Submission to the Corporations and Markets Advisory Committee

Crowd Sourced Equity Funding

This submission is made by CrowdIQ in response to the Corporations and Markets Advisory Committee's discussion paper regarding crowd sourced equity funding.

Introduction

CrowdIQ appreciates the opportunity to comment on the discussion paper 'Crowd Sourced Equity Funding' issued by the Corporations and Markets Advisory Committee (CAMAC) in September 2013 and updated in October 2013 (the Paper).

CrowdIQ

CrowdIQ is an equity-based crowd funding platform that offers people equity in unlisted Australian registered businesses in exchange for their investment. CrowdIQ allows a wide base of potential investors to access startup investing - an asset class that was previously only available to high-net-worth or sophisticated angel investors.

CrowdIQ's Position

We believe that there is enormous potential to cultivate crowd sourced equity funding (CSEF) as a vehicle for economic growth and innovation in Australia. To realise this potential, we believe that a statutory and compliance framework should be created that is specific to CSEF to allow equity based transactions to flow across an online platform, and allow the full potential of the crowd to be engaged. A regulatory regime must provide appropriate protection for investors, while minimising compliance obligations, legal complexity and uncertainty and liability risks for issuers.

As CrowdIQ is writing this submission from the position of an intermediary, we make the following specific comments in relation to the licensing requirements of intermediaries outlined at section 3.3 of the Paper.

- The Current ASIC guidance on CSEF (12-196MR ASIC guidance on crowd funding, 14 August 2012), states that the facilitator of crowd funding ' may be legally considered as the person making an offer to arrange for the issue that financial product', and therefore may be required to hold an Australian Financial Services Licence (AFSL).
- An intermediary should provide facilitation services and not financial advice to any investor or issuer. On this basis, whilst we recommend that all intermediaries be registered with ASIC, an intermediary should not be required to hold an AFSL.
- However, it is a question of fact as to whether an intermediary actually provides 'financial product advice'. We believe that this will be dependent on the extent to which the intermediary provides information that is intended to influence a person in making a decision in relation to a financial product. Nonetheless, we believe that the primary service that the intermediary provides is to facilitate the engagement of investors with issuers and not to solicit the investment.

The options proposed in section 7 of the Paper

The Paper discusses five possible options for reform. The five options are:

1. no regulatory change;
2. liberalising the small scale personal offers exemption in the fundraising provisions;
3. confining CSEF exemptions to sophisticated, experienced or professional investors;
4. making targeted amendments to the existing regulatory structure for CSEF open to all investors; and
5. creating a self contained statutory compliance structure for CSEF open to all investors.

We are of the view that option 5, the creation of a self contained statutory compliance structure, is the best option to pursue. A new regulatory framework should provide stakeholders with certainty and clarity in respect of the laws and regulations that apply specifically to CSEF, but also avoid any negative impacts on the existing complex laws for other regulated financial products and securities.

We have outlined below our high level comments in respect of the other options.

Option 1 - No regulatory change

The current Australian regime is not designed for CSEF and therefore, this is not a viable option.

Option 2 - Liberalising the small scale personal offers exemption in the fundraising provisions

The 20 investor ceiling would need to be substantially increased for any significant level of capital raising. This option on its own, is not a viable option.

Option 3 - Confining CSEF exemptions to sophisticated, experienced or professional investors

This will restrict regular investors from participating in CSEF and therefore limit CSEF fundraisers from accessing this pool of investors.

Option 4 - Targeted amendments to the existing regulatory structure for CSEF open to all investors

There are a number of areas within the existing regulatory regime that would require extensive amendments such as amendments to managed investment schemes, compliance requirements for public companies that fundraise and licensing requirements for financial services.

We do not believe targeted amendments would be an effective way to facilitate a CSEF regime. Also, such amendments may further complicate an already complex landscape in respect to the regulation of financial products and securities.

Matters for consideration

We have provided responses to the questions outlined in section 7 of the Paper.

Specifically, we have provided responses to questions 1 to 6 and 9.

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

The current Australian corporations legislation regime is unfeasible as it has onerous compliance, licensing and disclosure requirements that would cause CSEF in Australia to be commercially unfeasible.

Therefore, any attempt to reform the current landscape must be directed to enable CSEF to become an accessible form of capital raising. Specifically, we are of the view that the following provisions should be considered in this context:

- the consequent AFSL obligations in Part7.6 of the Act
- the definition of "dealing" in a financial product, defined in s766C of the Act, and;
- the fundraising disclosure requirements in Chapter 6D of the Act;
- the definition of "financial market" in s767A of the Act.

Question 2 - Should any such provision:

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

Yes. The small scale offering exemption should be varied to allow for up to 500 investors.

(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

Definitely not. CSEF should be available to all capable investors.

(iii) adopt some other approach.

Various caps could be placed on investors who are not considered to be sophisticated investors.

Question 3 - In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:

(i) proprietary companies

We would envisage that Australian issuers potentially seeking to access CSEF would be proprietary rather than public companies.

The current proprietary company shareholder limit under s113(1) of the Act should be amended to allow a viable level of CSEF to be conducted.

(ii) public companies

We do not believe any change is necessary in respect of public companies. We would not envisage public companies to access CSEF in the medium term.

(iii) 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?

No. We do not believe any variation in disclosure obligations of issuers to investors is warranted by difference in the structure by which investors invest.

Question 4 - What provision, if any, should be made for each of the following matters as they concern CSEF issuers:

(i) types of issuer: 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')

No restriction on the type of company which may issue shares through CSEF and such restrictions would be unnecessarily proscriptive.

