



**Australian Government  
The Treasury**

**Crowd Sourced Equity Funding  
Discussion Paper  
December 2014**



## Introduction

CrowdReady appreciates the opportunity to provide our comments on the Australian Government's Crowd-sourced Equity Funding Discussion Paper of December 2014. We are pleased that the Australian Government is looking towards finding the appropriate regulatory structure that minimises costs for Issuers, provides Investor protection and ensures that Intermediaries are sufficiently competent.

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.

Through a client, we provided a submission to CAMAC's CSEF Review in September 2013 and continue to provide updates on Australia's crowd sourced equity funding development to interested subscribers via our website, [www.crowdready.com.au](http://www.crowdready.com.au).

CrowdReady's view is that legislative and regulatory changes in Australia are necessary to facilitate CSEF in Australia. We believe that the CAMAC review was substantially well thought out and with a number of refinements, would deliver a model that balances Investor protection, Intermediary responsibilities and Issuer disclosure and compliance.

In terms of structure of a response, we have addressed the 23 questions put forward in order with a summary of CrowdReady's position at the conclusion. CrowdReady also offers its time and resources to the Australian Government should there be any further questions or discussions surrounding crowd sourced equity funding in Australia.

We have maintained the definitions of Investors, Intermediaries and Issuers as per the CAMAC CSEF Report of September 2013 and May 2014 (CAMAC Report) and the Crowd-Sourced Equity Funding Discussion Paper of December 2014 (CSEF Discussion Paper) for consistency and clarity.

Before commencing, we feel it is important to clarify our views regarding the nature of CSEF. In our view, CSEF is an extension of the current rewards based crowdfunding systems – however, one that includes a potential financial reward through shareholding. In essence, this includes raising capital of up to \$2m but more likely less than \$1m, from a large number of mostly unsophisticated or “retail” investors.

## 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?**
- 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?**

The main barrier to an efficient crowd sourced equity funding model in Australia is costs. This is exacerbated by the current legislative and regulatory structure that inhibits the raising of capital from a large number of smaller investors via the internet in newly established small companies. There is a chasm between the current small scale personal offering exemption and the public disclosure requirements, with managed investment schemes not being the ideal mechanism.

CrowdReady has also noted, along with the CSEF Discussion Paper, that recently a number of Australian companies that have sought to work within the current constraints of the legal and regulatory structure in Australia but all have fallen short of the true equity crowdfunding model seen in many other international jurisdictions. These offerings have included: equity online for sophisticated / wholesale / professional investors only; via a public company or managed investment scheme that then invests in smaller companies; via small scale offerings limitations / exemptions; or looking to and applying for CSEF type licences internationally where equity crowdfunding has already been legislated. From an Investor perspective, we note there are increasingly Australian Investors making equity contributions via international intermediaries that inevitably contributes to additional risk for Australian Investors. Each of these “solutions” typically has an intermediary charging relatively higher costs for access to smaller company’s equity raising. The latter, being licencing and investing in international jurisdictions, will become more prevalent should the Australian Government not introduce CSEF regulatory in the short term.

Both the CAMAC report and the CSEF Discussion Paper have highlighted the relatively high cost for small companies to raise capital from a large number of investors. The small scale offerings require Issuers to make ‘personal’ offers and restrict to itself to no more than 20 retail investors does not lend itself to a true equity crowdfunding model. Under the current regulatory environment, an equity crowdfunding model (raising small amounts from a large number of investors) would necessarily require the Issuer to become a public company (greater than 50 non-employee shareholders) and issue a prospectus. For companies raising relatively small amounts, say \$100,000, this would result in substantial monies being raised to pay for the upfront and ongoing costs under the current public company legislation. Costs for ASIC; writing, checking and issuing a prospectus (corporate advisory); audit fees; ongoing disclosure; legal fees etc. would necessitate raising at least double the amount required to build the business. Investors would rightly shy away with approximately 50% of equity being raised into regulatory and compliance costs.

Investor demand for equity crowdfunding is currently unquantifiable in Australia. Although it has been noted that there has been contributions by Australian Investor’s via international equity crowdfunding platforms as well as in the quasi-CSEF platforms



in Australia. As a guide, ASSOBS has raised over \$140m since their inception albeit under a high cost and highly regulated environment. Therefore, it is reasonable to assume that there is demand, albeit the level of this demand is currently unknown under the proposed Australian CSEF model.

