than traditionally financed ventures—investment can be highly geographically dispersed, and ventures can be established outside of areas in which their industries have traditionally been concentrated.[35]

Indeed, empirical research has shown that areas with low access to other capital sources—such as with fewer bank branches and with lower house prices—tend to have higher rates of crowdsourced ventures; and this affects in particular ventures which are not 'location dependent'.[36] Entrepreneurs do tend to be people with high levels of skills and education, but they derive greater benefit from crowdfunding if they do not have easy access to credit.[37]

It follows that facilitating CSEF in Australia would likely increase the overall flow of capital and create opportunities for less privileged Australians to access capital and to invest in startup ventures.

[33] Schwartz, above n25, 1468.
[34] Keongtae Kim and Il-Horn Hann, 'Does Crowdfunding Democratize Access to Capital? A Geographical Analysis' (Working Paper Robert H Smith School of Business, University of Maryland, October 1, 2013) 13.
[35] See, Agrawi et al, above n4, 34-6.; Lehner, above n4, 8.
[36] Kim and Han, above n34, 14-6. 'Location dependent' refers to ventures like theatres, restaurants or parties as opposed to 'location independent' ventures such as software and technology. See also, Giancarlo Giudici, Massimiliano Guerini and Cristina Rossi-Lamastra, 'Why Crowdfunding Projects can Succeed: The Role of Proponents' Individual and Territorial Social Capital' (SSRN working paper series 2255944, 24 April 2013).
[37] Kim and Han, above n34, 17.

Our proposed scheme

Question 9:Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

A self contained regulatory regime is the most appropriate method for ensuring CSEF will operate as designed with the right balance between regulation and freedom to access capital markets. Some amendments to the Corporations Act will be required.

We propose that a new Part be added to the *Corporations Act* providing a self-contained scheme. To facilitate this additional amendments to other discrete sections of the Corporations Act should be incorporated to account for otherwise inconsistent areas of the legislation.

The Part should begin by specifying its goals as follows:

a. to enable small proprietary companies to obtain financing by issuing securities through crowdfunding intermediaries;
b. to minimise the cost of regulatory compliance for both issuers and intermediaries;
c. to protect the interests of investors.

Question 2 : Should any such provision:
(i) take the form of some variation of the small scale offering exemption
(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or
(iii) adopt some other approach (such as discussed in Section 7.3, below).

We submit that the provision should take the form of a small scale offering exemption, as well as incorporating the amendments discussed below. Restricting the class of investors to sophisticated investors would continue to lock the majority of Australians out of investment in startups and would perpetuate the access to capital issues outlined above for non-profit and high-tech ventures, as well as for people who live outside of financial hubs. In addition, it would preclude the 'crowdsource' benefits of crowdfunding.

3. Corporate structure

Question 3: In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

To facilitate CSEF by proprietary companies, issuers must be able to offer shares to more than the 50 non-employee shareholders to which they are currently limited under section 113 of the Corporations Act. This necessitates a new exemption to s 113 to allow proprietary companies to issue shares through CSEF to more than 50 no-employee shareholders, provided that other requirements are met.

As outlined above, we envision that CSEF will predominantly assist small, initial stage businesses. These will lack the funds or the infrastructure required to register or operate as public companies, in large part because of the prohibitive costs of regulation faced by those companies. These startups would therefore be precluded by s 113 from issuing capital to more than 50 non-employee shareholders, rendering CSEF all but redundant.

It follows that small startup ventures—the class of companies with the greatest potential to benefit from CSEF—would not have access to CSEF unless s 113 is amended. Without these changes, CSEF would not be able to facilitate growth of SME.

(ii) public companies

It is not necessary to amend the current regulatory regime pertaining to public companies, as they can raise sufficient capital by listing on an approved stock exchange.

(iii) managed investment schemes.

MIS provide a viable way to ensure that companies can offer securities to invosteros without the investors obtaining a direct shareholding. However, MIS is likely to be impractical for small companies attempting to employ CSEF, due to the regulatory burden imposed on both the entity offering securities and the Responsible Entity (RE) by the regulatory scheme in the Corporations Act.

Should an MIS be used for CSEF, the intermediary would assume a significant portion of the associated risks and therefore would constitute the RE and would therefore be obliged to hold an AFSL. In order to comply with the requirements for an AFSL, an intermediary must comply with the capital liquidity and ongoing reporting requirements set out in Chapter 7 of the

Corporations Act. The consequent compliance costs would effectively prohibit all but sophisticated entities from becoming intermediaries.

In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

Where an issuer wishes to issue securities through an MIS and the intermediary is an appropriate RE, the disclosure obligations of the issuer should not differ from those that would apply if it were issuing direct interests in the company. This would once again place an onerous burden on intermediaries and therefore would render it unlikely that intermediaries would choose to facilitate the issuance of securities in this fashion.

4. Issuers

Question 2 : Should any such provision:
(i) take the form of some variation of the small scale offering exemption
(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or
(iii) adopt some other approach (such as discussed in Section 7.3, below).

We submit that the provision should take the form of a small scale offering exemption, also incorporating amendments to the Corporations Act to ensure that CSEF is appropriately accounted for.

Restricting the class of investors able to engage in CSEF to sophisticated investors would continue to lock the majority of Australians out of investment in startups. This would create nothing more than a new advertising forum and would not permit CSEF to open up the equity markets as it has the potential to. Such a restriction would perpetuate the access to capital issues outlined above for non-profit and high-tech ventures, as well as for people who live outside of financial hubs.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:
(i) types of issuer: should there be restrictions on the classes of issuers permitted to employ CSEF?

