

Submission in regard to the The Corporations Amendment (Crowd-sourced Funding) Bill 2015

By Paul Niederer.

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- Consultant to multiple platforms and governments worldwide on Equity Crowdfunding
- Chosen by Shanghai - Lujiazui Government too lead an "Expert Work Station" on "Blockchain research and application" relative to funding and matchmaking platforms

JOB? Funding?

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The catchcry from the proponents of this legislation has been

1. It creates "Jobs!"
2. it will result in more "Small Business Funding"

However in my extensive experience **it will do neither**.

Which is a shame as in essence we are commenting on legislation that will be used by very few small businesses raising capital but will incur cost structures for intermediaries and regulators that will at the end of the day be paid by taxpayers and investors.

COSTS?

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For the millions of dollars it will cost to implement and administer this legislation there is no evidence that this it will actually improve the ability for entities to raise capital nor gain traction or jobs or recover the millions it has cost to date and will cost in the future.

You ask why?

WILL IT WORK FOR SMALL BUSINESSES? NO.

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Two reasons:

1. The proposed legislation is pitched at companies (*top right in the next two diagrams below*) wanting to raise millions due to its insistence on using **licensed intermediaries** (costly) but also getting the intermediaries to take responsibility for the raises (also costly) means capital raising costs to small businesses of \$20k to \$80k per raise. (This is further evidenced by the requested late changes to raise the turnover size to \$25 million). Another nod towards the big end of town and away from the sub \$1m raises). This legislation will not be practical, functional or economical for raises under \$1 million.
2. It is **outdated** even before implementation. Worldwide "disruption" is eliminating archaic structures like regulation prescribed intermediaries. Witness how the following disruptors have eliminated age old structures. Uber, AirBNB, Bitcoin, Realestate.com.au, Webjet, Expedia, eBay etc. Regulated intermediaries are no

longer part of the internet driven trust chain. Things aren't done this way any more. Every industry worldwide has declining numbers for intermediaries as peer to peer business evolves. The Equity crowdfunding solution **should embrace disruption** NOT **position it for disruption** by creating a new breed of intermediaries! .

