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Manager  
Financial System Assessment Unit  
Financial System and Services Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

### **Submission - “Crowd-sourced Equity Funding” discussion paper dated December 2014**

OzCrowd welcomes the opportunity to provide our views on the proposed Crowd-sourced Equity Funding (**CSEF**) framework by way of submission and we appreciate the invitation to participate in the Melbourne roundtable being held on 16 February 2015.

#### **Background**

OzCrowd was established in 2013 to provide a platform exclusively for Australian projects and can be considered one of the most liberal platforms worldwide. We allow all Australian individuals, community groups, charities and businesses to launch crowdfunding campaigns on OzCrowd and we have seen significant growth in both interest and funds raised as time has progressed.

Being one of the few operating platforms in Australia and considering extending our services to CSEF (subject to appropriate regulatory changes), we are in a unique position to provide our views from an intermediary perspective. Separately, having personally worked with small businesses and start-ups on a daily basis as a corporate and tax lawyer, I have significant practical experience to contribute to the consultation process.

Whilst I am a board member of the Crowd Funding Institute of Australia (**CFIA**) it should be noted that this submission represents my views and those of OzCrowd and may not align with all members or offices of the CFIA.

#### **Discussion Paper – Responses**

1. **Is the main barrier to the use of CSEF in Australia a lack of a CSEF regulatory structure, or are there other barriers, such as a lack of sustainable investor demand?**

As noted in the introduction to the Discussion Paper, the current Corporations Act prohibitions and restrictions make it impractical or impossible for small companies to raise funds from a large number of investors. In our view, whether other barriers may impact on the take-up of CSEF cannot be accurately determined until regulation is implemented.

We expect investor demand to increase similarly over time as retail investors become accustomed to the alternative investment opportunity where there is sufficient deal flow. Accordingly, whilst we acknowledge the need to provide for adequate investor protection (and in fact, we are very supporting of appropriate mechanisms to protect the reputation of the industry) particular attention must be given to ensuring all parties are able to participate in the proposed regime as efficiently as possible.

2. **Do the existing mechanisms of the managed investment scheme regime and the small scale personal offer exemption sufficiently facilitate online offers of equity in small companies?**

Both the Managed Investment Scheme (**MIS**) regime and the Small Scale Personal Offer (**SSPO**) exemption fall short of providing the ability for the issuers to efficiently access funds from the “crowd”.

3. **Other than the restrictions identified above in relation to limitations on proprietary companies, public company compliance requirements and disclosure, are there any other barriers to the use of CSEF in Australia?**

Risk-appetite and investor education are potentially further barriers which may limit the uptake in CSEF, even where an efficient model is developed. We believe that, as with any new concept, it will take time for the market to adapt.

4. **Should any CSEF regime focus on the financing needs of small businesses and start-ups only, or is there a broader fundraising role?**

This depends on the mischief sought to be addressed by limiting CSEF to small businesses or start-ups. Whilst we appreciate that there may be a view that the new regime might be exploited by larger entities to circumvent the traditional safeguards of the Corporations Act in capital raising, we caution against limiting CSEF “concessions” to particular sized businesses due to the following:

- Complexity – how will the definition be applied, revenue definitions (such as those within the income tax regime) may exclude small businesses that have high revenue but low profits due to their market
- Avoidance – entities may seek to structure around the definition
- Generally very large entities have greater trouble convincing the crowd that they should get involved in a crowdfunding initiative.

Rather, we suggest that a cap on total funds raised by issuers within a 12 month period will ensure the regime is appropriately targeted to the right segment of the market.

5. **Do you consider that, compared to existing public company compliance costs, the exempt public company structure is necessary to facilitate CSEF in Australia?**

A mechanism to reduce the prohibitive public company requirements (auditor appointment and review, annual general meetings, extensive disclosure documents) is definitely required. However, in our view, rather than the complexity of implementing a new company type, we suggest a provision is included in the Corporations Act which requires a minimum level of additional investor protection for any Proprietary Company which undertakes CSEF - we envisage provisions which feature in appropriately drafted shareholder agreements such as regular summarised financial updates, rights of first refusal, tag along/drag along rights, distribution policies, etc.) would suffice.

6. **To what extent would the requirement for CSEF issuers to be a public company, including an exempt public company, and the associated compliance costs limit the attractiveness of CSEF for small businesses and start-ups?**

The exempt public company does well to remove some of the prohibitive elements however it will only form a short-term solution if limited to a particular time period and we believe it may increase complexity (and

therefore delay the implementation of the regime). An alternative mechanism as described in our response to question 5 above should be considered.

