Australian Private Equity &
Venture Capital Association Limited

2 February 2016

Committee Secretariat
Senate Standing Committees on Economics
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Parliament House
CANBERRA
ACT 2600

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Dear Sir/Madam,

Submission on the *Corporations Amendment (Crowd-sourced Funding) Bill 2015*

The Australian Private Equity and Venture Capital Association Limited (AVCAL) welcomes the opportunity to make a submission to the Senate Economics Legislation Committee's inquiry into the *Corporations Amendment (Crowd-sourced Funding) Bill 2015*.

AVCAL is the national association representing the private equity and venture capital industries in Australia. Our members comprise most of the active private equity and venture capital firms in Australia. These firms provide capital for early stage companies, later stage expansion capital, and capital for management buyouts of established companies.

We are supportive of the Government's plans to introduce a legislative framework to facilitate the use of crowd-sourced funding (**CSF**) in Australia, as part of broader efforts to help improve access to capital for startups and high-growth companies. AVCAL's view is that the rules should be simple and cost-efficient, and principally targeted at successfully aligning the interests of startups and CSF investors.

In this submission, we have provided our views on the key design features of a new CSF policy framework. This submission focuses on the following issues in relation to the eligibility requirements for a CSF offer:

1. Requirement for CSF issuers to "not have a substantial purpose of investing in securities or interests in other entities or schemes, and none of its related parties have such a purpose"

a) **"Related parties" restriction**

Section 738H(f) specifies that an eligible CSF company, and any related party, must not have "a substantial purpose of investing in securities or interests in other entities or schemes".

The inclusion of "related parties" within this condition has potentially significant implications for the quality and depth of the pool of eligible startups that can use the CSF regime. Some of the most successful CSF campaigns to date have been by startups which also had directors or other investors which include VCs, investment groups and angel investors.[1] Where these co-investors are caught up in the definition of "related parties", this may disallow many of the most promising startups from accessing CSF, resulting in a reduction in the overall quality and depth in the pool of eligible companies.

[1] For example, the largest CSF round to date was backed by Israeli CSEF intermediary OurCrowd, which raised US$6m of a US$19.5m funding round for Borro, an asset-backed online lender. Other investors in that round included VC investors such as Rocket Internet AG, Canaan Partners and Augmentum Capital. One of Australia' s most successful crowdfunded ventures, Ingogo, raised $1.2m on VentureCrowd, out of a total $9.1m funding round led by financial backers UBS and Canaccord Genuity.

AVCAL strongly recommends that the drafting of Section 738H(f) of the Bill in relation to "related party" should be reviewed given the potential unintended implications of excluding promising startups from the CSF pool.

b) **Exclusion of investment companies from crowdfunding**

The proposed framework disallows investment companies or funds from crowdfunding. While AVCAL generally agrees with this restriction, it is unclear why funds should be excluded from using the CSF regime where they invest solely in businesses that are eligible to use the CSF regime themselves.[2] Allowing such early stage funds to access the "crowd" would support the policy goals of the CSF framework and open up greater opportunities for retail investors to achieve greater diversification of their CSF interests.

As highlighted in previous AVCAL submissions, there are benefits arising from allowing pooled funds that invest in a portfolio of startups to crowdfund, i.e. to "crowdfund a fund". This would allow non-professional investors the opportunity to access via CSF platforms a professionally curated, diversified portfolio of investments for a relatively small initial outlay. Such opportunities can be particularly valuable in early stage investing where access to expertise, information and diversification are highly desirable for successful investment in novel, high-risk ventures.

It would also be consistent with the policy objective of the CSF framework "*to provide finance for innovative business ideas and additional investment opportunities for retail investors*".[3]

It should be noted that companies that engage in investment activity as a core part of their business models have successfully crowdfunded in the past, and allowing this under the CSF framework would help facilitate innovation and broaden the range of CSF investment opportunities for retail investors. For example, some of the most successful CSF platforms operate on a curated basis, where the platform (or a related party) selects potential offerors on a competitive basis, and takes a minority stake in the startups accepted for listing on the platform. At the same time, the crowdfunding platform itself may be a startup that wants to raise capital on its own platform. In such situations, the requirement above may disallow that platform from being able to either raise money through CSF or execute its business model.