We submit that only proprietary companies should be permitted to become issuers. Whilst issuers are likely to be small proprietary companies, we do not propose a limit on the size of companies able to access this market.

We submit that the following entities must be specifically prohibited from acting as issuers:

1. Pooled investment or private equity funds,
2. Banks,
3. Superannuation funds, and
4. Any other AFSL holder or entity acting as an ADI, custodian or depository service.

The prohibition on such entities acting as issuers would prevent these entities from using CFSLs to circumventing other disclosure requirements under the *Corporations Act*; and would thereby ensure CFSL is used solely for the purposes for which it was designed, rather than to increase the ability of other companies to invest.

(ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF?

Issuers should be able to offer:

1. Shares,
2. Debt in the form of corporate bonds, and
3. Basic stock options.

More complex financial products must be specifically excluded from CSEF funding. These should include:

1. Derivatives (other than basic stock options),
2. Contracts for difference, and
3. Any asset backed securities.

This exclusion will ensure that the risks associated with CSEF are minimised.

The class of shares offered should not be restricted. Nevertheless, the following information must be provided:

1. The intermediary must include a general statement of the types of securities on offer.
2. An issuer must include a statement detailing the type of investment and associated rights.
3. Both the intermediary and the issuer must encourage the issuer to seek independent advice prior to their investment.

(iii) maximum funds that an issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF? Should that ceiling

include any funds raised under the small scale personal offers exemption?

In keeping with the overall scheme of the *Corporations Act*, we submit that an issuer's funding through CSEF and small-scale personal offers will be capped at $2 million per annum. This follows the limit placed in the USA under the JOBS Act and brings it into line with our current small-scale offer limitations.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer?

We submit that Australia should follow the American model regarding advertising securities for CSEF. In this model, advertising by the issuer is prohibited unless it is for the sole purpose of directing potential investors to the intermediary. This will ensure that the prohibitions on advertising for securities are not breached by issuers.

In many instances, issuers will use other forms of social media to promote their venture. This is consistent with the idea that the crowd exists as a conglomerate of internet based investors who are generally technologically astute and use their 'virtual' and 'actual' networks to communicate. If such 'advertising' is disallowed then the benefits of the 'crowd' cannot be fully embraced.

5. Intermediaries

To prevent fraudulent conduct and ensure that issuers and investors are satisfied in the stability of their investments and capital, the JOBS Act allows both registered brokers and registered intermediaries to engage in crowd sourcing.[38]

A successful platform will need to maximise the size and number of successful projects and generate positive media attention. A platform on which fraud is rife and most startups fail would probably not last long.[39]

5.1. Licencing

[38] JOBS Act s4(a)(6).
[39] See, Agrawi *et al*, above n4, 19.

Question 5: In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

At first glance, to act as an intermediary offering securities, an intermediary must hold an Australian Financial Services Licence (AFSL).[40]As mentioned above, we feel that the requirements for obtaining and complying with an AFSL are currently far too onerous for crowdfunding intermediaries—largely due to the limited use of such a licence in crowdfunding purposes. Instead, we suggest that like in the US JOBS Act, both AFSL holders and a new class of registered intermediaries should be able to offer securities. The requirements to hold an intermediary licence are detailed below.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of intermediary (also relevant to Question 5):

(a) should CSEF intermediaries be required to be registered/licensed in some manner:

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role?

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform?

These matters are dealt with in 5.2 Registered Intermediary below.

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman?

Whilst an internal dispute resolution mechanism would be ideal, such a mechanism is unlikely to be appropriate given that investors must be aware of the risks involved in such investment. As such, where an investor believes that an intermediary has breached their duties, they will have recourse to ASIC or the financial services ombudsman. Nevertheless, should an intermediary feel that such a mechanism would be appropriate they are encouraged to include this on an 'opt-in' basis.

5.2. Registered Intermediary

We submit that a registered intermediary licence should be created to regulate the entities which run CSEF through online portals. This will be similar to an AFSL however will have less onerous reporting requirements and not require

[40] *Corporations Act 2001* (Cth) s

a key person, in exchange for a limitation on their dealings to only CSEF purposes.

To receive a licence a registered intermediary must:

1. Run an online platform for the purpose of providing CSEF;
2. Be able to pay its debts as and when they become due and payable;[41]
3. Either have total assets that exceed liabilities as shown on their most recent balance sheet, or have adjusted assets that exceed liabilities;[42]
4. Must have at least $2 million net tangible assets to cover the trustee facilities that they operate,[43]
5. Insurance of at least $2 million (see section **Error! Reference source not found.Error! Reference source not found.**)and
6. Comply with any other requirements such as submitting forms or applications as may be required by ASIC or the regulations for the purposes of applying for a CSEF licence.

In addition to ensuring that it maintains the requisite approval criteria, a registered intermediary must also submit annual audited financial statements to ASIC.

A registered intermediary must not:

1. Give financial advice;
2. Deal insecurities in any way other than as directed for CSEF purposes;
3. Operate an MIS as an RE;

Given that crowdfunding is dependent on an online community, and investors use the medium of the 'crowd' an intermediary must use an online platform. This is consistent with the recommendations of the SEC.[44] In addition, this online platform must allow investors to form a 'crowd' by hosting platforms on which potential registered investors can discuss the merits of the various online investments. The role of the intermediary is "to bring the issuer and the potential investors together and to provide safeguards to potential investors."[45]

5.3. Relationship with issuers

(ii) intermediary matters related to issuers: these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF?

