

Submission on regulatory framework for crowd-sourced equity funding

Thank you for the opportunity to provide a submission on the Crowd-sourced Equity Funding Discussion Paper, released by the Treasury on December 8 2014.

1. ZenBus Advisory's business

1.1 ZenBus Advisory provides business advice for new ventures by combining macroeconomic forecasts with insights from behavioural science. Consequently, we consider our advice to be an important component in the appropriate allocation of funding for early-stage businesses and we have an interest in ensuring that providers of that funding are able to assist businesses in an efficient way.

2. Response

2.1 We see a clear need to develop a robust regulatory framework for CSEF. Jurisdictions where this funding mechanism is developed are advantageous for early-stage ventures, enabling innovation to flourish. Business activity lost in this arena, via migration of talent or simply through opportunities not taken, is obviously difficult to quantify but can be reasonably expected to have material economic and social impacts.

The CAMAC model overall displays features that should strengthen investor comfort in CSEF and provide potential issuers with a sound framework for meeting regulatory compliance whilst not imposing stifling administrative burdens in the early stages of business development.

In summary, ZenBus Advisory's key items within this submission are:

The CAMAC model is an appropriate framework for CSEF in Australia, alignment with other jurisdictions (particularly NZ) is seen as beneficial but not necessary. If the domestic and NZ markets are not aligned this would be unlikely to hamper CSEF if the domestic framework is appropriately constructed.

The regulatory framework should not prescribe a fee structure for intermediaries.

Intermediaries should be able to hold an interest in issuer securities.

Investor protection should be in the form of cooling off rights, and an annual cap on the total sum that can be invested in CSEF (but not caps on investments comprising this annual sum). Capping the annual sum balances individual protection and individual choice by imposing a limit

that can be seen to be addressing the total CSEF market size rather than addressing any individual's financial circumstances and risk-taking propensity.

3. Questions

3.1 Question 1. The main barrier to CSEF is the lack of a robust regulatory structure. The cap on the number of equity holders in small proprietary companies is a major impediment. Exemptions around limiting factors currently may not always be appropriate to serve the funding requirements of small and start-up businesses. CSEF should be bound by a structure that is sufficiently constructed to be inclusive of both investor and business needs.

3.2 Question 2. Existing exemptions that enable some level of CSEF presently are not sufficient to enable the industry to develop. Maintaining the availability of investment options to sophisticated investors removes one of the fundamental drivers of growth in this industry: the openness of investment opportunities to anyone willing to accept the risk carried in the opportunity. A regulatory structure for CSEF needs to widen the pool of potential investors.

3.3 Question 3. The fragmented nature of the market and the lack of a secondary market represent a barrier to uptake of CSEF. This is a component of the risk involved in investing in small businesses and start-ups and should form an important component of disclosures to potential investors.

3.4 Question 4. A regulatory structure for CSEF should be limited to small and start-up businesses. Funding destinations should be clearly defined as small or start-up businesses not materially connected to other business entities. Regulation should preclude entities connected to existing larger-scale businesses from accessing crowd-sourced equity as a low-cost and low-risk funding option even if that funding is for a clearly defined new project or venture.

3.5 Question 5. The exempt public company structure seems a sound method to ease regulatory/administrative burdens on emerging businesses whilst also providing investor comfort. This would assist CSEF by providing a clearer place for CSEF in the spectrum from private to public equity.

3.6 Question 6. The proposed company structure should not limit the appeal of CSEF. Companies capable of carrying the responsibilities associated with seeking external funding from investors, and in effect going public, should be the target for CSEF.

3.7 Question 7. There are risks of companies taking advantage of the proposed new exempt public company structure. Regulatory oversight should be the response rather than not enacting the changes that would provide much benefit to legitimate companies operating under this structure. Exempt public companies should not be connected to existing larger companies or to any publicly listed companies.

3.8 Question 8. The proposed caps and thresholds related to issuers are currently appropriate.

3.9 Question 9. CAMAC's recommendations may provide a barrier to market participation. Intermediaries should be able to invest in issuers provided full disclosure of this is available to other potential investors. Fees based on funds raised should also be permitted, with the market between issuer and intermediary being the final decider. Intermediary financial interest in issuer success should be seen as a positive sign, and limiting this may not provide clear benefits.

3.10 Question 10. The proposed investor caps align relatively well with the aims of providing investors with funding choices and providing consumer protection, though the cap on the amount an investor may provide to a single issuer may be limiting. This \$2,500 per investor per issuer cap may hamper the capability of smaller appeal issuers to raise funds and also imposes artificial limits on the risk level that investors can willingly accept. The overall annual cap of \$10,000 should be sufficient alone to protect CSEF investors.

3.11 Question 11. CAMACs model for CSEF should consider including cooling-off rights for investors and thresholds of sophisticated investor interest for equity issuances to proceed (refer to response to Q20).

3.12 Question 12. Australian and NZ regulatory frameworks need not align completely. If alignment is deemed appropriate, we are of the opinion that not all aspects of NZ's CSEF regulatory frameworks are mirrored. For example, refer to Q13 response.

3.13. Question 13. Investor caps are primarily appropriate at the level of absolute annual cap, proposed at \$10,000. How this is composed should be a matter for individual investors to determine. It should be possible to invest \$10,000 in one single offering. Investor protection should take the form of education on risks involved, not prevention of risk taking at levels that investors may feel comfortable with.

3.14 Question 14. Disclosure should be uniform regardless of investor cap levels.

3.15 Question 15. The status quo would very likely result in migration of investment opportunities away from Australia.

3.16 Question 16. No input.

3.17 Question 17. The compliance costs estimated in Treasury modeling seem realistic.

3.18 Question 18. No input.

3.19 Question 19. The CAMAC model is overall sound. It could additionally benefit from several features of the NZ model such as:

- variable fee structure for issuers including fee as a percentage of funds successfully raised

- intermediary investment in issuer equity offering should be permitted

3.20 Question 20. Restrictions on intermediaries compensating promoters of issuer securities seem appropriate to develop trust in the CSEF industry (similar to US model).

The model in place in Italy has a number of features that protect investors without imposing restriction of choice. These are particularly notable as ZenBus Advisory is against caps which limit the sum of investments beneath the annual permitted cap. These positive features are:

- a cooling off right: Investors can retract investments at any time until the CSEF campaign closes (This could be in place until 72hours before campaign close, to ensure that last minute withdrawals can not jeopardize a fund raising achieving its target)
- 5% of the total funding raised must be from institutional or professional investors (analogous to sophisticated investors in present CSEF framework). This provides a level of comfort in the validity of issuers successful in obtaining funding. This component of funding should not be inclusive of any intermediary investment.

3.21 Question 21. The issues outlined in the discussion paper would be expected to also apply to (non-convertible) debt instruments. The appetite for retail debt funding for start-ups and small businesses may be different enough from that for equity so that enhanced regulatory structures would be less of a consideration for potential investors when determining whether to holding debt rather than equity in any start-up ventures.

3.22 Question 22. Issuer and intermediary responsibilities as set out in the proposed CSEF regulatory structure could be applied to debt products.

3.23 Question 23. The options proposed by CAMAC would not hamper development of a secondary market.

Please don't hesitate to contact Michael Hardiman for any clarification required on this submission from ZenBus Advisory.

Regards,

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