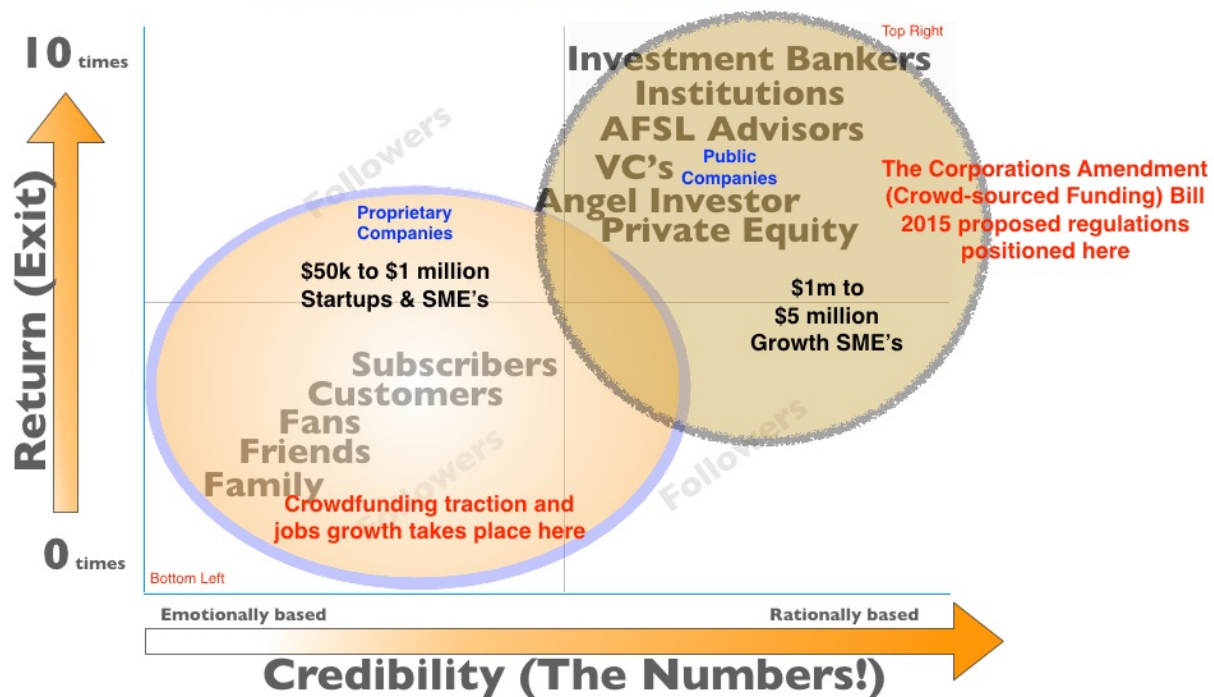
So what does all this mean

It means that The Corporations Amendment (Crowd-sourced Funding) Bill 2015, if traction ever results, is best for ...

- 1) **Medium sized** established companies with **larger turnovers**
- 2) that can **afford to pay an AFSL holder** \$30k to \$80k per raise
- 3) and they want to raise **more than a million** at a time (\$1 million + raises)
- 4) most likely in capital cities **not in a regional area**
- 5) and it is not the small business who is raising capital who makes the decision to raise (use the legislation). It is the curation front end of the **regulated licensed platforms that decide** which of the nation's small businesses are "**qualified**" to raise capital. :-)

As you can see from the diagram below "unlisted company (small business) raises" that are uncertain off their possible exit and don't often have the numbers/financials (track record) for serious investors fall in the bottom left quadrant. This is exactly where innovation takes place. See also European Crowdfunding Network diagram below.

The Corporations Amendment (Crowd-sourced Funding) Bill 2015- mismatch with most StartUps and SME's