[41] This is similar to rule 13 of PF 209.
[42] Ibid.
[43] Again, this is akin to rule 19B of PF 209, however has been adjusted to account for limitation on the amount that issuers can raise through CSEF.
[44] SEC paper p66430-66431.
[45] SEC p66430.

With the exceptions noted above in **Error! Bookmark not defined.**'**Error! Reference source not found.**', we submit, that it should be at the discretion of intermediaries to ascertain which entities should be allowed to use their platform. Due to the commission relationship, it will be in the commercial interests of intermediaries to only permit high-quality projects.

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management?
(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers?

Aside from the specific disclosure requirements mentioned above in '**Error! Reference source not found.**', we submit that any criteria for preliminary and ongoing due diligence checks should be set at the discretion of the intermediaries, bearing in mind their duty to ensure that the investors are well informed.

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal?

When an issuer uses an intermediary's platform they must agree:

1. The target amount to be raised;
2. The time for the raising;
3. The method of dealing with over or under subscription.

As stated above, by statute, until an issuer has received subscriptions for the greater of either $10,000 or 10% of the amount to be raised, the issuer is unable to receive the funds. This protects the interests of the investors in the fund as it ensures that the issuer receives a sufficient amount of capital to fulfil the business needs.

Similarly, an oversubscription of the greater of 10% or $10,000.00 (providing such an oversubscription will not be in excess of the $2 million cap on capital raising) is the maximum that an issuer can recoup.

Prior to the final date of funding, or any later date set in the case of an under subscription, such funds are to be held by the intermediary on trust for the issuer. Each issuer's funds must be held in a separate trust account for the issuer, to be released at the ascertained date, provided the requisite amount of funds has been received.

Under this new proposal, investors must be alerted by the intermediary as to these limits at the time of investing. They must also receive notice in the following circumstances:

1. when the 10% threshold has been met,
2. once the target amount is met,
3. at the final date of funding,
4. or if there is to be any change to the final date or amount of funding,
5. any other matter deemed relevant for the purposes of keeping investors adequately informed of their investment.

5.4. Relationship with investors

(iii) intermediary matters related to investors: these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors?

We submit that all investors must be registered members of an intermediary before they are permitted to invest any funds in issuers on that intermediary's platform. Regarding the registration process, we submit that intermediaries should be required to ensure that all investors complete a basic questionnaire before registering on the platform.

Investors should be required to provide:

- Basic personal details—ie name, address, occupation, etc;
- Their personal financial circumstances, including annual income, level of debt, value of family home,
- Their Tax File Number.

These requirements mirror those set out by the SEC and will ensure that investors do not double

Investors should also be required to acknowledge that they are risking the loss of their investment.

These requirements should be subject to the regulations.

(b) what risk and other disclosures should intermediaries be required to make to investors?

In addition to the Disclosure regime set out at **Error! Reference source not found.**, before committing to any investment, an investor must confirm that they are aware that they may lose their investment in its entirety. Such an acknowledgement must be prominently displayed separate to any other questionnaire. An investor will be prohibited from investing without acknowledging the risks of their investment.

In addition, general disclosure and risk statements must be advertised prominently on the intermediary's platform and a full risk disclosure statement must be made available by the intermediary stating that it does not constitute financial advice in any way. For more information see **Error! Reference source not found.** Disclosure regime.

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached?

As each investor is required to provide their TFN and their personal income on registration, this should not be difficult to monitor. This will ensure that the Intermediary and going further, the ATO, would be able to flag where an investor's limit has been breached.

The investment limits are as follows:

level of income	total assets	maximum investment per issuer	maximum investment per annum
up to $100,000	$1 million	$1,000.00	$5,000.00
up to $150,000	$1 million excluding family home	$2,000.00	$10,000.00
sophisticated investor for the purposes of s708(8)(c) of the Corporations Act		5% of annual income or net worth	10% of annual income or net worth

Note that these limits are based on the US JOBs Act and the Australian Corporations Act 2001.

(d) what controls should be placed on intermediaries offering investment advice to investors?

Intermediaries like all other entities cannot provide investment advice unless they hold an AFSL. Instead, to ensure that investors are aware of the risks, we submit that disclaimers should be prominently displayed at the point of signing up and at the point of investing to ensure that the investor is aware that they are not being provided advice and should see independent advice.

(e) should controls be placed on intermediaries soliciting transactions on their websites?

In accordance with the restrictions on offering financial advice and facilitating secondary security markets, intermediaries should not be permitted to solicit any transactions other than those listed on their platform by issuers. The issuer will be responsible for directing the investor to their section on the platform, not the intermediary.

(f) what controls should there be on intermediaries holding or managing investor funds?

As explained above, in response to question (g) under 5.3 Relationship with issuers, intermediaries must hold investments on trust until a certain threshold or time limit is reached. Other than this, intermediaries should not be permitted to hold or manage investor funds unless they hold an AFSL.

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other?

Intermediaries should be required to provide investors with the following company details of the issuer:

1. company secretary,
2. directors,
3. senior management
4. if appropriate, the industry group,
5. the registered office, and
6. method of contacting the company.

