Corporations and Markets Advisory Committee: consultation on crowd sourced equity funding

Community Sector Banking

Community Sector Banking is an innovative banking service which was launched in 2002 and specialises in providing banking and financial solutions to the not-for-profit sector across Australia. Community Sector Banking is a joint venture between Community 21, a company owned by not-for-profit organisations and Bendigo and Adelaide Bank Limited (BEN). Community Sector Banking seeks to improve and expand the movement and effectiveness of capital in support of not-for-profit activities, identify new streams of capital and maximise the sector's capacity to deliver positive community outcomes and social change. Currently Community Sector Banking provides financial services to over 7,500 not-for-profits. Given the sector's acknowledged role and effectiveness of delivering positive social activities and outcomes, any increased capital flowing to these activities will greatly enhance the national balance sheet. Also, given BEN's track record of building appropriate governance structures in partnership with communities across Australia to improve the health and wellbeing of each community, we believe we are in a strong position to develop an effective framework for investment through a Crowd Funding model directed to provide the flow of capital to such community and not-for-profit activities. While we continue to work through the development of our model and approach, we welcome the opportunity to provide our comments to ASIC as they formulate their views as to the appropriate regulatory structures that might apply to Crowd Funding.

The emergence of Crowd Funding in Australia presents considerable opportunities for the not-for-profit sector to improve their impact across Australian communities, helping to improve local economies and the effectiveness of not-for-profit activities. Any increased capital to the not-for-profit sector beyond the current philanthropic and government support would greatly enhance the impact of the sector's work in communities across Australia. While the primary focus of Crowd Funding to date has appears to have been on creative projects and seed funding, Community Sector Banking's model will focus on Crowd Sourced Funding (philanthropic, rewards based or debt/equity based) for a range of not-for-profit projects, social enterprises and community projects.

Its role then is one of facilitating positive social change by creating pathways for new capital through investment in a range of these projects to deliver enhanced social and economic change.

Whilst still in the development phase, the Community Sector Banking model is based on new economy thinking and is designed to stimulate and facilitate these new streams of capital thus providing citizens with a platform through which they can support and invest in projects which will benefit their communities and the broader Australian society.

As Crowd Funding matures in Australia and evolves from simple donation and rewards based funding platforms to incorporate peer to peer lending and equity based investment funding, there will be a requirement to build the regulatory framework that ensures that there is maximum transparency and protections for investors and appropriate payments systems gateways to protect the funds flow from investor through to investment. While acknowledging the special nature of these not-for-profit and community investments that we are looking to support and facilitate, we feel it is essential that the appropriate protections and transparency are required in a Crowd Funding model to ensure investors have confidence in the flow of capital and the effectiveness of their funding and investment support.

We encourage the current Australian Securities and Investment Commission review of the regulatory environment for Crowd Funding to take account of the potential benefits and impact Crowd Funding can have on the development of new capital flows for social infrastructure, social enterprise and community development.

Crowd Funding also presents a real opportunity to leverage Government and Philanthropic investments by adopting a matched funding model utilising crowd platforms, thus enhancing the funding available to support such important community supporting activities.

As stated, Community Sector Banking considers it is appropriate to have a robust regulatory environment, transparent payment systems and clear investor reporting responsibilities in any Crowd Funding structure. Combining a Bank payment gateway with a crowd platform, together with a strong connection with the not-for-profit sector and the individual projects, should enhance our proposition and the likely success of individual projects.

While there is genuine potential for community, social enterprise and for-benefit projects, facilitated through a Community Development Finance Institution like CSB, we believe our model may require special application or exemption from any proposed regulations that are adopted in relation to Crowd Sourced Equity Funding (CSEF) generally.

We believe investors, properly informed and engaged, will be able to discern the range of value (beyond pure financial) that will be created by applying such investment through the proposed CSB Crowd Funding model.

