



Senate Standing Committee for Economics

Corporations Amendment (Crowd-sourced Funding) Bill 2015 [Provisions]

Introduction

CrowdReady appreciates the opportunity to provide our submission on the Australian Government's facilitating crowd sourced equity funding Corporations Amendment Bill 2015 (Bill) and Corporations Amendment Regulations 2015 (Regulations). We are pleased that the Australian Government is moving forward on facilitating the crowd sourced equity funding framework.

CrowdReady aids the development of crowd sourced equity funding (CSEF) in Australia. By providing independent analysis and comment, we assist entrepreneurs, investors and crowdfunding platforms to build a sustainable and trusted eco-system.

CrowdReady has previously provided submissions to:

- CAMAC's CSEF Review in September 2013;
- CSEF Public Consultation Process in February 2015;
- Treasury in August 2015; and
- The draft Crowd Sourced Funding Bill in November 2015.

CrowdReady also continue to provide updates on Australia's crowd sourced equity funding development via our website, www.crowdready.com.au.

Viewpoint

CrowdReady believes that further undue delays in the implementation of crowd sourced equity funding would be more detrimental to the Australian startup eco-system than moving forward on the proposed regulatory and legislative model.

Our view is that the current Bill and Regulations are more facilitating in nature rather than encouraging crowd sourced equity funding in Australia. We are of the opinion that this Bill is the first step in facilitating an effective financial interest crowdfunding regime in Australia, with the need to facilitate and legislate for proprietary company (e.g. under \$2m and simply copying the New Zealand model), property and peer-to-peer lending within the next 12 months.

However, there are a few minor amendments to the Bill that the Senate Standing Committee for Economics should consider that will improve equity crowdfunding in Australia whilst still balancing the need for Investor protection, Intermediary responsibilities and Eligible CSF company disclosure and compliance.

CrowdReady also offers our time and resources to the Senate Standing Committee for Economics in February 2016 for elaboration or discussions on crowd sourced equity funding in Australia.



1. Issuers

The CAMAC Report of May 2014 outlined the exemptions from public company disclosures which were not fully covered in the Bill or Regulations (as per the following table with the highlighted sections discussed further below):

Obligation	Corporations Act reference	Public Companies using CSEF
Continuous disclosure (being a disclosing entity)	ss 111AC(1), 111AF, Chapter 6CA	No
Application for registration	s 117	Yes
Display company name	s 144	No
Mandatory office opening hours	s 145	No
Information on how to contact the company	s 146A	Yes
Duties to act with due care and diligence and in good faith	ss 180, 181	Yes
Controls on termination benefits	Part 2D.2 Div 2	Yes
Minimum number of directors	s 201A(2)	Yes
Rules for resolutions for appointment of public company directors	s 201E	No
Shareholders' right to obtain information about directors' remuneration	s 202B	Yes
Related party transactions	Part 2E.1	Yes
Statutory procedures for shareholder meetings (other than AGM)	Part 2G.2	Yes
Hold AGM	s 250N	No
Two-strikes rule	s 250R(2), (3), Part 2G.2 Div 9	No
Keep financial records	s 286	Yes
Financial report	s 292	Yes (to shareholders only)
Directors' report	ss 292, 298, 299	Yes (unlisted company obligations only)
Remuneration reporting requirements	s 300A	No
Shareholder entitlement to report	s 314	Modified: online only
CSEF capital raising limits in 12 month period		\$5 million
Appoint an independent auditor	s 327A	No (unless certain thresholds met)
Have financial report audited	s 301	No
Half-year financial report	Part 2M.3 Div 2	No
Takeover provisions	Chapter 6	No



Financial Reports

Issue:

- confidentiality is important to startup businesses
- public company general purpose financial reports cost/benefit

Explanation:

An annual financial report should be available only to shareholders. The Bill indicates that the financial report should be lodged with ASIC, which in effect, allows for public consumption. Given the startup nature of the potential companies utilising crowd sourced equity funding, and the potential for public consumption of its Intellectual Property and financials, we suggest that either such lodgements with ASIC be confidential or not required to be lodged during the exemption period.

The financial reports should be special purpose public company financial accounts – there is less disclosure than general purpose accounts – but are more readily digestible for retail investors and more easily collated by startups.

Recommendation:

- financial report available only to shareholders
- public company special purpose financial reports

Half-year financial reports

Issue:

- half year financial reports are an unnecessary burden

Explanation:

The Bill and Regulations do not appear to have excluded the provision to provide half-yearly reports – an unnecessary burden on startups. CrowdReady has indicated in previous submissions the requirement of Issuers to be registered for quarterly GST, ensuring that appropriate management accounts are kept up to date and reported.