In addition, the intermediary must provide an online discussion forum through which investors can pose questions to the issuer, the answers to which can be viewed by other investors as well as communicate with one another. The intermediary will be required to moderate comments to the extent that is reasonably possible to ensure that discussion is relevant to the purposes of investment and to prevent harassment and abuse.

6. Restrictions on investors

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(i) permitted types of investor: should there be any limitations on who may be a CSEF investor?

We submit that to invest in a CSEF an investor must be:

1. A natural person, and
2. Above 18 years of age.

(ii) threshold sophisticated investor involvement (Italy only): should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors?

We submit that such a requirement would substantially defeat the purpose of the proposed scheme and would perpetuate current obstacles to finance affecting large portions of the population.

(iii) maximum funds that each investor can contribute: should there be some form of cap on the funds that an investor can invest? In this context, there are a number of possible approaches under *Issuer linked caps* and under *Investor linked caps*.

Additional requirements should be imposed on any investor investing more than $500 in any individual issuer, and no investment should be made above $2,000 in any one issuer by any one investor.

Investors should also be subject to individual caps on their total annual investment. Each investor should be assigned a class according to their financial circumstances, and appropriate limits should be placed on each class.

(iv) risk acknowledgement by the investor: should an investor be required to acknowledge the risks involved in CSEF?

As explained above, the intermediary must require this before investment.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors?

Disclosure is divided into initial disclosure and ongoing disclosure.

6.1. Initial disclosure

We submit further that there should be some mandatory minimum standards of disclosure, which include the following:

1. The purpose for which funds will be used;
2. General limitations on investment and usage of information;
3. The nature of the company;
4. The company's management structure, including the names of all officers and their qualifications;
5. The issuer's business plan;
6. The issuer's projected income;
7. Where available, audited financial statements;
8. Any other relevant financial information; and
9. A statement of both general and specific risks.

This information must be made available first to the intermediary and second to the investors, in order to ensure that the investors are able to make educated investment decisions. Whilst the financial records from a start-up will not go very far,[46] the more informed an investor is, the more sound their investment decision will be.

This is likely to be subject to regulation by ASIC, however we submit that as these are initial stage companies that the same rigorous scrutiny applied to product disclosure statements and prospectuses should not be applied.

[46] See, Blakeley C Davis and Justin W Webb, 'Crowd-Funding of Entrepreneurial Ventures: Getting the Right Combination of Signals' (2012) 32(3) *Frontiers of Entrepreneurship Research* 1, 3.

Instead, each investor must be made aware of the risks associated with the investment and must consent to the assumption of risks both upon subscribing to the intermediary and upon investing.

6.2. Ongoing disclosure

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(viii) reporting: what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment?

To guard against prohibitive costs on issuers, we submit that it would not be appropriate to impose the same level of disclosure currently imposed on disclosing entities under Part 1.2A of the *Corporations Act*. Issuers would predominantly be small, initial or early stage companies and bearing such a burden would be far beyond their capabilities. To facilitate this we propose an addition sub-section to section 111AF which relates to securities held by 100 or more persons, excluding where those securities are held under a CSEF regime.

Whilst we do not believe that an issuer should be a disclosing entity, we propose that some degree of ongoing disclosure is essential to ensure that investors remain informed of their investment. The level of disclosure will be applied on the following graduated basis.

Limit each investor can invest	**Total funds raised**	**Disclosure required**
<$500.00	$100,000.00	Level 1
$500.00>$2,000.00	$2,000,000.00	Level 2
>$2,000.00	$2,000,000.00	Level 3

Level 1 -Disclosure under level one will involve annual disclosure of short-form details of the company's financial situation.

Level 2 – Disclosure under Chapter 2M of the Corporations Act.

Level 3 – Entity will be a disclosing entity under Part 1.2A of the Corporations Act.

These three levels are designed to ensure that companies engaged in crowd sourcing give sufficient information on an ongoing basis to their investors and to ASIC. This will help prevent fraudulent conduct by the issuers and ensure accountability.

6.3. General Disclosure

Question 7 In the CSEF context, what provision, if any, should be made in order that investors be made aware of:

(i) the differences between share and debt securities?
(ii) the difference between legal and beneficial interests in shares?
(iii) any classes of shares in the issuer and its implications for investors?

The intermediary should be obliged under the new legislation to provide all potential investors with an explanation of the different financial products which are offered. This explanation should provide all information that an ordinary reasonable investor would require to understand their rights and obligations in relation to the securities.

This information will include:

1. Type of security;
2. Class of security;
3. Rights attaching to the type and class of security; and
4. Explanation of the different between the legal and beneficial interest in a security.

The explanation must have the following features:

1. Be easily accessible, by any person who visits the online platform;
2. Provided in plain English; and
3. Be in at least size 12 point font; and
4. Prominently displayed at the point of offering securities and on the home page.

A related question is whether disclosure, alone, would suffice.

Such disclosure will only suffice to alert the investors to the inherent risks of CSEF. In addition, intermediaries should also be obliged to provide investors with a disclaimer recommending that they seek independent financial advice from an accredited advisor before making any serious financial decisions. This will ensure that investors make an independent assessment of the risks involved in CSEF or of investing in a particular issuer.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary?

Investors should be informed of their right to make complaints to both the financial services ombudsman and ASIC. These two bodies will have oversight over the activities of an intermediary and so should be able to sufficiently discipline the intermediary as they see fit.