Investors through KIVA (www.kiva.org) for example in peer to peer loans often reinvest their investment into the next loan, much like a revolving fund or in fact a donation. Philanthropic venture capitalist using crowd platforms as a payment gateway or vehicle for change would benefit from appropriate transparency in project selection and progress, but if the regulatory costs become too high it will limit the impact and the effectiveness of Crowd Funding as a platform for change.

context

Before dealing with the specific questions raised in the Corporations and Markets Advisory Committee's Consultation on Crowd Sourced Equity Funding Discussion Paper, we feel that it is important to clarify our views regarding the nature of CSEF. In our view, the term CSEF is currently used to describe a number of very different and distinct concepts.

At one extreme, it refers to an activity which is akin to that undertaken in accordance with the existing Small Scale Offering Provisions (SSOPs) of the Act. Those who hold to this definition naturally see CSEF in practice as a means of extending the current activities to a wider audience, with a natural requirement to amend current restrictions on offer promotion, limits on raising amounts, and make allowances for larger numbers of investors. The view may be that the amounts to be raised in total fall within the $500,000 - $5m range, with individual investors being relatively sophisticated, and investing tens of thousands of dollars each (or more).

At the other end of the spectrum are those who view CSEF as being an extension of existing rewards based Crowd Funding systems – one which simply adds the ability to offer a financial return to those types of projects currently funded through this system. They see that the amounts to be raised nearly always less than $500,000, and very often are less than $100,000. They view the average investor as being relatively unsophisticated in an investment sense, likely to invest smaller amounts which may nonetheless represent a material exposure for them relative to their net worth.

At Community Sector Banking, we tend towards the latter definition, and this is the context in which we have responded in this document. We therefore focus on issues such as the efficient handling of large numbers of investors, of relatively small investments in private enterprises, and systems and disclosures necessary to inform and protect ordinary "retail" investors.

matters relating to issuers

Question 1	In principle, should any provision be made in the corporation's legislation to accommodate or facilitate CSEF? If so, why, if not, why?

A number of amendments have been made to the Act over the past 20 years to accommodate changes in the way that investors interact with issuers, not the least of which include the introduction of the Managed Investment Act, and the more recent FOFA regulations.

We see the current explosive growth in the Crowd Funding sector, and corresponding interest in the concept of CSEF to represent another paradigm shift in the way investors can interact with issuers. Further, evidence from overseas confirms that there is a growing demand amongst investors to participate in CSEF, and a near endless demand from small innovative businesses for the capital.

The Act currently makes general distinctions between public, private and small scale offerings. However, we believe that CSEF is fundamentally different as it represents a new category akin to "micro-scale" offerings. Logically, any new category of investment necessarily involved some legislative change in order to ensure efficient and effective operation of the particular investment market.

ASIC has released a number of statements regarding both Crowd Funding and CSEF, however to date, these have been general warnings without any material prescriptive guidance. This has created uncertainty in the market regarding the legality of not only CSEF,

but also simple rewards based Crowd Funding. As uncertainty is not conducive to an efficient operation of any market, we feel that it is appropriate for clear guidance to be issued, and believe that this must necessarily be accompanied by some legislative amendments.

Whether it be implemented via specific legislation, class order relief, or a combination of both, there is a clear need for:

1. a safe harbour for the operators of existing Crowd Funding platforms; and
2. clear guidelines for the operation of a CSEF platform.

With respect to (2) in particular, failure to provide a clear legislative framework will serve only to keep legitimate participants out of the market, whilst having little or no effect on investor led demand. This is a recipe for disaster, as it will simply leave the door open for less scrupulous operators and issuers to take advantage of investors under the auspices of inappropriate or ineffective legislation.

Question 2	Should any such provision: 1) take the form of some variation of the small scale offering exemption and/or 2) 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 3) adopt some other approach (such as discussed in Section 7.3, below).

We are firmly of the view that a simple amendment to the small scale offering provisions (SSOPs) is not sufficient to provide for the efficient functioning of the CSEF market (based on our interpretation of CSEF).