Recommendation:

- no half-year financial reports are required
- ensure CSF eligible companies are registered for GST

Directors

Issue:

- director disclosure and appointments should reflect startup nature

Explanation:

The Directors' Report financial report disclosure should be equivalent to the unlisted company obligations only rather than the broader public company disclosure requirements. In addition, we believe that the rules for appointment of public company directors under s201E of the Corporations Act will be an administrative burden given the exemption to hold an AGM, where general practice includes the voting on directors' appointments, rotations and resignations. Shareholders have recourse through calling a meeting of members with 5% or more of the voting shares on issue.

Recommendation:

- exemption from s201E for holding general meetings confirming director appointments



Auditors

Issue:

- too low a threshold to justify cost/benefit of audited reports

Explanation:

CrowdReady contends that an auditor should only be needed to be appointment after \$2million is raised, not \$1million, to align itself with the s708 small scale offerings, which can raise up to \$2million in any one year in a proprietary company. The estimated cost of an auditor is \$20,000 per annum and we believe this money would be better allocated to growing the business and so would prefer to see the option of an appropriately qualified accountant (CPA, CA) to prepare / sign off on the accounts for up to \$2million rather than appointing a financial audit firm.

Recommendation:

- increase threshold to \$2m to align with small scale offerings

Offer Timing

Issue:

- inflexible approach to offer opening timing

The Bill and Regulation's wording regarding the time an offer can be open, being three months, is appropriate. However, the restrictions on extending the offer of lesser time (for instance, research suggests that two months is the "ideal" open period) is inflexible, prohibiting an extension for a month (but still within the three month maximum). CrowdReady believes that an extension of one month (but within the three months of the offer being first open) allows for better flexibility, allows Issuers who are close to their minimum subscription to meet their funding requirements, and does not materially effect Investors.

Recommendation:

- offers can be extended to a total of three months, without the need to close and then reopen the offer



2. Investors:

Investor Caps

Issue:

- Incentive for CSF Issuers to change responsible intermediary

Explanation:

There has a number of changes to the quantum of investor caps (from \$2,500 to \$10,000) and the removal of total investor caps (from \$10,000) since the original CAMC Report. The Government has accepted the difficulty for Intermediaries in administering and reporting on investor caps across numerous CSF raisings. However, the Bill may have left an unintended consequence, as there is an incentive for an Issuer to change the responsible Intermediary if it wishes to raise additional monies within a 12 month period. In section 6.10 of the Regulations, the investor cap only relates to the same intermediary, thereby providing an incentive to change the responsible intermediary and effectively 'reset' the investor caps from the recent CSF shareholders.

We do not foresee too many CSF Issuers conducting more than one capital raising in any 12 month period, and suggest that Investors have the opportunity to invest again and not be diluted, but believe that there should not be an incentive to change a responsible Intermediary.

Recommendation:

- Remove incentive for CSF Issuers to change responsible intermediary

Investor Cap Exemptions

Issue:

- inconsistent with small scale offerings

Explanation:

Under s708 of the Corporations Act, namely the small scale offerings, there are a number of investor 'types' that are not counted towards the \$2million cap, and with crowd sourced equity funding, CrowdReady believes should be exempt from the \$10,000 investor cap limit.

Namely, s708(12) includes the senior manager of the Issuer or their family members. Startups in general, and naturally crowd sourced equity funding, is likely to be supported by key management and family members, but under the Bill, will be restricted to an investor cap of \$10,000. We believe this unnecessarily restricts a source of capital that would be allowable under small scale offerings, which requires no disclosure, against crowd sourced funding which will offer disclosure and risk warnings. This will actively encourage small scale offerings with no disclosure or risk warnings prior to any crowd sourced equity funding campaign – potentially putting these investors at a disadvantage in terms of information.

Further, investors with a past or current relationship to crowd sourced equity funding Issuers (such as customers or suppliers), who do not qualify for exemptions under the Bill, should have the option to invest in sums greater than \$10,000.

Recommendation:

- consistency with small scale offerings, namely s708(12)



Sophisticated Investors

Issue:

- outdated and inconsistent with international jurisdictions

Explanation:

Whilst not strictly the sole domain of crowd sourced equity funding, the current process of being certified as a sophisticated investor is outdated and inconsistent with international jurisdictions. The requirement for an accountant to certify whether a person is a sophisticated investor is inefficient and inappropriate. CrowdReady believes that a self-certification process for sophisticated investors should be implemented to align itself with the US and UK.