In addition, to protect investors, an intermediary must have professional indemnity insurance. We suggest that an intermediary should maintain an insurance policy covering professional indemnity and fraud by its officers that is both: appropriate having regard to the nature of the activities carried out by the licencee under the licence; and covers claims of $2 million. This is similar to the requirement for RE under the AFSL Conditions however lowers the limit from $5 million to $2 million.[47] The lower level of coverage takes account of the cap on investments and the limit of investment by any individual investor.

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised?

An intermediary should be required to prominently display the percentage commission or any other fees that will be collected by them. This is to allow investors to make an educated investment decision based not only on the financial product and issuer but also on the intermediary used. The more transparent the disclosure, the more effective the crowd will be at sourcing the best investments and selecting the most appropriate intermediary.

(j) what, if any, additional services should intermediaries provide to enhance investor protection?

We submit that no additional services would be necessary.

7. Compliance costs

In general, it is necessary to minimise compliance costs—otherwise the regulatory changes will have little impact. Where the regulatory burden is too onerous, the aim of crowd—sourcing, to obtain funds from a large pool of investors are not maximised. For instance, in the US, the crowdsource-style loan brokering companies *Prosper* and *Lending Club* were established to service broad sections of the community. As regulatory oversight increased, they responded by narrowing their customer base. Now, they primarily serve borrowers who had access to traditional credit, thus defeating the purposes of crowd-sourcing.[48]

[47] Pro Forma 209, Australian financial services licence conditions, updated November 2013, at p.16.

[48] Lisa T Alexander, 'Cyberfinancing for Economic Justice' (2013) 4 *William & Mary Business Law Revie* 309, 345. These are ‘peer-to-peer lending’ sites, which connect borrowers to investors for the provision of small loans. This is distinct from

8. Restrictions on dealing with security

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(v) cooling off rights: should an investor have some right of withdrawal after accepting a CSEF offer?

We propose that the legislation will provide a mandatory cooling-off period of 3 days to allow investors time to re-evaluate their investment. To further protect investors, this period should be extended to 7 days or where the amount invested is above $500.00.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(vi) subsequent withdrawal rights (Italy only): should an investor have some further withdrawal right subsequent to the offer?

Beyond the cooling off period, in the absence of fraud or some other conduct contrary to law, the investor should not have a right of withdrawal. Under our proposed scheme, the investor would be made sufficiently aware of the risks involved in CSEF such that it further withdrawal rights would not be required.

Not only are withdrawal rights unnecessary for investors, they would be detrimental to issuers. Permitting investors to withdraw investments at will would leave issuers without any certainty as to whether they would receive funds that they ostensibly raise. Further, if investors were able to withdraw their investments at will, CSEF issuers could be used as repositories of small amounts of money for short periods of time by persons fraudulently purporting to be investors.

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF?

On-sale of securities creates a secondary market. Under Australian law, in order to act as a market maker, an entity must be licensed by ASIC unless subject to an exemption.[49] To be licensed, the market maker must hold an

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crowdfunding as they only connect individuals to each other, they do not connect one borrower to a whole 'crowd' of lenders.

[49] *Corporations act 2001* (Cth) Ch 7.

AFSL and comply with ASIC's Market Integrity Rules.[50] Whilst an intermediary should not be restricted from holding an AFSL and applying to ASIC to be a market maker, a requirement that it does so in order to merely operate as an intermediary would impose a far higher burden than is appropriate. As noted by the SEC, only where an intermediary wishes to comply with this higher regulatory threshold should they be allowed to conduct a secondary market.[51]

This would not apply where the issuer approves of the on-sale of the securities.

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities?

We submit that, as in the US, investors should be prohibited from onselling existing securities for one year, subject to a number of specific exceptions, including: selling to friends and family; selling back to the issuer in the event of a buyback; and selling to a sophisticated investor. In addition, further sales must be on the same terms as the shares were acquired.

9. Cooling off

It is already standard on most platforms to prevent a startup from receiving funding until a certain threshold is reached.[52] In particular, ASSOB requires a 10% deposit at the time of application and does not require full payment until a specified threshold of share sales has been reached.[53] In addition, we propose that the legislation will provide a mandatory cooling-off period of three business days to allow investors time to re-evaluate their investment. This period may be longer for certain types of investments, or where the amount invested is above a certain threshold.

[50] ASIC, *Market supervision and surveillance* https://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Market%20supervision%20and%20surveillance updated 28 August 2013, accessed 8 December 2013.
[51] *Crowdfunding; Proposed Rules,* SEC Federal Register, 78(214), Tuesday 5 November 2013, p.66459.
[52] Agrawi et al, above n4, 31.
[53] Ahlers, above n3, 12.

10. Liability

Question 4 What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF? What defences to liability should apply?

All shareholders who obtain shares through CSEF will already be protected as shareholders under the Corporations Act and the Common Law. We submit that these extant protections are sufficient

Given we do not propose to increase the liability of the directors or controllers of the issuer, we do not propose any further defences. The directors should owe the same duty towards shareholders who obtained their shares through CSEF as they would to any shareholders.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites?