There are also the usual Investor concerns regarding investing in illiquid and small business whatever the fundraising process – a risk that is generally offset by the potential for higher reward. There are a number of Australian intermediaries (noting the uncapitalised I) that have worked within the current legislative / regulatory environment to offer quasi-equity crowdfunding sites, each of these have had to make changes – high costs, Investor-type restrictions, working under international jurisdictions where CSEF has been legislated, interposed structures etc. – none of which encourage the typical crowdfunding style contributor.

### **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?**

There are a number of other barriers to the successful introduction of crowd sourced equity funding in Australia. We believe the main barriers to entry include the current legislative and regulatory framework leading to high costs for smaller enterprises wishing to raise capital from a large number of investors. That is, the equity crowdfunding model. We will not re-iterate the current issues with SSOB and public company disclosures for the CSEF model – we will take these as known.

- Pre offer advertising – this is an area that creates significant problems for fundraising under the current legislative environment. CAMAC’s view of directing potential Investors to the Intermediary website is correct. However, additional guidance for Intermediaries and Issuers, especially given the prevalence of social media (and success with rewards based crowdfunding) needs to be considered as part of the review. It is essential that Issuers have the opportunity to let their social network know early of their intentions, for a social media campaign can “make or break” crowdfunding campaigns.
- Managed investment schemes – whilst in theory this could be the equity crowdfunding model in Australia, there are additional risks for responsible entities as well as costs that would need potentially make this option financially unviable. We note the disconnect of a trust structure between Investors and Issuers is given as a reason under CAMAC’s Report for opposing this approach.
- Complexity – crowdfunding, whether it be rewards, donation or equity, needs to be a relatively simple process for contributors (or Investors). Crowdfunding is by its very nature an online process. If Investors are required to submit additional information to the Intermediaries via paper form (whether it be risk acknowledgement, PDS style application forms, 100 point ID checks or AML / CTF certifications), this will impede the potential of crowdfunding in Australia. These processes must be allowed in an online format. Please note CrowdReady’s suggestions regarding AML / CTF (including 100 point certification) in regard to investor caps.

- Issuer streamlining – the CAMAC Report has indicated standard or template based formats for equity crowdfunding. CrowdReady sees this as an imperative to enhance Investor and Issuer transparency / comparative purposes and reduce the risk for Intermediaries. For example, Risk disclosures, Issuer Offer Disclosure in a template form will be important – it will also save on costs. CrowdReady is happy to assist in helping framework these documents.
- Education – in the relatively complex world of capital raising under the current legislative environment, the proposed equity crowdfunding reforms will still require the Intermediary to ensure that the Issuer (and its officers) has an understanding of the Corporations Act, common law and other legal remedies that may be available to Investors for information that is either misleading or deceptive. In addition, the Intermediaries will likely need to provide some level of information to potential Issuers (an Issuer Guide for instance) that outline the roles and responsibilities as well as a checklist and agreement that is signed by the Issuer and the Intermediary. Generally, the education element will be catered for by the equity crowdfunding industry.

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

We believe it would be ill advised to restrict the CSEF fundraising role to small business and start-ups only. Equity crowdfunding is generally known worldwide as a method to which Investors will have the opportunity to invest in small businesses and start ups. Rather, the CSEF regime should allow CSEF to evolve where investor demand meets Issuer supply within the other restrictions outlined. Implementing further restrictions could be reserved after a reasonable period for a governmental review.

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

While the exempt public company itself may not be considered necessary, CAMAC's recommendations for a company structure between the disclosure requirements of a private and public company does require legislative change.

CrowdReady is not opposed to the introduction of an exempt public company as per the CAMAC Report or utilising the proprietary company legislation with additional ongoing disclosure and requirements for those raising under the CSEF model. Either way. The CAMAC Report recommends more limited disclosure requirements, which are well thought out and appropriate for smaller organisations.

In addition, CrowdReady suggest that all Issuers should opt in for GST at the exempt public company registration to ensure Issuers maintain and record their financials on a regular basis – for their benefit as well as Investors.

**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?**

We believe that the current public company upfront and ongoing disclosure requirements has and will continue to impede crowd sourced equity funding in Australia. With regard to exempt public companies, there are additional upfront and ongoing compliance requirements that are more substantial than private companies, but this should be expected as a reasonable trade-off for easier access to fundraising.