The existing SSOPs are essentially designed to facilitate capital raising in the $1m-$2m range (or up to $5m as a result of ASIC Class Order 02/273). Although it is possible to raise funds from an arbitrary number of investors using the various subsections in S.708, in practice, small-scale offerings generally attract a maximum of 20 investors.

This implies that the average investment size by an individual in a small-scale offering will be in the tens to hundreds of thousands of dollars, which is generally inappropriate for CSEF. Further, the SSOPs are structured around the concept that the investors are either professional/sophisticated, or have some other link to the investee that might allow them to make an informed decision despite the limited level of required disclosure.

By way of example, under CSEF, we believe that it is likely that an organisation that wishing to raise $250,000 might receive funds from up to 250 investors, each investing around $500-$2000. Unlike a small-scale offering, these investors are unlikely to be “sophisticated investors” or have any personal knowledge of, or connection with, the issuer.

We therefore have a situation where not only is there an order of magnitude difference in both the quantum of investment and number of investors, but also one in which the fundamental tenets of the SSOPs (sophistication or connection or knowledge outside of the otherwise limited disclosure) break down.

We therefore do not consider that the CSEF market can be efficiently or effectively regulated or accommodated merely through amendments to the existing SSOPs, or by limiting involvement to investors who satisfy a modified version of a sophisticated investor. [1]

As a consequence of the above, we therefore believe that the most efficient and preferred structure for the operation of a regulated CSEF platform will be through the existing MIS provisions (as suggested in S. 3.2.4 of the *Discussion Paper*) and we will generally provide answers in this context. Note that for consistency with this document we will continue to refer to the RE of the MIS as the "intermediary" and the ultimate investee companies as "issuers".

Question 3	In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of: 1) proprietary companies 2) public companies 3) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

As noted in the *Discussion Paper*, under the MIS structure, there are no specific changes required to the regulation of proprietary or public companies. However, with respect to the regulation of MIS, there will be a number of amendments or areas where relief is required.

Although it is feasible to operate a CSEF within the current definition of a financial assets MIS, we believe that there may be a benefit to introducing a new AFSL authorisation for the promotion and operation of a CSEF Platform. This would allow the introduction of specific regulatory guidelines and practice notes specific to the operation of the CSEF market under the same framework as applies to all other types of collective investments.

Specific issues that will need to be addressed include:

Liquidity: the MIS will be illiquid as defined in the Act (more than 20% invested in illiquid assets). However, individual asset pools may be liquid at various times, as will the general cash balances of investors prior to allocation to an issuer, or following the repayment of capital. Under current legislation, relief would be required to allow investor redemptions of these liquid amounts.

Allocation of shared costs: consideration needs to be given as to whether a system needs to be formalised for the sharing of general MIS overheads across asset pools.

Valuation/pricing: due to the nature of the issuers, it is highly unlikely that any accurate value can be placed on individual investments without significant analysis

[1] Note however that we are not suggesting that there is not an additional need to make some amendments to the existing SSOPs to extend the effectiveness of existing platforms such as the Australian Small Scale Offering Board (ASSOB). We merely believe that although such amendments will be useful in further bridging existing funding gaps, they will not be sufficient to allow the efficient operation of a broad based demand-let CSEF.

(incommensurate with the level of investment). This creates issues for the RE (in terms of its normal duties to report accurately to investors). The RE will need significant flexibility with respect to the way these items are reported to investors.

Auditing and Financial Reporting: the issues of both valuation and overheads flow into the processes of audit and annual/interim reporting. With respect to audit, it is impractical for an auditor to make an assessment of the value of an underlying investment. Provision needs to be made for auditors to be able to rely on whatever pricing methodology is adopted by the RE – that is to say, audit should be confined to an assessment of the flow of fund into and out of the trust account, and whether the MIS holds the appropriate issuer securities.