Regulatory Mismatch with Crowdfunding©Paul Niederer 2017

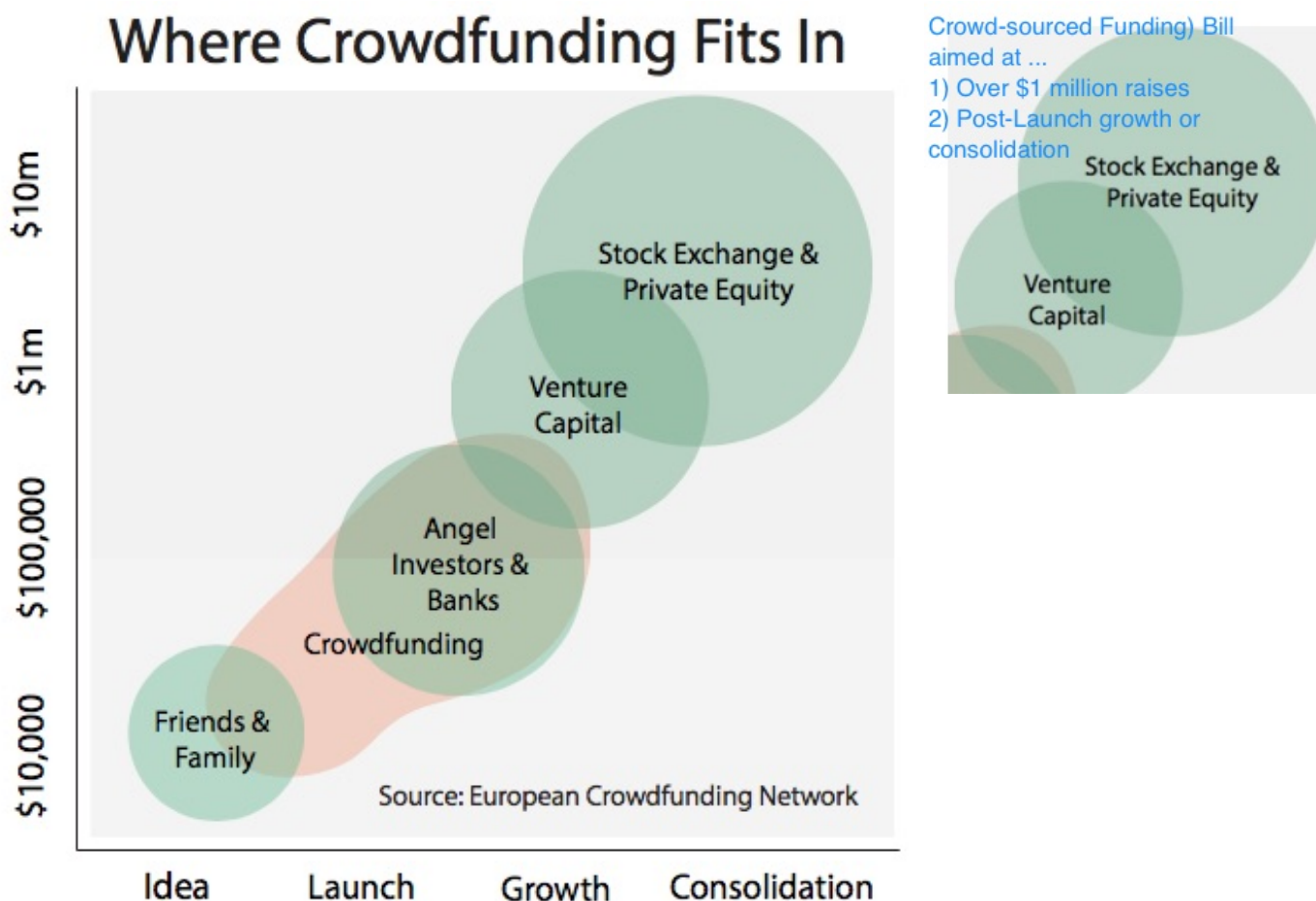
The Corporations Amendment (Crowd-sourced Funding) Bill 2015 is pitched near TOP RIGHT in the diagram above. A good positioning for the regulator and incumbent intermediaries who can tack this onto their existing operations but not for the majority of small businesses. (BOTTOM LEFT in diagram above)

WHAT ABOUT SMALL BUSINESSES?

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Say you are a small business wanting to raise \$500k. and perhaps a regional business. You will need to be “selected” by a licensed intermediary (probably major city based) as a match for their own front end curation standards and willingness to take responsibility for your raise. For them to do this for you, they will give you no guarantee as to whether or not they raise the funds for you and you will have to pay between \$20k and \$80k by the time they deliver **shiny, colourful pitch documents, videos and offer documents worthy of the intermediaries business** but maybe not yours.

The following diagram from the European Crowdfunding Network was produced after mine above but it even more clearly shows **that a system (legislation)** looking at \$25 million turnovers, with regulated intermediaries needing to be paid fees to operate is nowhere near the bottom left of this diagram. The Corporations Amendment (Crowd-sourced Funding) Bill 2015, is TOP LEFT in this diagram (see inset) also and that is a long long way from innovative small businesses needing \$200k to \$1 million to seed, launch or grow their business.



GOOD FOR INTERMEDIARIES

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This legislation as written is good for the intermediary and the regulator, as they get paid upfront but not good for small businesses wanting to raise funding. However if volume business does not result intermediaries will turn to other financial services opportunities. We have already seen this in other jurisdictions where platforms started in the start-up sector and to keep alive they move to debt funding, real estate and other areas and no longer solely work in the area the legislation was intended. (More jobs, More Small Business Funding)

As I said in a recent newspaper article “Perpetuating costly licensed entities to manage peer-to-peer transactions and having a myriad of ceilings and caveats is counter-productive in a world being disrupted by the elimination of intermediaries.”

WHY WE ENDED UP WITH SUCH UNWORKABLE LEGISLATION

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The pathway this legislation has taken explains why it is so far from positively embracing the reality of the emerging internet based financing opportunity for small businesses.