There are additional costs associated with the exempt public company regime but the main expenses relating to disclosure requirements has been somewhat offset by proposed CSEF legislation (namely, template offer documents) and that financial audits have been delayed in order to provide these companies with the ability to build their businesses before undergoing the more stringent public company regulations and costs.

There will still be some additional costs for Issuers that may be required under the proposed exempt public company regime, namely director credit / bankruptcy checks and police checks, Issuer credit reports, Issuer's major shareholders reports, and ASIC searches.

### **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?**

There are risks of arbitrage in the introduction of any new legislation whether it relates to the proposed CSEF model or anything else. A method to reduce the compliance arbitrage as suggested would be a time limit to raise money under a CSEF model otherwise be required to fall under the private or public company regime depending on their shareholder base.

The risk is significantly outweighed by the potential benefits of facilitating CSEF in Australia.

### **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?**

From our knowledge, there are no regulatory caps on Investors in any capacity for any other financial product in Australia.

However, we acknowledge that investing in start ups is a higher risk investment option than many other financial assets (alas the need for high rewards) and there is a need to reduce the regulatory overlay in Australia to facilitate CSEF. The concern over fraud appears to have been exaggerated given early international experience.

We favour the New Zealand model in relation to Investor caps.

CrowdReady is concerned that the CAMAC model doesn't fully allow for Investors who know the Issuer (1<sup>st</sup> connection including family and friends) or know of the Issuer (2<sup>nd</sup> connection). That is, those who are "connected" to the Issuer. Industry statistics from



ASSOB show that 50% of a start-ups capital is raised from friends and family, 25% from people one connection away and the other 25% from third parties/not connected. First connections are especially likely to be the sources of the majority of capital raised in the smaller raising (less than \$250,000) campaigns. This should be encouraged rather than dissuaded by limits.

CrowdReady suggests the following retail investor cap regime (assuming there is one):

- Maintain \$2,500 investor cap and \$10,000 in any one year. However, make these “soft” caps and therefore more in line with the New Zealand no cap limit. Individual investments under this amount will be required for the regular disclosure requirements as suggested by CAMAC and no requirement for an AML / CTF. This will save costs for Investors if using an online process or time if using a paper based form.
- Allow further investment above these caps with increased risk disclosure and Investor details by the Intermediary (included under AML / CTF and also reason the Investor believes they should exceed the cap – e.g. Issuer known to the Investor; Investor’s personal financial resources are sufficient). This additional “compliance hurdle” whereby further information is required from the Investor may provide further thought as to the associated risks.

**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?**

The Intermediary remuneration suggested under CAMAC is a significant impediment to a normal operating financial market, let alone under the CSEF model. The proposal for a flat fee, or one that is not based on a proportion of capital raised, is ill-advised.

It is contrary to how financial markets work, how the crowdfunding model works and would be an inhibitor to start ups requiring small amounts of equity. CrowdReady believes that initially, the equity crowdfunding campaigns will generally be well below the \$2m Issuer cap and indeed; the vast majority are likely to be raising less than \$500,000. A percentage model based on a successful capital raising and the amounts raised is important to enable rather than impede smaller capital issues.

In regard to restriction on Intermediary investment in Issuers, CrowdReady believes this should be reconsidered. Whilst noting that there is the potential for a conflict of interest and a perceived “endorsement” of one Issuer over another, this should be balanced by the type of people who will run and work at equity crowdfunding platforms. Many of the reward based contributors have been staff at the internet platform provider. At CrowdReady, our staff would like to participate in equity crowdfunding campaigns and limiting this may indeed be counter-productive.

Rather, there are already significant conflicts of interest requirements under the Corporations Act and especially in any entity applying for and /or receiving an Australian Financial Services Licence (as is recommended). To offset some of the conflicts of interest concern, these Issuers for whom associates of the Intermediary will invest, should have to make these pledges within the first half of a campaign to ensure



that pledges are not made to meet capital raising milestones. With regard to disclosing this to other potential Investors, we think this disclosure may in fact be detrimental to other campaigns. CrowdReady believes this could be managed via internal procedures for participation by an employee or officer which be signed off internally and reported annually to ASIC.