With respect to financial reporting, apart from the problems of valuing a portfolio of potentially thousands of private companies, the preparation of any report under current accounting standards is generally meaningless for investors who each hold interests in sub-asset pools. In short, the preparation of an accurate balance sheet and income statement is impossible, and nevertheless meaningless. We therefore suggest that a major component of any legislative amendments or relief should focus on ensuring that an RE (and its directors) are able to report in a sensible and meaningful manner to investors without incurring prohibitive audit, accounting or potential legal costs.

Ringfencing: the basic structure of a CSEF MIS would be based on issuing different classes of units in relation to different investments. Current legislation is not able to create an absolutely "perfect" system of asset ringfencing when dealing with issues that affect the MIS overall, relative to those that affect individual classes of unit holders. That is, there are some liabilities that can cross over the artificial boundaries in asset pools and some lack of clarity regarding the right of indemnification of an RE out of the assets of the MIS. A clear distinction between each of the discrete and mutually exclusive classes of units needs to be legislated in relation to SCEF in MIS to allow for ringfencing.

Communication: although there is provision in the current legislation for reports to be provided electronically, this cannot be made mandatory by the operator of a scheme. We suggest that due to the entirely "on-line" nature of the CSEF platform, there is no requirement for an intermediary to offer a hardcopy option. The alternatives would be either email or a login to an investor specific site.

Question 4	What provision, if any, should be made for each of the following matters as they concern CSEF issuers: 1) **types of issue**r: should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups') 2) **types of permitted securities**: what classes of securities of the issuer should be able to be offered through CSEF 3) **maximum funds that an issuer may raise**: should there be a ceiling, and if so what, on the funds that can be raised by each issuer in a particular period through CSEF. Should that ceiling include any funds raised under the small scale personal offers exemption 4) **disclosure by the issuer to investors**: what disclosures should issuers

have to provide to investors

5) **controls on advertising by the issuer**: what controls, if any, should there be on advertising by an issuer
6) **liability of issuers**: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defenses to liability should apply
7) **ban on a secondary market**: should CSEF be limited to new issues, excluding on-selling of existing securities
8) **any other matter**?

Dealing with each item in turn:

1) **Issuer type:** we believe that all investees should be required to be corporation (public or private) and be registered for GST. This creates a consistence of regulation and draws a clear distinction between CSEF (which should be for a business purpose) and other forms of Crowd Funding (such as support for a personal project, cause or charity). It also allows, for example, the reporting requirements of the issuer to be linked to other normal business activities – quarterly reporting to the CSEF platform operator would be done at the same time (and including similar information) as a quarterly BAS, annual investor updates prepared and provided to the platform operator at the same time as the lodgement of company statements or tax return etc. This reduces the administrative burden on the issuers by incorporating the requirements into normal business reporting timelines.

2) **Security type:** we believe for simplicity of understanding, issuers should be limited to simple financial instruments – ordinary shares, simple preference shares and debt. Although in theory the interposition of an MIS with a professional Responsible Entity does allow more sophisticated instruments to be issued (as the actual investor would be the RE), the restriction to simple instruments encourages transparency and will avoid the need for complicated disclosure in a supplementary or Part 2 document.

3) **Maximum funds to be raised:** The market for small scale offerings is already serviced by existing platforms such as ASSOB (or others who avail themselves of the extensions to the SSOPs under CO 02/273) and other "angel" networks of sophisticated investors. A CSEF platform should aim to fill a funding gap and not be a mechanism for investees to avoid the rigour of these established systems. That is, it should provide access to funding at an earlier business stage, or where the quantum is not sufficient to justify the overheads or processes associated with (for example) ASSOB. As a result, we believe that a reasonable and practical limit to the amount that an issuer could raise should be in the order of $250,000 - $500,000.

4) **Issuer disclosure to Investors:** under the MIS structure, there are two layers of disclosure. The first is general information about CSEF investing and the MIS as well as all of the customary risk disclosures. This would naturally take the form of a Part 1 disclosure document - an "umbrella" PDS.

