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## **Crowd sourced equity funding: Response to Discussion Paper**

Thank you for the opportunity to respond to the Corporations and Markets Advisory Committee ('**CAMAC**') Discussion Paper on crowd sourced equity funding ('**CSEF**').

We strongly support the concept of CSEF as an avenue for both small businesses and social enterprises to access capital to support their growth. Our particular interest is in how CSEF can support social enterprises, which our response primarily discusses.

### **About Chuffed**

Chuffed ([www.chuffed.org](http://www.chuffed.org)) is Australia's first not-for-profit crowdfunding platform. It supports Australian not-for-profits and social enterprises to run engaging online crowdfunding campaigns to raise funds and build support for their ventures.

We are supported by our Founding Partner, The Telstra Foundation.

Several of the organisations that we support, fall under the category of 'social enterprises' – defined as businesses that trade for a social purpose. These businesses take several incorporation structures but the majority are owned and/or run by not-for-profit organisations (generally incorporated as Companies Limited by Guarantee or Incorporated Associations). Chuffed, itself, would be classified as a 'social enterprise' that is owned by a not-for-profit company limited by guarantee.

We believe that several of these social enterprises would benefit from access to crowdsourced funding from equity, equity-like and debt structures. Furthermore, from the investor-perspective, CSEF could direct a significant volume of capital into the social enterprise sector from investors who prefer to receive both a social and financial return on their investments.

***Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF. If so, why, if not, why?***

We believe that explicit provisions should be made in the corporations legislation to accommodate CSEF. The current legislation does not make the

legality or illegality of CSEF clear which has prevented the growth of any significant CSEF sector in Australia.

CSEF would provide significant benefits not only to issuers looking to raise funds but also to investors looking to diversify their portfolio across a range of investments, particularly those looking for more 'impact investing' opportunities.

We believe that any adjustment to the legislation should balance:

- Managing the risk to investors through various regulatory mechanisms; with
- The reality that this form of raising funds is likely to involve a large number of small investments which likely do not represent a significant portion of any individual's net wealth; with
- The reality that this form of fundraising involves several social and community proof mechanisms which lead to very low levels of fraud

**Question 2: Should any such provision:**

- (i) take the form of some variation of the small scale offering exemption and/or**

We believe there are several models that could facilitate the emergence of a CSEF market, of which a variation of the small scale offering exemption is an option. In order for this option to be viable, the variations will need to be implemented, which include but are not limited to: lifting the shareholder cap (passed 100 shareholders, preferably unlimited) and removing the ban on advertising.

- (ii) confine CSEF to sophisticated, experienced and professional investors? If so, what, if any, change should be made to the test of a sophisticated investor in this context, or**

We do not believe that there is reason to confine CSEF to sophisticated, experienced and professional investors. If the aim is to manage investor risk, better options are to place provisions on the type of information that must be made available to investors and through caps on the amount that an individual investor can invest.

We believe that any restrictions of this nature would severely limit the possibility of a community to support local social enterprises.

**Question 5: In the CSEF context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?**

We believe that current obligations of intermediaries to ASIC provide sufficient protection for all parties involved. The addition of extra requirements such as financial services licensing would prove to be too high a regulatory burden for most CSEF intermediaries and would severely limit the intermediary market.

**Question 6: What provision, if any, should be made for each of the following matters as they concern CSEF intermediaries:**

**(i) permitted types of intermediary (also relevant to Question 5):**

Intermediaries should be registered with ASIC as CSEF intermediaries but should not be required themselves to have any further financial services licensing. They should outline the processes that they use to handle funds for the different security types and whether they will be involved in the processing of any returns to investors.

They should have some mode of internal dispute resolution process, but this should be limited to the functioning of the platform only and not the performance of the investments.

**(ii) intermediary matters related to issuers:**

- We do not believe that there should be restrictions to the types of projects or issuers permitted to raised funds through CSEF. It may be appropriate to place a limit on total amount of capital raised per issuer so that very large scale capital raising does not attempt to circumvent appropriate current legislation in place.
- Intermediary platforms are not best placed to conduct due diligence on issuers. This should be done by a separate sponsor or reference who may be required to be licensed in a different manner.
- Issuers, not intermediaries, should be held liable for investor losses resulting from any misleading statements made by issuers on the website or by any fraudulent activity conducted by the issuer. This places the liability in the hands of the person most responsible for these actions. Appropriate legislation should make this liability clear particularly if the intermediary acts as a merchant receiving funds from investors, potentially placing it in a liable position from its bank's point of view.
- Intermediaries should be limited from themselves making investments into issuers that they host and prevented from hosting projects from issuers in which they have a commercial interest. This would potentially represent a conflict of interest. All approval processes conducted by the intermediary should be done as a neutral party at arm's length.
- Issuers should have the option of placing a minimum threshold for funds raised. If they do not reach this minimum threshold, funds should not be transferred from the investors (or intermediary) to the issuer. This threshold should be optional and set by the issuer with the processing managed by the intermediary.

**(iii) *intermediary matters related to investors***

- It would not be economically feasible for intermediaries to screen or vet investors. Intermediaries should make reasonable attempts to ensure that the information about the investor that is provided is genuine information though.
- Intermediaries should be required to provide investors with a pro-forma risk disclosure about the nature of CSEF investments, the content of which could be stipulated in the legislation
- Intermediaries should limit any particular individual user on their platform to the appropriate limit per investment, and potentially across their platform. It would be impractical for intermediaries to check the total investments across all CSEF platforms unless this was provided in a centralized system.
- Intermediaries should not offer investment advice to investors unless they are otherwise licensed to do so.
- Intermediaries should be able to advertise their services as a CSEF platform and be able to showcase investment opportunities for the purpose of demonstrating what they do. The intermediary should also be able to offer advice to the issuer on how to advertise their offering.
- Intermediaries should be required to disclose all fees on any project page as well as as close to the point of transaction as possible in a simple format that clearly shows how much of their investment will go to the issuer and how much will go to the intermediary.

***Question 8: What provision, if any, should be made for each of the following matters as they concern CSEF investors:***

- (i) *permitted types of investor:*** *should there be any limitations on who may be a CSEF investor*

We believe that there is no reason to limit who may be a CSEF investor. Any limitation would unduly restrict the ability of social enterprises to raise funds in their community.

- (ii) *threshold sophisticated investor involvement (Italy only):*** *should there be a requirement that sophisticated investors hold at least a certain threshold interest in an enterprise before it can make CSEF offers to other investors*

We do not believe a threshold requirement is necessary. This would unfairly bias against newer ideas that may not yet have any sophisticated investors such as several small businesses.

- (iii) **maximum funds that each investor can contribute:** *should there be some form of cap on the funds that an investor can invest. In this context, there are a number of possible approaches under Issuer linked caps and under Investor linked caps*

We believe that a reasonable cap of \$10,000-\$20,000 per investor per offering should be placed. We do not believe that this should be linked to the income or net wealth of the investor as this would be impractical to monitor.

- (iv) **risk acknowledgement by the investor:** *should an investor be required to acknowledge the risks involved in CSEF*

Yes, the investor should be required to acknowledge and understand the risks of investing via CSEF through agreeing to an online pro-forma risk statement.

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We at Chuffed believe that CSEF has enormous potential to open up investments into not just the small business sector, but also into social enterprises who perform a critical role in our society. Setting up an appropriate regulatory structure for CSEF to operate is a critical first step in making CSEF a reality and we commend CAMAC on addressing this issue thoughtfully.

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