To further reduce either actual or perceived conflicts of interest, Intermediaries would be required to establish an internal policy as part of their AFSL application, which outlines the methodology and timing of where individual Issuers are located on their website, with prominence given to any one Issuer at any particular time being automated. This would minimise conflicts of interest or potential remuneration to Intermediaries for “highlighting” or otherwise, one campaign over another.

The Intermediary should not be able to offset their normal fee for equity in the business as this would set a precedent and potentially under capitalise the Intermediary from a cash flow perspective, but officers and employees should be able to invest their after tax income into such entities.

**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 investor caps in themselves do not necessarily provide additional protection for Investors, but rather as a means to highlight the inherent risks of small / start up investments. It is the additional investment related specific risk disclosures that provide adequate protection for Investors. As noted, we cannot point to any other financial product where there are Investor limits.

**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?**

We note our suggestion to the CAMAC model already provided and refer to the summary at the end of this submission.

We note the requirement of financial audits after a certain timeframe (or turnover / expenditure) for exempt public companies to convert into public companies. CrowdReady is of the opinion that there has been a need for legislative change when it comes to disclosing entities and public companies. We believe it is more important that disclosing entities are required to provide the full ongoing and upfront disclosure requirements than those entities that happen to have in excess of 50 non-employee shareholders. On that basis, there should not be a time limit for exempt public companies to convert into public companies but it should be based on reasonable turnover or capital raising limits. We suggest that any exempt company that raises from ‘the crowd’ more than once should have to convert into a public company after twelve months and secondly, when their turnover exceeds \$2m or expenditure exceeds \$1m.





In addition, we see the requirement of financial audits when converting from a exempt public company to public company requiring the Issuer to have financial audits extending up to potentially five years is an expensive exercise and has little value add. The current audit process would be for a minimum of two years historical for conversion to a public company (with a note regarding comparisons) and is reasonable to be brought forward under the CSEF regime.

**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?**

The proposed CSEF model by CAMAC has many similar features of the NZ model but could be called more restrictive in its application. With a few minor amendments to the CSEF model, as suggested in our response, we believe that the disparity between the two nation's equity crowdfunding models would not be too large as to entice Australian companies to raise money through the New Zealand model. Whilst there would be additional cost for Intermediaries in having two separate models and outside the Trans Tasman mutual recognition framework, refinements to the CSEF model in Australia via a five year review would allow for greater independence of Australian regulators to enact changes.

**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?**

Yes, increased disclosure levels are appropriate for additional levels of investment, with the exception of sophisticated, professional and wholesale investors. Retail investors should be able to invest up to the \$2,500 investor limit without the need for extensive disclosure or AML / CTF checks. This would allow the crowd funding model to flourish without the need for back and forths with potential investors and crowdfunding platforms. AML / CTF disclosure would be otherwise covered if the investor has an Australian bank account, perhaps as a prerequisite for investment above the investor limits.

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

The different levels of disclosure should be consistent across all Intermediaries. The usual exemptions for sophisticated, professional and / or wholesale investor should be maintained.

**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?**

Maintaining the status quo would entice potential Issuers, Intermediaries and Investors to other jurisdictions. This has already been illustrated by Australian investors under the newly established New Zealand model, whereby a significant proportion of capital raised for Issuers has been from Australia. A number of Intermediaries have considered or are undertaking New Zealand CSEF licencing applications due to the relatively slow nature of CSEF regulatory reform. We would expect this to increase under the status quo.

Whilst the New Zealand model does provide many similar CSEF parameters as Australia's proposed framework, there are other jurisdictions where Australian Investor's rights may be more difficult to ensure. That is, the risk of continuing down the status quo may in fact be more dangerous for Investors than implementing Australia's own regulatory overlay. Further, successful potential Australian Issuers will likely have future profits (and employment) benefiting international jurisdictions, furthering the concerning "brain drain" of a relatively unsophisticated and small capital raising market for small enterprises in Australia.

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

The costs and benefits have been adequately covered in the CAMAC report, the CSEF Discussion Paper and CrowdReady's response.

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

The estimated costs under the CAMAC model for compliance are generally accurate.

There are a number of items that are missing including financial and compliance audits for Intermediaries (assuming these are required to be public companies under AFSL requirements). There are also additional costs to Intermediaries (or Investors if the cost is passed on) for online AML / CTF checks and there is limited acknowledgement of the time and effort to understand the Issuer's offering, educate Issuers on CSEF requirements and guide Issuers through the process.