- 1) CAMAC studied draft regulations around the world to achieve “best of breed” of **other countries legislation NOT practice**. I write with authority here as I had many meetings with the SEC and other financial regulators worldwide in the early days of writing regulations as that wanted my views on what could work.
- 2) It was early days. None of these jurisdictions were operational and had no actual operational experience. As detailed in the World Bank report on Crowdfunding Australia was the only country with a history of over 300 retail equity crowdfunding raises. At this stage though no input was requested from existing Australian platforms by CAMAC.
- 3) CAMAC recommended the best practices they gleaned in their report from their theoretical research overseas.
- 4) Government departments and Industry participants like ASSOBS, Equitise, VentureCrowd, Capital Pitch and Crowdfund UP pointed out that the legislation as drafted would not work effectively.
- 5) Billsen came up with a workable compromise then a reshuffle took place.
- 6) Government then engaged with ASIC and Treasury, disregarded industry input and rolled back The Corporations Amendment (Crowd-sourced Funding) Bill 2015 to predominately CAMAC’s academic findings
- 7) Legislation was drafted on this basis and fine tuned against selected interest group requests
- 8) The legislation ventured back and forth and is now at the Senate Committee

So basically we have an academic research document that has no evidence or basis of practical experience or implementation being fine-tuned in the hope it will work. **It wont.** There is no evidence world-wide that equity crowdfunding funding raises, for small business, anchored by regulated intermediaries, gain the traction their proponents espouse as the reason for doing this. (Lots of small businesses being funded, lots of new jobs being created)

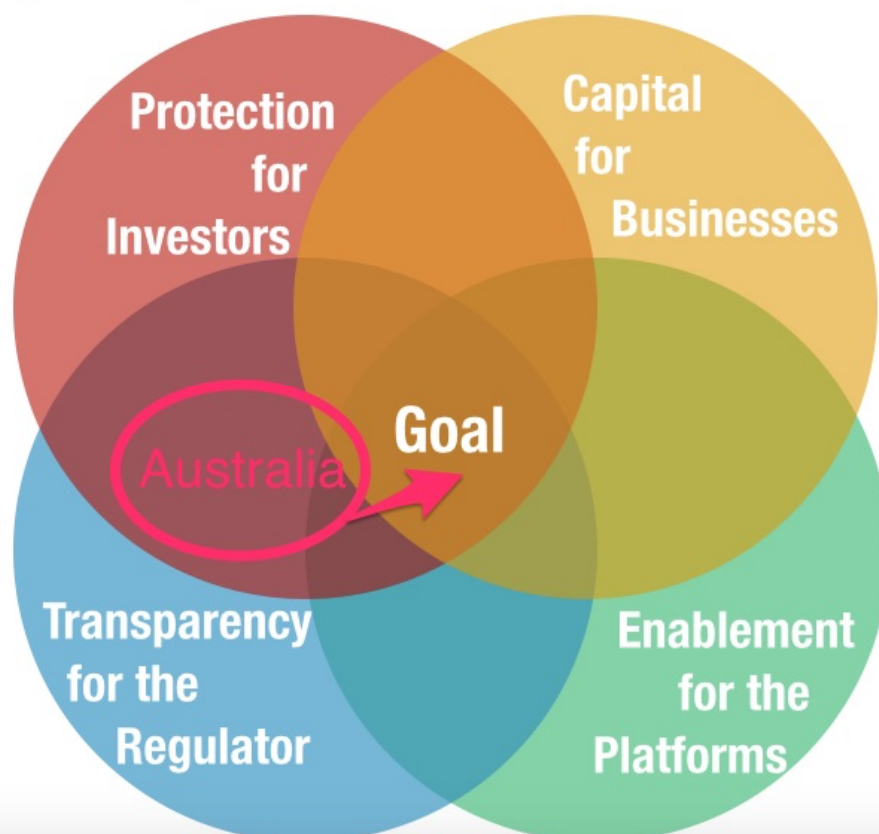
The following diagram from Crowdfund Capital Advisors (CCA) shows where crowdfunding legislation needs to sit to be successful. If it is too far over to the right or left it wont work. What is amazing with this proposed legislation is that it is pitched so far to the left in the diagram. Most people have said to wont work there yet it still proceeds through government in the hope that it might just work. This diagram shows why it will not. Mostly because