   This would then be accompanied by a Part 2 disclosure documents (effectively, a supplementary PDS) dealing with each individual issuer/issue. These would necessarily (for the purpose of clarity) be presented in a fairly standardised format and would contain information about each issuer (structure, ownership,

management & business description) and information on the investment proposition (the security type and their terms).

It is the responsibility of the intermediary (as the issuer of the umbrella and supplementary offer documents) to ensure that this information is factually correct, and it would not be unreasonable for the content of this section to be based on legislatively mandated disclosure requirements. However, these requirements must not be overly onerous or extensive – just the basic facts. Any requirement for detailed due diligence by the intermediary will create unsustainable operating overheads (given the relatively small size of each issue).

However, it is the very nature of Crowd Funding for there to be additional information as the key to any successful Crowd Funding or CSEF project is for the issuer to *create engagement with the public*. This is normally achieved via whatever means are appropriate to the project – additional information provided on a website, informative videos, social media updates etc – failure to provide this engaging content invariably results in a failed project/raising. Importantly, this information is *outside of the control of the intermediary*, and it must be absolutely clear that it does not form part of the offer document by reference – *even though some of the information might necessarily be included on "issuer additional information pages" prepared by the issuer but hosted on the intermediary site.*

Note that by "absolutely clear" we are not simply referring to an obligation being placed on the intermediary to put in relevant disclaimers, but rather than there be a standard form of disclaimer mandated, which if implemented will provide the intermediary with a clear legal standing and watertight defense against any action that might otherwise result from statements originating from the issuers.

5) **Advertising:** following on from the previous item, it is absolutely vital for issuers to be able to promote their projects. This may require some relaxation of the existing restrictions on advertising, or potentially an extension of the relief provided by CO 02/273.

6) **Issuer liability:** As under our proposal all issuers will be corporations and the issuer is raising funds from a single investor (the MIS), the liability of directors and officers of the issuer is already determined by the Act – that is, they control a private company that has made certain statements as part of a capital raising. Logically, the due diligence defense should apply. Fortunately, under the proposed MIS model, the issuer is dealing with an experienced Responsible Entity, as opposed to directly dealing with hundreds of investors.

7) **Secondary sales:** any investment made by the MIS in issuers should be for newly issued securities or instruments rather than the sale of shares by current owners. Secondary sales of units in the MIS are already sufficiently dealt by existing legislation (ie no established secondary market for the units, and the RE not permitted to operate a market).

matters related to intermediaries

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 the existing AFSL licensing requirements provide a suitable framework for CSEF intermediaries. Where the platform is operated using an MIS structure, the requirement would be that the entity is licensed to operate a financial asset MIS. Intermediary changes are covered further in Question 6 in addition to the aforementioned AFSL authorisation recommendation for CSEF providers.

Should the decision be made to allow a CSEF platform to operate under a structure other than a unit trust MIS, it may be appropriate to create a new category of authorisation to "operate a CSEF platform or scheme".

We do not consider that it is necessary to require licensing of those platforms that only offering rewards or presales. However in the absence of the appropriate license, they would be principally responsible for ensuring that the projects they promote do not contain equity or financial instrument elements. This would continue the ongoing uncertainty for these operators, so it would be useful for any legislative amendments or class orders to provide a clearly defined safe harbour in which they can operate.

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

1) **permitted types of intermediary** (also relevant to Question 5):
   a) should CSEF intermediaries be required to be registered/licensed in some manner
   b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role
   c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform
   d) should an intermediary be required to have an internal dispute resolution and be a member of an external dispute body, such as the Financial Services Ombudsman.

2) **intermediary matters related to issuers:** these matters include:
   a) what, if any, projects and/or issuers should intermediaries not permit to raise funds through CSEF
   b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management
   c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers
   d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites
   e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

f) what possible conflict of interest/self-dealing situations may arise between issuers and intermediaries (including intermediaries having a financial interest in an issuer or being remunerated according to the amount of funds raised for issuers through their funding portal), and how these situations might best be dealt with
g) what controls should be placed on issuers having access to funds raised through a CSEF portal.