(ii) types of permitted securities: what classes of securities of the issuer should be able to be offered through CSEF

Only ordinary shares and preference shares and the rights and obligations of shares issued through CSEF should be identical to shares already on issue.

(iii) 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

No ceiling on the amount an issuer may raise. Amounts raised by issuers through CSEF are generally small in the context of broader capital markets and therefore there is no evidence that such a limit is even relevant.

(iv) disclosure by the issuer to investors: what disclosures should issuers have to provide to investors

Whilst we consider that the disclosure requirements outlined in the Offer Information Statement contained in the Corporations Act 2001 s715 would be somewhat appropriate, the requirements of s715(2) may be overly onerous in the IT start-up context.

We also note that UK CSEF sites set their own requirements which go beyond those of UK company law.

(v) controls on advertising by the issuer: what controls, if any, should there be on advertising by an issuer

An issuer should be allowed to advertise freely, however such advertising must not be misleading or make financial forecasts which are unreasonable or unrealistic.

(vi) liability of issuers: in what circumstances should the directors or controllers of the issuer have liability in relation to CSEF. What defences to liability should apply

We do not believe that the use of CSEF should create any specific liability for issuers' directors or controllers beyond those already existing under current corporation legislation.

(vii) ban on a secondary market: should CSEF be limited to new issues, excluding on-selling of existing securities

We believe CSEF intermediaries should be able to facilitate both issues of new securities, and the sale of existing securities

(viii) any other matter?

No comment.

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?

Intermediaries should be licensed as intermediaries by ASIC. We believe that current licensing requirements would in principle enable ASIC to tailor the terms of licences specifically for CSEF intermediaries.

A modified form of AFSL licensing is appropriate such as the principles outlined in the Financial Markets Conduct Act in New Zealand.

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:

(a) should CSEF intermediaries be required to be registered/licensed in some manner

Yes. A modified AFSL would be appropriate and one that would minimise the initial regulatory burden on the sector.

(b) what financial, human, technology and risk management capabilities should an intermediary have for carrying out its role

No comment.

(c) what fair, orderly and transparent processes must the intermediary be required to have for its online platform

An intermediary site should have a minimum level of information available on the site, such as terms and conditions, privacy policy, risks involved etc.

However, many of these features will be driven by the market and demanded by investors.

(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

Yes. Intermediaries should be required to have a stated internal dispute resolution process and should be members of an approved external dispute body.

(ii) 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

Persons banned from being a Director of a company or those persons that have any previous fraud convictions.

(b) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on issuers and their management

An intermediary should undertake that all issuers are correctly registered proprietary companies and directors have undertaken police checks.

(c) what preliminary/ongoing due diligence checks should intermediaries be required to conduct on the business conducted by issuers

Only at the pre listing stage should a due diligence be undertaken by intermediaries. This would include checks to ensure that;

- appropriate risk disclosures are made and the company has the authority to conduct a fundraising;
- the company is properly incorporated; and
- financial forecasts are not unrealistic or unreasonable.

(d) to what extent should intermediaries be held liable for investor losses resulting from misleading statements from issuers made on their websites

The intermediary should not bear any liability for statements made by issuers, in particular if appropriate due diligence has been conducted.

(e) to what extent should intermediaries be held liable for investor losses resulting from their websites being used to defraud investors

The intermediary should not bear any liability for investor losses, in particular if appropriate due diligence has been conducted.

(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

Intermediaries should not be permitted to transact in any company raising funds by way of CSEF. Any risk from the potential for a conflict of interest arising from the intermediary's remuneration and a project fund raising target is negligible.

(g) what controls should be placed on issuers having access to funds raised through a CSEF portal

Funds should only be released to the issuer when equity ownership has been completed with investors and fundraising targets have been achieved.

(iii) intermediary matters related to investors: these matters include:

(a) what, if any, screening or vetting should intermediaries conduct on investors

No screening or vetting is necessary.

(b) what risk and other disclosures should intermediaries be required to make to investors

Simple and general risk disclosures should be required.

(c) what measures should intermediaries be required to make to ensure that any investment limits are not breached

Intermediaries should be required to monitor project funding limits.

(d) what controls should be placed on intermediaries offering investment advice to investors

Intermediaries should be prohibited from providing any investment advice. Also, we do not believe CSEF platforms would want to offer investment advice as this would seem to run contrary to the spirit of the business model, and would presumably require separate licensing by ASIC for the provision of investment advice.

(e) should controls be placed on intermediaries soliciting transactions on their websites

Intermediaries should not promote their platforms on the basis of projected or forecast returns.

(f) what controls should there be on intermediaries holding or managing investor funds

All funds should be held in trust, in individual accounts. Funds should only be released to the issuer when equity ownership has been completed with investors and fundraising targets have been achieved.

(g) what facilities should intermediaries be required to provide to allow investors to communicate with issuers and with each other

Communication facilities between investors and issuers should be at the intermediaries discretion.

(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

Intermediaries should refer complaints to both internal resolution and external dispute resolution services.

(i) what disclosure should be made about the commission and other fees that intermediaries may collect from funds raised

All intermediary fees should be disclosed.

(j) what, if any, additional services should intermediaries provide to enhance investor protection

No comment

(iv) any other matter?

Tax incentives should be provided for small to medium enterprises who are able to achieve CSEF target amounts.

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?

We are of the view that option 5, the creation of a self-contained statutory compliance structure is the best option to pursue.

A new regulatory framework should provide stakeholders with certainty and clarity in respect of the laws and regulations that apply specifically to CSEF, but also avoid any negative impacts on the existing complex laws for other regulated financial products and securities.