- It is not favourable or cost effective for small businesses to raise capital this way
- It is costly and risky for platforms to staff up to meet regulatory requirements for small businesses wanting to raise \$200k to \$1 million

The red circled Australia in the diagram below is where the The Corporations Amendment (Crowd-sourced Funding) Bill 2015 is focussed now. It needs to shift massively to the right.

The CCA Balanced Stakeholder Framework

All 4 Sectors Need to Come Together to Create a Vibrant Crowdfunding Ecosystem



WHAT SMALL BUSINESSES NEED TO GET FUNDED

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Most small businesses are not heading for IPO's or being bought by Google. They don't have complex needs. They just need to compliantly handle the processing of money from people that are passionate about their opportunity and want to invest via the internet. This is what the legislation should allow.

In reality they simply want to gather investors that together may want to in total fund them to their next stage of development of say \$500K.

They need to be able to do this on a peer to peer basis, take responsibility for the raising by working with a recognised crowdfunding platform that operates according to agreed guidelines but they are not licensed. The platform effectively publishes the offering, according to unlicensed platform guidelines like eBay and Alibaba.com.

As we move forward these equity crowdfunding investments will be able to be seen in distributed ledgers powered by the blockchain where peer to peer investment is legitimised by being recorded in the blockchain by parties that are legitimised and connected by smart contract protocols. No room for intermediaries here as investments can be made for a fraction of what the processes and structures this legislation prescribes. That is when this legislation will be disrupted. That may be only a year or two away. We will have barely got started with The Corporations Amendment (Crowd-sourced Funding) Bill 2015 when disruption, probably from Singapore, Dubai or the U.K will occur.

A WORKABLE SOLUTION THAT CAN START TOMORROW

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Ditch the legislation.

The best way to embrace this disruption is not with legislation that empowers intermediaries and will thus lack traction.

The best way to embrace this disruption is to use an appropriate 'sandbox' like the regulators in the UK, the most productive and forward looking crowdfunding country in the world.

The best way is for the government and ASIC to work with industry players, already operating or intending to operate in the equity crowdfunding space such as Pozible, ASSOBS, Equitise, VentureCrowd, Capital Pitch and Crowdfund UP to "sandbox" test what works in the market and develop a mutually beneficial framework that allows the benefits of equity crowdfunding to flow on to small businesses and the start-up community. Some may use Managed Investment Schemes in their structures, others may use the Small Scale Offerings Legislation, others may use a hybrid of both or whatever. It is essential that this approach inspires broad, managed innovation.

They would do this under the existing Corporations Act without any amendments until required by sandbox endeavours.

What that means is that if the platform that is working with ASIC for example could raise more funding, more compliantly if it increased the maximum amount invested by a retail investor to \$15,000 then they could trial that. OR a Class Order Operator using the Small Scale Offerings Legislation might use the Sandbox to test what happens when the number of retail investors in a company shifts from a 20 cap to 50 or 100. Over a period of time the most conducive ecosystem for handling internet based capital raising for small business will evolve. Legislation can then be drafted based on the real world.

Nowhere in the world is there a smooth running successful system for Equity Crowdfunding. The “smooth running system” won’t be dreamed up by regulators and government departments for sure. So why not develop it through a controlled sandbox innovation process. There is virtually no downside to this because the regulator would be fully involved.

Crowdfunding is just an enhanced broader version of friends and family funding that uses the internet to transact. Random unconnected people do not invest in unlisted companies until a relationship has developed. A Sandbox approach is the fastest and most cost effective way to sort this.

Ditch the legislation, create a crowdfunding sandbox for existing platforms, let platforms innovate, let the regulator monitor it, learn, adapt and lead the world, Australia.