AVCAL recommends that the requirement that the offeror should "*not have a substantial purpose of investing in securities or interests in other entities or schemes, and none of its related parties have such a purpose*" be amended to allow investment companies or funds that invest solely in CSF-eligible companies to be able to access the CSF regime.

[2] Although the Corporations and Markets Advisory Committee's 2014 report "*Crowd sourced equity funding*" recommended against allowing "complex institutions" such as investment institutions to crowdfund, it did so on the basis that these arrangements had "the capacity to seek funds from the public through the processes under Chapter 6D (Fundraising) of the Corporations Act". However it should be noted that early-stage funds face similar problems to startups in accessing public funds, hence their ability to access the CSF framework should not be ruled out as being inconsistent with the policy objective.

[3] *Explanatory Memorandum to the Corporations Amendment (Crowd-sourced funding) Bill 2015,* p.3.

2. Requirement for the company and related parties not to have more than one CSF offer open at any one time

Section 738R requires that a company must not crowdfund at the same time a related party of the company is crowdfunding.

As set out above, if a startup is already part of accelerator, angel or VC portfolios which are deemed to be related parties, this may disqualify other startups in those portfolios from crowdfunding even if they are operate completely independently of the first startup.

AVCAL recommends that the requirement in Section 738R that the company and related parties should not have more than one CSF offer open at any one time should be amended given the potential unintended implications of excluding promising startups from the CSF pool.

3. Requirement for equity crowdfunders to be unlisted public companies with under $5m in consolidated gross assets and $5m in consolidated annual turnover

a) Unlisted requirement for related parties

Section 738H(e) in the Bill and Sections 2.14 and 2.26 in the Explanatory Memorandum to the *Corporations Amendment (Crowd-Sourced Funding) Bill 2015* states that in order to be eligible for the CSF regime, neither the company, nor any related parties, can be a listed corporation.

The inclusion of "related parties" in this requirement may be problematic if it affects startups which have received seed funding from corporate accelerators/VCs with listed parent entities, or VC investors that have listed companies in other parts of their portfolios. In such cases, these listed companies are typically independent of the startup seeking CSF and have no control over any investment decision relating to the startup. A corporate-backed accelerator may not be able to further fund the startup for various reasons, for example if it is seeking further capital beyond of the accelerator's investment mandate.

AVCAL recommends that the requirement in relation to "related parties" in determining a company's unlisted status should be reviewed, given the potential unintended implications of excluding promising startups from being eligible to crowdfund.

b) Thresholds of $5m in consolidated gross assets and $5m in consolidated annual turnover

Section 738H(2) states that a company is an "eligible CSF company" if it complies with the asset and turnover tests prescribed therein.

However, the use of "consolidated gross assets" and "consolidated annual turnover" for the asset and turnover tests may be problematic, if other related parties such as existing directors and investors (e.g. angel or early stage VC groups, or corporates) are caught up in this definition. As explained in Section 1, promising startups have existing seed investors but may yet still seek CSF investment for various reasons. These may be, for example, to diversify their shareholder base, expand their public profile, or to supplement or replace institutional capital for further product development and expansion.

It should also be noted that other countries such as New Zealand, for example, do not impose a similar cap on the size of the company that can access CSF. Prescribing thresholds on issuer size may inadvertently disqualify some genuine startups from crowdfunding. In any case, the caps on the amount of CSF capital that can be raised will likely result in smaller companies self-selecting to use the CSF regime anyway.

AVCAL recommends that the requirement in relation to consolidated gross assets and consolidated annual turnover be reviewed to ensure that promising startups that have received seed funding from other investor groups are not disqualified from being eligible to crowdfund.

If this is not possible, then a secondary solution may be to address the unintended effect of disqualifying genuine startups that are part of larger early stage investment portfolios by virtue of the "consolidated gross assets" and "consolidated annual turnover" requirements. This may, for example, draw on the Employee Share Schemes legislation where the startup concessions are available to eligible startups with less than $50m aggregated turnover, but with a carve out for businesses funded with Venture Capital Limited Partnership (VCLP) and Early Stage Venture Capital Limited Partnership (ESVCLP) vehicles.

If you would like to discuss any aspect of this submission further, please do not hesitate to contact me or Dr Kar Mei Tang on 02 8243 7000.

Yours sincerely,

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AVCAL