3) **intermediary matters related to investors:** these matters include:
   a) what, if any, screening or vetting should intermediaries conduct on investors
   b) what risk and other disclosures should intermediaries be required to make to investors
   c) what measures should intermediaries be required to make to ensure that any investment limits are not breached
   d) what controls should be placed on intermediaries offering investment advice to investors
   e) should controls be placed on intermediaries soliciting transactions on their websites
   f) what controls should there be on intermediaries holding or managing investor funds
   g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other
   h) what disclosure should be made to investors about being able to make complaints against the intermediary, and the intermediary's liability insurance in respect of the role as an intermediary
   i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised
   j) what, if any, additional services should intermediaries provide to enhance investor protection.

4) **any other matter**?

Dealing with each item in turn:

1) We believe that the existing AFSL requirements (for retail investors) should be applied to operators of CSEF platforms, including the normal requirements relating to experience, capacity, compliance and membership of a dispute resolution scheme. We note an External Dispute Resolution Scheme may require a higher annual premium for intermediary Crowd Funding providers given the potential for a high number of investors and the risk nature of the investment but consider it important to maintain this level of consumer protection.

2) We consider that a decision regarding whether a particular issuer be allowed to raise funds through an intermediary should be made by the intermediary, based on information at hand at the time, and on the assessment of the intermediary regarding the suitability of the issuer for their particular platform. Intermediaries have a commercial interest in maintaining their reputation, and a general responsibility for protecting investor interests, which suggests that this form of self-regulation should be effective.

The requirements for initial due diligence by the intermediary should be commensurate with the level of investment being sought by the issuer. There should be a basic requirement to confirm the legal status of the entity, its shareholding structure, directors, management and principal business. This would form the basis of a Part II disclosure issued by the intermediary. Additional information required for existing businesses would include details of any legal action, and a copy of current financials statements signed off by a qualified accountant.

Beyond that, any additional information should be supplied by the issuer, whose officers should sign a declaration to the effect that all information published by them with respect to the offer and the business is true and correct. In addition, as a high level risk mitigation policy, there should be a signed restriction on the use of funds raised to not be used by directors or their related parties in a personal capacity (that is, the use of funds is restricted from personal exertion income).

The provision of this sworn statement to the intermediary then clearly determines where any liability for investor losses lies – intermediaries are liable for any breakdown of their system, while issuers are principally liable for statements covered under their declaration. That is, by obtaining the statement, the intermediary can automatically afford itself of the due diligence defense.

Although it is possible for this type of system to be abused (such as intermediaries accepting statements that they know to be false), such abuse contravenes sufficient other sections of the Act for it to be a generally workable solution, given the size of individual issues and the nature of the issuers.

With respect to self-interest/dealing, the existing regulations in the Act relating to the conduct of Responsible Entities should apply to intermediaries. Further, the advantage of using an MIS structure is that it can create a disconnect between investing in the MIS and allocating funds to any particular issuer.

Finally, the provision of funds to issuers should be based on current Crowd Funding systems – funds are only provided once a minimum threshold is reached. This might be achieved by applying the usual PDS four-month time limit applicable to raising a minimum subscription amount to each underlying issuer.

Importantly, the ability for an investor to withdraw a pledge at any time prior to the issuer reaching their minimum subscription hurdle creates a natural “cooling off” period.

3) CSEF Platform Operators should not be required to undertake any specific screening of investors, other than those normally required of those investing in a conventional MIS – principally those associated with AML/CTF requirements. It should be noted however that even this requirement may be overly onerous for investors who only wish to invest small amounts of money. We would therefore suggest that in addition to being able to utilise the services of online services such as Veda, some consideration be given to requesting that AUSTRAC accept that, where funds are only ever received from an Australian bank account and paid back to that same bank account (with no capacity for the investor to specify any variation), the intermediary may be permitted to rely on the AML/CTF checks that have necessarily already been performed by the relevant bank. This would be subject to the approval of the

relevant bank and may require some amendment to privacy policies, however it is a cost effective and workable solution in the long term.