Recommendation:

- Self-certification for sophisticated investors

Listed Entity

Issue:

- Related party to a listed company definition is too broad

Explanation:

Whilst recognising the Government's intention to minimise any disclosure arbitrage, the restrictions on listed entities investment or otherwise in eligible CSF companies has the potential to discourage innovation. CrowdReady foresees the option for innovative individuals / teams within listed companies being supported from a financial and resource perspective but also through crowd sourced equity funding campaigns as a means of proof of concept. The current Bill and Regulations make no allowance for such and in fact restrict this avenue to innovation.

Recommendation:

- CSF Issuers with listed company parent entities are able to open a CSF Offer if the listed entity maintains ownership of less than 50%



3. Intermediaries:

Australian Financial Services Licence

Issue:

- Financial resources of responsible intermediary

Explanation:

CrowdReady has been one of the few industry supporters of Intermediaries being required to hold an Australian Financial Services Licence. We are comfortable with the Bill and Regulations on this view for equity crowdfunding platforms but believe the level of competencies should be equivalent to those of operating registered managed investment schemes to retail investors from a financial, human resource, IT, compliance and organisational perspective. Thus, the requirement to hold a minimum of \$150,000 in cash or cash equivalent net tangible asset (NTA) should provide a reasonable buffer to ensure the solvency of the responsible intermediaries.

Recommendation:

- Ensure minimum cash and/or equivalent NTA of \$150,000

Intermediary Vehicle

Issue:

- Significant segment of equity crowdfunding restricted

Explanation:

Under the Bill and Regulations, notably s738G(1), there is no avenue for an intermediary vehicle (such as a unit trust) to pool retail investors' money for the sole purpose of investing into an eligible CSF company. This should be rectified by allowing investment via a discrete unit trust which has the sole purpose is to invest in a company that meets the proposed Bill's eligible CSF company criteria. The pooling of investors into a single structure may also minimise the administration burden on eligible CSF companies for ongoing reporting. We would recommend the same level of disclosure and due diligence checks under the proposed Bill and Regulations and thus providing Investor protection, yet facilitating the use of a discrete unit trust.

Under the current legislative framework, a discrete unit trust would be required to be a registered managed investment scheme (MIS). An MIS is more appropriate for a portfolio based approach rather than for an investment in one eligible CSF company. However, given the internal and external compliance, registration and auditing costs of operating an MIS that invests into one eligible CSF company, it would not be cost effective.

CrowdReady's recommended approach is to amend the Bill to allow for a discrete unit trust whose sole purpose is to invest in one eligible CSF company. We would further recommend that the discrete unit trust would not need to be registered as a managed investment scheme, but that the responsible intermediary would need to have an AFSL that included the authorisation to operate a registered managed investment scheme for retail investors. This is to ensure that the responsible intermediary has the competencies, experience and skills to operate a unit trust.

An extension of the discrete unit trust structure, is that it also provides Investors with the opportunity to invest alongside a professional, or angel, investor into an eligible CSF intermediary under the same investment terms and valuations. It should be noted that there are two common types of equity crowdfunding: entrepreneur-led and investor-led (for further



information, please see our articles¹). Investor-led equity crowdfunding generally utilises a discrete unit trust (or syndicate) and is prominent and growing in the UK and US with respected platforms such as SyndicateRoom and Angellist.

Under the scenario where discrete unit trusts are facilitated under the Bill and Regulations as outlined above, it provides flexibility and allows Australian investors the same opportunities as their international contemporaries.

Recommendation:

- Allow discrete unit trusts for investment in eligible CSF companies
- Require responsible intermediaries registered managed investment scheme authorisation

Related Party

Issue:

- Ensuring responsible intermediaries are independent

Explanation:

The Intermediary should not be considered a related party, associate or 'agent' of the Issuer for providing a crowdfunding service and this should be disclosed in writing under the Regulations. The Intermediary is required to disclose its fees, equity or pecuniary interests in the Issuer, which should remain, and be sufficient for these purposes.

Recommendation:

- The Regulations to provide this assurance for the Intermediary

Application money

Issue:

- Efficient, yet third party, holder of application monies

Explanation:

It is not clear in the Bill or Regulations whether the Intermediary needs to appoint a third party Custodian (as per registered managed investment schemes) for application monies. CrowdReady's view is that for efficiency purposes, whilst maintaining independence and safety, application monies should be held in a trust account by an Authorised Deposit Taking Institution and released to the either the Issuer (if successful) or refunded to Investors (if unsuccessful), rather than appointing a third party Custodian.

I am available during February to discuss further in person should that assist the Senate Standing Committee.

Contact:

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¹ <http://www.crowdready.com.au/news-1/2015/9/an-entrepreneurs-perspective-entrepreneur-led-v-investor-led-equity-crowdfunding> October 2015; <http://www.crowdready.com.au/news-1/2015/9/an-investors-perspective-entrepreneur-led-v-investor-led-equity-crowdfunding> September 2015