Some additional expenses that Issuers are likely to incur, whether their equity crowdfunding campaign is successful or not, is the due diligence requirements under the CAMAC model. Namely, these are third party checks but would include director credit / bankruptcy checks and police checks, Issuer credit reports, Issuer's major shareholders reports, ASIC searches and the ASIC fees to establish a company. Given a minimum of three directors and significant shareholders, the actual costs will add up and the time spent for Intermediaries and Issuers would be larger than that within the appendix.

**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?**



This is somewhat difficult to ascertain presently. As examples, New Zealand has seen some early success and is a useful proxy for Australia. OurCrowd has raised over \$100m in 56 portfolio companies under an accredited investor regime.

Pozible, in rewards based crowdfunding, started slowly but is gaining momentum with \$14m raised in 2014 and \$25m in total.

But maintaining the status quo, there will be further quasi-equity crowdfunding sites, as has already been seen, but will either not enter the mainstream or result in Australian Investors seeking opportunities in international jurisdictions unless there is regulatory change.

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

Please see summary.

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

CrowdReady supports that Intermediaries should be AFSL holders.

In addition, the authorisation for crowd sourced equity funding should be similar to the Responsible Entity regime for authorisation to operate managed investment schemes for retail clients. This is justified on the basis of the potentially large amounts from a large number of Investors that the CSEF model may invoke. Knowledge and experience in this area of handling client's money is imperative to enhance the trust and build a trusted eco-system for crowd sourced equity funding in Australia.

The 'Responsible Entity' equivalent authorization encompasses higher levels of organisational, compliance (including conflicts of interest), financial, human resources, technology, and risk management requirements. This is also to ensure that the Intermediaries are adequately positioned and financed to provide their services.

**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?**

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

The response here is made with an eye to proceed with equity crowdfunding in Australia quickly. That is, complicating the offerings could lead to delays that benefits neither the Investor, Intermediary, the Issuer, nor Australia.

For the most part, the consultation paper could apply to debt funding. However, there does need to be an intermediary who has experience and can assess the risk of any Issuer of debt crowdfunding (or peer to peer lending). CrowdReady believes that this could either be incorporated under the proposed changes or introduced within 12 months of CSEF regulatory change.



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

The secondary market for CSEF is currently an ideal rather than a reality. Apart from the ASX for equity, other secondary markets are so thinly traded as to make them basically obsolete. We would suggest that a CSEF secondary market be even more thinly traded. It may also lead to complicating the regulatory reforms required now and delay. There is an avenue for Intermediaries to introduce buyers and sellers but take no part in their negotiation. Nonetheless, a secondary market may develop (outside of a natural exit via IPO or trade sale) from industry participants but the timing may be 12 months after the introduction of an appropriate CSEF regime.



## Summary

CrowdReady's view is that legislative and regulatory changes in Australia are necessary to facilitate CSEF in Australia.

We believe that the CAMAC review was substantially well thought out and with a number of refinements, would deliver a model that balances Investor protection, Intermediary responsibilities and Issuer disclosure and compliance.

We do not believe that the status quo is a reasonable option.

In summary, the Australian Government should reconsider the following elements of the CAMAC report and align more effectively with New Zealand, if that is the chosen course of action:

- Soft Investor caps;
- Increased disclosure / justifications for exceeding Investor caps;
- Intermediary remuneration based on a proportion of successful capital raising;
- Intermediary conflict of interest to be self regulated - internally signed off and reported to ASIC on an annual basis;
- AFSL requirements for Intermediaries to be as exhaustive as those for a Responsible Entity with registered managed investment schemes, especially in regard to conflicts of interest;
- Intermediary websites positioning of campaigns to follow pre-determined methodology and advised to ASIC at the time of AFSL application;
- Issuers to be required to register for GST;
- All "exempt public companies' Issuers to be registered for GST;
- A reworking of the requirement for financial audits and the conversion of exempt public companies to public companies; and
- Most importantly, implement CSEF legislation in a timely fashion.

CrowdReady appreciated the opportunity to provide our comments on the Australian Government's Crowd-sourced Equity Funding Discussion Paper of December 2014. We are available for further discussion if deemed an avenue worth considering.

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