With respect to disclosures, other than those normally required for any retail MIS, there should be a set of specific Crowd Funding related warnings designed to highlight the high-risk nature of the investments, and suggesting a limitation on participation in the sector. With respect to SMSF investors, this limitation could be legislated and managed in much the same way as the in-house asset restrictions (through the audit process of the relevant SMSF). There should not however be any specific requirement for the CSEF Platform Operators to police these recommendations or limitations.

With respect to the offering of investment advice, solicitation/advertising and the holding of investors' funds, we believe that the existing AFSL/MIS restrictions and custodial requirements are appropriate and should be applied to the CSEF Operators without significant amendment.

This also extends to the requirement to have an appropriate complaints handling and dispute resolution system, as well as appropriate Professional Indemnity insurance. Likewise, the requirements regarding disclosure of financial interests should also apply.

matters relating to investors

Question 7	In the CSEF context, what provision, if any, should be made for investors to be made aware of: 1) the differences between share and debt securities 2) the difference between legal and beneficial interests in shares 3) any classes of shares in the issuer and its implications for investors. A related question is whether disclosure, alone, would suffice.

These distinctions should form part of any governing document – be that the umbrella (Part 1) PDS under an MIS structure, or some other minimum disclosure requirement on the platform.

As to whether such disclosure is sufficient, the answer really depends on whether any restriction is placed on the types of securities that issuers can offer under the CSEF regulations. If these are limited to simple debt and equity investments, then the disclosure should suffice.

Question 8	What provision, if any, should be made for each of the following matters as they concern CSEF investors: 1) **permitted types of investor:** should there be any limitations on who may be a CSEF investor 2) **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

3) **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
4) **risk acknowledgement by the investor:** should an investor be required to acknowledge the risks involved in CSEF
5) **cooling off rights:** should an investor have some right of withdrawal after accepting a CSEF offer
6) **subsequent withdrawal rights (Italy only):** should an investor have some further withdrawal right subsequent to the offer
7) **resale restrictions:** should there be restrictions for some period on the on-sale of securities acquired through CSEF
8) **reporting:** what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment
9) **losses:** what recourse should investors have in relation to losses resulting from inadequate disclosure
10) **remedies:** what remedies should investor have in relation to losses results from poor management of the enterprise they invest in
11) **any other matter**?

Note that our commentary below attempts to balance the protection of investors and the on-line nature of Crowd Funding platforms. On this basis and dealing with each item in turn:

1) As stated previously, we consider CSEF to be a mechanism for a broadening of the funding base for small or innovative Australian businesses. As such, there should be no limitation on the type of investor.

2) The theory that by requiring one "sophisticated" investor to participate might seem to provide extra protection to general public investors, but in reality, we believe it will do the opposite and create an undue level of complacency in non-sophisticated investors. Ostensibly, there are investors who are sophisticated by definition and those who are sophisticated in the plain English sense of the word as a result of experience and knowledge, but inevitably, those groups do not always overlap. As a consequence, the fact that someone meeting the current definition has invested does not therefore mean that they have conducted any significant or effective due diligence on the issuer.

3) We feel that a reasonable **limit** on a per investment basis should be $2,500 - $5,000, however we accept that this is based on our particular interpretation of the likely CSEF investor profile (as discussed at earlier in this paper) and that others may recommend higher values.

   Irrespective of the limit on individual issuers, we do not however think that it is appropriate for an intermediary to be responsible for policing whether investors have exceeded any particular limit with respect to their total exposure to CSEF. Rather, the disclosure document should clearly indicate that these are high-risk investments and only suitable for a portion of investable capital.

Nonetheless, it would be quite feasible to place a limit on total exposure to CSEF by a SMSF, as these entities are independently audited, and already deal with overall limits such as the in-house asset limitations.