7. **Compared to the status quo, are there risks that companies will use the exempt public company structure for regulatory arbitrage, and do these risks outweigh the benefits of the structure in facilitating CSEF?**

As per our response to question 4, whilst we appreciate that there may be a view that the new regime might be exploited by larger entities to circumvent the traditional safeguards of the Corporations Act in capital raising, we caution against limiting CSEF “concessions” to particular sized businesses due to the following:

- Complexity – how will the definition be applied, revenue definitions (such as those within the tax act) may exclude small businesses that have high revenue but low profits due to their market
- Avoidance – entities may seek to structure around the definition
- Generally very large entities have greater trouble convincing the crowd that they should get involved in a crowdfunding initiative.

Rather, we suggest that a cap on total funds raised by issuers within a 12 month period will ensure the regime is appropriately targeted to the right segment of the market.

8. **Do you consider that the proposed caps and thresholds related to issuers are set at an appropriate level? Should any of the caps be aligned to be consistent with each other, and if so, which ones and at what level?**

Whilst we see a cap of \$2 million in any 12-month period as a positive start, we would envisage this may not be large enough for certain ventures. Based on enquiries received to date, we expect a cap of \$5m to be more appropriate.

We do have a significant practical concern regarding the cap were it to apply to CSEF as a whole, rather than through a particular intermediary, as without a central database it would be difficult to monitor. This can be dealt with either through the cap only applying to one particular platform or the obligation being shifted to the issuer and thereby the intermediary should not have to undertake the process to confirm how much has been raised on various platforms.

9. **Do CAMAC’s recommendations in relation to intermediary remuneration and investing in issuers present a significant barrier to intermediaries entering the CSEF market, or to companies seeking to raise relatively small amounts of funds using CSEF?**

As a platform contemplating expanding our services in CSEF, CAMAC’s recommendations would severely limit the attractiveness both from our perspective and our potential clients. Crowdfunding is attractive due to the limited start-up cost and ability to pay for the services using part of funds received. If variable fees by reference to funds raised were prohibited, we would expect much less competition from an intermediary perspective and many less issuers taking advantage of the model.

10. **Do the proposed investor caps adequately balance protecting investors and limiting investor choice, including maintaining investor confidence in CSEF and therefore its sustainability as a fundraising model?**

The investment caps are significantly detrimental to the regime. From a compliance perspective, similarly to our response to question 8 above, without a central database it will be considerably difficult to monitor the level of investment by each particular investor across all intermediaries. Further, limiting individual contributions to any specific quantum decreases the likely take-up and success of issuers meeting their target quantum. We strongly advocate that with adequate disclosure, investment caps are not necessary.

11. **Are there any other elements of CAMAC's proposed model that result in an imbalance between facilitating the use of CSEF by issuers and maintaining an appropriate level of investor protection, or any other elements that should be included?**

With respect to promotion, given the nature of crowdfunding, it is recommended that an approach is taken whereby advertising is permitted outside of the intermediary platform but limited to basic information – name, business and directing people to the intermediary whereby the full details, including risk statement would need to be read and acknowledged.

12. **Do you consider it is important that the Australian and New Zealand CSEF models are aligned? If so, is it necessary for this to be achieved through the implementation of similar CSEF frameworks, or would it be more appropriate for CSEF to be considered under the Trans-Tasman mutual recognition framework?**

We do not believe that it is necessary for the models to be aligned. The key point is that the regime is implemented to provide for the highest chance of success and economic rewards for all parties.

13. **Do you consider that voluntary investor caps and requiring increased disclosure where investors contribute larger amounts of funds appropriately balances investor protection against investor choice and flexibility for issuers?**

We believe that a template disclosure document will more appropriately provide investor protection and certainty.

14. **What level of direction should there be on the amount of disclosure required for different voluntary investor caps?**

As above, we believe that a template disclosure document will more appropriately provide investor protection and certainty.

15. **How likely is it that the obstacles to CSEF that exist under the status quo would drive potential issuers, intermediaries and investors to move to jurisdictions that have implemented CSEF regimes?**

From our experience and enquiries on our platform to date, we expect that the more likely outcome is that issuers will either consider alternative fundraising activities (we have had many businesses try rewards-based crowdfunding due to the inability to participate in CSEF) or alternatively and particularly for the smaller ventures, forgo the opportunity they are seeking to raise funds for.