Under the preexisting law, intermediaries would potentially be liable for misleading statements made by issuers. Under section 1041H of the Corporations Act a person will be liable for engaging on conduct that would be misleading or deceptive or likely to mislead or deceive.[54] This is a question of fact and degree as to whether the intermediary is responsible for misleading statements.[55]

In *ACCC v Google,*[56] the High Court determined that where a party has no control over the subject matter that is published on its website, it cannot be held responsible for any misleading statement therein. It follows that an intermediary would not be held liable for any information written by an issuer which it allows to be published but has no authorial input into. Conversely, where the intermediary has a greater deal of control over the publication of information originally provided by the issuer, it will be held responsible for the contents.[57]

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[54] *Corporations Act 2001* (Cth) s1041H (1).
[55] *Australian Competition and Consumer Commission v Google Inc.* [2013] HCA 1.
[56] *Australian Competition and Consumer Commission v Google Inc* [2013] HCA 1, [58]-[7] (French CJ, Crennan and Kiefel JJ)
[57] *Cf, Clarke v Nationwide News Pty Ltd* (2012) 201 FCR 389.

These laws could potentially impose on intermediaries the onerous burden of being strictly liable for content which they could not have reasonably known would be misleading or deceptive. Accordingly, we submit that there should be a defence inserted into s 1041H, providing that an intermediary will not be held liable for any misleading or deceptive statements published on its website where the statements were provided by an issuer and the intermediary could not reasonably have known that they were misleading or deceptive.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors?

We submit that intermediaries should have a responsibility to the investors to make reasonable enquiries of issuers before permitting them to use their platform to ensure that the issuers are not engaging in fraudulent conduct.

To that end, the intermediary must receive regular audited financial statements from the issuer. In the event that an issuer has previously operated as a business, its financial statements for the proceeding 2 years—or if it has not operated for 2 years, then as far back as possible—must be given to the intermediary to ensure that they are a viable entity.

Question 6 What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with?

When considering conflicts of interest between an intermediary and the issuers using its platform, it is important to recognize that these are predominantly aligned. An intermediary will be successful to the extent that it attracts both a large pool of investors and a large pool of high-quality issuers. In order to achieve this, it is in the intermediary's interests that its ventures succeed.

Nevertheless, in order to prevent self-dealing, an intermediary should not be permitted to hold equity in or take any other legal or beneficial interest in any issuer using its platform. This will restrict the intermediary's interest to the success of the crowd-funding event and not to the success of the company as a

whole. Further, the officers and employees of an intermediary may be restricted from dealing with the equity of the issuer under statutory prohibitions of insider trading.[58] In order to ensure that CSEF is covered, CSEF should be included in the application of this division.[59]

Question 8 What provision, if any, should be made for each of the following matters as they concern CSEF investors:

(ix) losses: what recourse should investors have in relation to losses resulting from inadequate disclosure?

Investors must be made aware of the inherent risks of CSEF from the outset. As explained above, we submit that investors should be required to acknowledge that they are aware of these risks, both at the time of signing up to the intermediary and at the time of investing. Further, the amount that an individual investor may invest ought to be limited, in order to prevent unsophisticated investors jeopardising their livelihood.

With this in mind, we submit that there should be no specific recourse for investors in relation to losses beyond the current requirements of the Act. This investment is akin to investment in a proprietary company, not a public company and so the same high threshold should not be met.

Inadequate disclosure depends on the type of disclosure document and the time at which it was provided. As previously stated, issuers are required to provide a business plan, a copy of the constitution and shareholders agreement prior to using the platform. This information should not be subject to the same regulatory guidelines as such information provided under a product disclosure statement or a prospectus, which would be excessively costly.

Instead, we submit that issuers should have an obligation to provide ongoing financial information to shareholders on an annual basis. As set out above, the content and level of auditing of such information is dependent on the amount of money raised by the entity through CSEF. As with any financial statement, the issuer will have a duty to ensure that the statements are not misleading, which its investors can enforce through a class action.

(x) remedies: what remedies should investor have in relation to losses results from poor management of the enterprise they invest in

We submit that the remedies under the *Corporations Act* and the common law are sufficient in this instance.

See, Corporations Act 2001 (Cth) Pt 7.11 Div 2A.
Corporations Act 2001 (Cth) s 1042B1002.

Submission to the Corporations and Markets Advisory Committee

Crowd Sourced Equity Funding

This submission is made by CrowdIQ in response to the Corporations and Markets Advisory Committee's discussion paper regarding crowd sourced equity funding.

Introduction

CrowdIQ appreciates the opportunity to comment on the discussion paper 'Crowd Sourced Equity Funding' issued by the Corporations and Markets Advisory Committee (CAMAC) in September 2013 and updated in October 2013 (the Paper).

CrowdIQ

CrowdIQ is an equity-based crowd funding platform that offers people equity in unlisted Australian registered businesses in exchange for their investment. CrowdIQ allows a wide base of potential investors to access startup investing - an asset class that was previously only available to high-net-worth or sophisticated angel investors.

CrowdIQ's Position

We believe that there is enormous potential to cultivate crowd sourced equity funding (CSEF) as a vehicle for economic growth and innovation in Australia. To realise this potential, we believe that a statutory and compliance framework should be created that is specific to CSEF to allow equity based transactions to flow across an online platform, and allow the full potential of the crowd to be engaged. A regulatory regime must provide appropriate protection for investors, while minimising compliance obligations, legal complexity and uncertainty and liability risks for issuers.

As CrowdIQ is writing this submission from the position of an intermediary, we make the following specific comments in relation to the licensing requirements of intermediaries outlined at section 3.3 of the Paper.