4) Under an MIS or similar structure, a risk acknowledgement would be a necessary part of any application process.

5) As mentioned above, despite the fact that the underlying investments will be illiquid, provision could be made for a short cooling off period provided it is exercised prior to the closing of any raising. This mirrors the current operation of Crowd Funding sites where investors can cancel a pledge at any time prior to the campaign reaching its threshold target.

6) Subsequent withdrawal rights are impractical; however note our previous comments regarding a requirement to be able to allow redemption in relation to certain classes of units even when the MIS as a whole is by "illiquid" by definition.

7) Secondary sales (of investor interests in the MIS) will be covered under the current market-making restrictions as it applies to MIS. The RE intermediary will obviously be able to trade the underlying investments in accordance with the constituent issuer documents and the law.

8) We have made some mention above about the requirement for legislative changes or relief to statutory reporting and audit of the platform/MIS as a whole. With respect to meaningful reports to investors, there should be provision for an online issuer update area where the intermediary posts annual updates to the information contained in the Part II disclosure (such as changes to share structures, directors, management, etc), and also where reports produced by the issuer are published. We consider that it is reasonable for issuers to provide general quarterly updates, which may include the financial information that would normally be included in a BAS, as well as a general update. As the former may be sensitive, and option should be available for that information to only be accessible by the relevant investors.

9) Investors must have the usual recourse to the intermediary with respect to errors it makes in the operation of the CSEF platform or offer document. However, it must be made clear that they have no specific individual recourse to the intermediary in relation to items published by the issuer, and that where the intermediary has received an appropriate declaration from an issuer with respect to certain matters that do actually form part of the disclosure document, the intermediary is entitled to rely on that declaration as a clear due diligence defense. With respect to negligence, fraud or misleading and deceptive conduct on behalf of the issuer, the intermediary (as the actual legal investor) will have full legal rights of recovery. However, provision must be made for the intermediary to elect to not pursue action where it is uneconomic to do so.

10) Investors effectively have no direct rights against the issuers, other than a claim that the issuer's misrepresentations induced them to invest in the MIS. Given that the RE has the right to pursue the issuer under such circumstances and is arguably in a better position to make a cost benefit analysis of such action, it may even be desirable to remove the capacity of an individual investor to pursue issuers (especially given the quantum of individual investments).

Question 9	Should any accommodation for CSEF in the Corporations Act be in the form of incremental adjustments to the existing provisions, or be in the form of a self-contained regulatory regime for CSEF?

Based on our comments in this submission, we would suggest that the necessary changes could be incorporated into the Act incrementally. Our preference for operating a CSEF Platform under the existing AFSL/MIS legislation (with amendment) suggests that a complete self-contained regime is not required at this time.

Question 10	What, if any, other matters which come within the scope of this review might be considered?

conclusion and next steps

The emergence of the CSEF market presents a unique opportunity to mobilize capital for a variety of new investments, however when mobilized for the support of investment in social infrastructure and development initiatives for the Australian Not for Profit sector they can produce some very valuable outcomes for the broader Australian community. The social investment market is unique in so far as success is measured on the basis of both financial performance and social outcomes, this unique distinction needs to be taken into consideration when framing the regulatory environment for CSEF.

Community Sector Banking believes that any CSEF framework will be greatly enhanced by the inclusion and support of the investments proposed under the CSB Crowd Funding framework, and a regulatory regime that provides investor engagement and transparency within an appropriate MIS structure will enhance the flow of capital to a range of new investments.

The CSEF systems will require clear guidelines for operators, investors and issuers alike. However, there are key components under the MIS, including issues of liquidity and ringfencing, as outlined earlier in this submission, that require further exploration, this would lead to greater clarity and operation efficiency.

Community Sector Banking is keen to work with the regulator to insure that the opportunities presented by CSEF can be developed whist ensuring that appropriate protection is provided to all stakeholders.

Community Sector Banking would welcome the opportunity to participate in further discussions and forums to assist in developing the CSEF market in Australia.

END