We understand that there are a number of intermediaries that are awaiting the form of regulation change to decide whether to enter the market. Whether these intermediaries move to alternative jurisdictions is difficult to gauge. We are aware of at least one intermediary which has set-up in New Zealand due to the status quo

in Australia. From our perspective, we will continue to operate in non CSEF crowdfunding in Australia and consider opportunities as and when they arise.

From an investor perspective, we would expect many are seeking alternative investments including high-risk ventures. If Australia does not provide adequate deal flow or regulation is prohibitive there will definitely be a segment of the market that invests through international platforms.

**16. What are the costs and benefits of each of the three options discussed in this consultation paper?**

From a high level, our view is that a hybrid of the CAMAC and New Zealand models will ensure that CSEF has the greatest chance of success within Australia. In particular, we believe the model implemented requires the following New Zealand features:

- Reduced complexity by removing exemptions from certain company compliance costs and fewer caps and thresholds for issuers
- Intermediaries are not restricted in fees they can charge or the interests they can acquire in issuers using their platforms, potentially increasing the pool of CSEF investors and intermediaries
- The ability for intermediaries to charge a fee proportional to the funds raised would be consistent with existing market practice for equity capital raisings and provide an incentive for intermediaries to only list issuers they consider will successfully raise funds
- Disclosure-only approach to business due diligence by intermediaries

Further, the following CAMAC recommendations are also suggested:

- One class of shares may be offered excluding options and convertible securities
- A mechanism to reduce the prohibitive public company requirements (auditor appointment and review, annual general meetings, extensive disclosure documents). Rather than the complexity of implementing a new company type, we suggest a provision is included in the Corporations Act which requires a minimum level of additional investor protection for any Proprietary Company which undertakes CSEF - we envisage provisions which feature in appropriately drafted shareholder agreements such as regular summarised financial updates, tag along/drag along rights, distribution policies, etc.)
- Offers can only be conducted through one intermediary and that intermediary can make the offer and process the acceptances only through its online website
- No investor-screening requirement
- Risk disclosure template

Separately, even where intermediaries were required to undertake limited due diligence, licensing should be restricted to a non-onerous or costly process and should not require an AFSL or AML.

17. **Are the estimated compliance costs for the CAMAC and New Zealand models presented in the appendix accurate?**

**CAMAC** – we believe the public company cost for certain issuers is likely to be significantly more than estimated, and is difficult to quantify broadly. System costs are also likely to be greater where Australian-based labour is required.

**NZ** – Similarly to CAMAC estimates, system costs are also likely to be greater where Australian-based labour is required.

18. **How many issuers, intermediaries and investors would be the expected take up online equity fundraising in Australia under the status quo, the CAMAC model and the New Zealand model?**

Again, difficult to quantify, particularly without knowing the lay of the land in terms of the final proposed regime. However, based on the 100 or so enquiries we have received regarding CSEF on OzCrowd, a model similar to New Zealand will have significant interest from an issuer perspective. Given the number of intermediaries interested in this reform, we again expect significant interest if a favourable model was implemented. For retail investors, it provides a new avenue and we expect interest would increase over time, particularly as understanding developed. Retail investors are already making such investments into family and friend proprietary companies with almost no protection.

19. **Are there particular elements of the New Zealand model that should be incorporated into the CAMAC model, or vice versa?**

Please refer to our response to question 16 above.

20. **Are there particular elements of models implemented in other jurisdictions that would be desirable to incorporate into any final CSEF framework?**

Given models implemented in other jurisdictions have had limited time on the market and/or limited success, our view is that the hybrid New Zealand / CAMAC model referred to above has the greatest likelihood of servicing the needs of small business whilst offering investors efficient access to alternative investments, exposure and associated returns.

21. **Do the issues outlined in this consultation paper also apply to crowd-sourced debt funding? Is there value in extending a CSEF regime to debt products?**

Whilst we would welcome de-regulating the debt market to provide for peer-to-peer debt lending as seen internationally to a certain extent, we suggest the current focus should be to implement an appropriate CSEF regime as quickly as possible.

22. **To what extent would the frameworks for equity proposed in this discussion paper be consistent with debt products?**

As above.

23. **Would any of the options discussed in this paper, or any other issues, impede the development of a secondary market for CSEF securities?**

We envisage a secondary market will take a significant time post implementation of CSEF to provide the volume required to operate effectively.

We thank you for the opportunity to participate in this consultation process. If you would like to discuss further, please contact me directly on 0401 154 313.

Yours faithfully



**Nick Karolidis**  
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OzCrowd