- The Current ASIC guidance on CSEF (12-196MR ASIC guidance on crowd funding, 14 August 2012), states that the facilitator of crowd funding ' may be legally considered as the person making an offer to arrange for the issue that financial product', and therefore may be required to hold an Australian Financial Services Licence (AFSL).
- An intermediary should provide facilitation services and not financial advice to any investor or issuer. On this basis, whilst we recommend that all intermediaries be registered with ASIC, an intermediary should not be required to hold an AFSL.
- However, it is a question of fact as to whether an intermediary actually provides 'financial product advice'. We believe that this will be dependent on the extent to which the intermediary provides information that is intended to influence a person in making a decision in relation to a financial product. Nonetheless, we believe that the primary service that the intermediary provides is to facilitate the engagement of investors with issuers and not to solicit the investment.

The options proposed in section 7 of the Paper

The Paper discusses five possible options for reform. The five options are:

1. no regulatory change;
2. liberalising the small scale personal offers exemption in the fundraising provisions;
3. confining CSEF exemptions to sophisticated, experienced or professional investors;
4. making targeted amendments to the existing regulatory structure for CSEF open to all investors; and
5. creating a self contained statutory compliance structure for CSEF open to all investors.

We are of the view that option 5, the creation of a self contained statutory compliance structure, is the best option to pursue. A new regulatory framework should provide stakeholders with certainty and clarity in respect of the laws and regulations that apply specifically to CSEF, but also avoid any negative impacts on the existing complex laws for other regulated financial products and securities.

We have outlined below our high level comments in respect of the other options.

Option 1 - No regulatory change

The current Australian regime is not designed for CSEF and therefore, this is not a viable option.

Option 2 - Liberalising the small scale personal offers exemption in the fundraising provisions

The 20 investor ceiling would need to be substantially increased for any significant level of capital raising. This option on its own, is not a viable option.

Option 3 - Confining CSEF exemptions to sophisticated, experienced or professional investors

This will restrict regular investors from participating in CSEF and therefore limit CSEF fundraisers from accessing this pool of investors.

Option 4 - Targeted amendments to the existing regulatory structure for CSEF open to all investors

There are a number of areas within the existing regulatory regime that would require extensive amendments such as amendments to managed investment schemes, compliance requirements for public companies that fundraise and licensing requirements for financial services.

We do not believe targeted amendments would be an effective way to facilitate a CSEF regime. Also, such amendments may further complicate an already complex landscape in respect to the regulation of financial products and securities.

Matters for consideration

We have provided responses to the questions outlined in section 7 of the Paper.

Specifically, we have provided responses to questions 1 to 6 and 9.

Question 1 - In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. if so, why, if not, why?

The current Australian corporations legislation regime is unfeasible as it has onerous compliance, licensing and disclosure requirements that would cause CSEF in Australia to be commercially unfeasible.

Therefore, any attempt to reform the current landscape must be directed to enable CSEF to become an accessible form of capital raising. Specifically, we are of the view that the following provisions should be considered in this context:

- the consequent AFSL obligations in Part7.6 of the Act
- the definition of "dealing" in a financial product, defined in s766C of the Act, and;
- the fundraising disclosure requirements in Chapter 6D of the Act;
- the definition of "financial market" in s767A of the Act.

Question 2 - Should any such provision:

(i) take the form of some variation of the small scale offering exemption and/or

Yes. The small scale offering exemption should be varied to allow for up to 500 investors.

(ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or

Definitely not. CSEF should be available to all capable investors.

(iii) adopt some other approach.

Various caps could be placed on investors who are not considered to be sophisticated investors.

Question 3 - In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

We would envisage that Australian issuers potentially seeking to access CSEF would be proprietary rather than public companies.

The current proprietary company shareholder limit under s113(1) of the Act should be amended to allow a viable level of CSEF to be conducted.

(ii) public companies

We do not believe any change is necessary in respect of public companies. We would not envisage public companies to access CSEF in the medium term.

(iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

No. We do not believe any variation in disclosure obligations of issuers to investors is warranted by difference in the structure by which investors invest.

Question 4 - What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) types of issuer: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

No restriction on the type of company which may issue shares through CSEF and such restrictions would be unnecessarily proscriptive.

(ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF

Only ordinary shares and preference shares and the rights and obligations of shares issued through CSEF should be identical to shares already on issue.

(iii) maximum funds that an issuer may raise: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption

No ceiling on the amount an issuer may raise. Amounts raised by issuers through CSEF are generally small in the context of broader capital markets and therefore there is no evidence that such a limit is even relevant.

(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors

Whilst we consider that the disclosure requirements outlined in the Offer Information Statement contained in the Corporations Act 2001 s715 would be somewhat appropriate, the requirements of s715(2) may be overly onerous in the IT start-up context.

We also note that UK CSEF sites set their own requirements which go beyond those of UK company law.

(v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer

An issuer should be allowed to advertise freely, however such advertising must not be misleading or make financial forecasts which are unreasonable or unrealistic.

(vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

We do not believe that the use of CSEF should create any specific liability for issuers' directors or controllers beyond those already existing under current corporation legislation.

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

We believe CSEF intermediaries should be able to facilitate both issues of new securities, and the sale of existing securities

(viii) any other matter?

No comment.

Question 5 - In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

Intermediaries should be licensed as intermediaries by ASIC. We believe that current licensing requirements would in principle enable ASIC to tailor the terms of licences specifically for CSEF intermediaries.

A modified form of AFSL licensing is appropriate such as the principles outlined in the Financial Markets Conduct Act in New Zealand.

Question 6 - What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:

(i) permitted types of intermediary:

(a) should CSEF intermediaries be required to be registered/licensed in some manner

Yes. A modified AFSL would be appropriate and one that would minimise the initial regulatory burden on the sector.

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

No comment.

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

An intermediary site should have a minimum level of information available on the site, such as terms and conditions, privacy policy, risks involved etc.

However, many of these features will be driven by the market and demanded by investors.

(d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman

Yes. Intermediaries should be required to have a stated internal dispute resolution process and should be members of an approved external dispute body.

(ii) intermediary matters related to issuers: these matters include:

(a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF

Persons banned from being a Director of a company or those persons that have any previous fraud convictions.

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

An intermediary should undertake that all issuers are correctly registered proprietary companies and directors have undertaken police checks.

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

Only at the pre listing stage should a due diligence be undertaken by intermediaries. This would include checks to ensure that;

- appropriate risk disclosures are made and the company has the authority to conduct a fundraising;
- the company is properly incorporated; and
- financial forecasts are not unrealistic or unreasonable.

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

The intermediary should not bear any liability for statements made by issuers, in particular if appropriate due diligence has been conducted.

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

The intermediary should not bear any liability for investor losses, in particular if appropriate due diligence has been conducted.

(f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with

Intermediaries should not be permitted to transact in any company raising funds by way of CSEF. Any risk from the potential for a conflict of interest arising from the intermediary's remuneration and a project fund raising target is negligible.

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

Funds should only be released to the issuer when equity ownership has been completed with investors and fundraising targets have been achieved.

(iii) intermediary matters related to investors: these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

No screening or vetting is necessary.

(b) what risk and other disclosures should intermediaries be required to make to investors

Simple and general risk disclosures should be required.

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

Intermediaries should be required to monitor project funding limits.

(d) what controls should be placed on intermediaries offering investment advice to investors

Intermediaries should be prohibited from providing any investment advice. Also, we do not believe CSEF platforms would want to offer investment advice as this would seem to run contrary to the spirit of the business model, and would presumably require separate licensing by ASIC for the provision of investment advice.

(e) should controls be placed on intermediaries soliciting transactions on their websites

Intermediaries should not promote their platforms on the basis of projected or forecast returns.

(f) what controls should there be on intermediaries holding or managing investor funds

All funds should be held in trust, in individual accounts. Funds should only be released to the issuer when equity ownership has been completed with investors and fundraising targets have been achieved.

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

Communication facilities between investors and issuers should be at the intermediaries discretion.

(h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary

Intermediaries should refer complaints to both internal resolution and external dispute resolution services.

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

All intermediary fees should be disclosed.

(j) what, if any, additional services should intermediaries provide to enhance investor protection

No comment

(iv) any other matter?

Tax incentives should be provided for small to medium enterprises who are able to achieve CSEF target amounts.

Question 9 - Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

We are of the view that option 5, the creation of a self-contained statutory compliance structure is the best option to pursue.

A new regulatory framework should provide stakeholders with certainty and clarity in respect of the laws and regulations that apply specifically to CSEF, but also avoid any negative impacts on the existing complex laws for other regulated financial products and securities.

Queensland Government Submission to the Corporations and Markets Advisory Committee Review of Crowd Sourced Equity Funding

The Queensland Government recognises that crowd sourced equity funding (CSEF) has the potential to improve access to risk capital, and to provide an alternative to friends and family as a source of finance for start-ups. High growth businesses who might be encouraged by this type of investment, can make a positive contribution to skilled employment and productivity growth. The introduction of CSEF could enable a more conducive environment for start-ups in Australia, given other jurisdictions (United States, Canada, United Kingdom, New Zealand and Europe) are introducing various forms of CSEF.

The Queensland Government is strongly committed to establishing and sustaining a robust economic environment in which to conduct business. This includes using science and innovation for economic success, encouraging entrepreneurship and innovation, fostering start-ups and facilitating the growth of small and high-growth potential businesses, cutting red tape, removing barriers and promoting the importance of small businesses to the community. The Queensland Small Business Strategy and Action Plan 2013-2015 and the Queensland Science and Innovation Action Plan outline these commitments.

In terms of issues raised in the discussion paper, there are a number of general matters that ought to be considered in the Australian context, should a regulatory option be pursued. For example consideration could be given to restricting the classes of issuer to ones similar to those allowed in the United Kingdom, that the types of securities permitted should be kept as simple as possible, excluding complex securities such as derivatives, and the maximum funds that an issuer may raise in any 12 month period should be set high enough to encourage a wide variety of projects, but recognise the potential for the dilution of investors' interests. Potential investors will need to have sufficient and accurate information to make an informed investment decision, and that CSEF should be limited to new issues, excluding the on-selling of existing securities.

Further, a company reporting regime in line with that currently required for proprietary limited companies, would balance regulation with the spirit of simplicity of CSEF, and minimise red tape. Additional information should be made available to the investor on request. An area of concern is the implication if the target investment level is not reached. Partial funding of a project may increase its risk of failure and investor losses. Consideration should be given to how offers that do not reach investment targets within the allotted timeframe are managed.

Queensland considers that in accordance with best practice regulation and with its commitment to lower regulation, the impacts of any proposal to regulate CSEF should be identified early on in the policy development process. Queensland suggests that the next step include robust cost benefit analyses on a number of alternative options, compared with the status quo. While CSEF is an innovative proposal, it is important to weigh up any potential, adverse impacts and risks against the expected outcomes of economic growth before committing to a particular course of action. Such an approach will facilitate sound decision-making and allow for an outcome that delivers a net benefit to the economy.

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