

# Crowding the finance industry would be equitable for all: a submission to the Corporations and Markets Advisory Committee review on Crowd Sourced Equity Funding

*Submitted by\**  
*Daniel Meyerowitz-Katz<sup>†</sup> and Hannah Glass<sup>+</sup>*

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\* Note: All views and opinions expressed in this submission represent the personal views held by the authors. Nothing in this submission is intended to reflect the opinion of any group, entity or body which either author may be associated with or employed by. This is provided for the purposes of information only and does not constitute legal advice and must not be relied on as such.

<sup>†</sup> Bsc (Fin Math & Stat), University of Sydney; LLB (Hons), University of Technology Sydney.

<sup>+</sup> B Inst(Dist)/LLB University of NSW; GDLP.

# Crowd-Sourced Equity Funding

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Crowd-Sourced Equity Funding .....	2
1. Introduction .....	3
2. What is CSEF and why should it be introduced? .....	4
2.1. Crowdfunding generally .....	4
2.2. Crowdfunding successes .....	5
2.3. Crowdfunding and the flow of capital .....	6
2.4. Crowdsourcing through crowdfunding .....	8
2.5. A more equitable system .....	9
Our proposed scheme .....	11
3. Corporate structure .....	12
4. Issuers .....	13
5. Intermediaries .....	15
5.1. Licencing .....	<b>Error! Bookmark not defined.</b>
5.2. Relationship with issuers .....	<b>Error! Bookmark not defined.</b>
5.3. Relationship with investors .....	<b>Error! Bookmark not defined.</b>
6. Restrictions on investors .....	15
6.1. Initial disclosure .....	22
6.2. Ongoing disclosure .....	22
6.3. General Disclosure .....	23
7. Compliance costs .....	25
8. Restrictions on dealing with security .....	26
9. Cooling off .....	27
10. Liability .....	28

# 1. Introduction

Crowd-sourced equity funding (CSEF) is a novel method of raising capital by offering equity or debt to a large number of primarily retail investors through an online crowd funding platform.

Currently CSEF is effectively not available in Australia. For a proprietary company to employ CSEF would require advertising the sale of securities—which amounts to a prohibited ‘public offer’—and then acquiring more than 50 non-employee shareholders, which is also prohibited.

In September of this year CAMAC undertook a preliminary review of CSEF in Australia and published a discussion paper outlining the possibilities for CSEF. In the discussion paper, CAMAC calls for submissions on: whether CSEF should be allowed in Australia, the nature of CSEF, and the changes that will be required to facilitate CSEF in the Australian market.

In our submission, we recommend that CSEF should be introduced in the Australian market. We suggest that Australia base their laws on the recently enacted American JOBS Act. The JOBS Act permits companies to raise up to \$1 million through crowd sourced equity funding, through an authorised CSEF platform.

To facilitate this, we propose the following changes to the Corporations Act:

1. Create limited exemptions to requirements of the Corporations Act, that prohibit CSEF, ie. CSEF companies are able to have more than 50 non-employee shareholders provided that they hold shares through CSEF.
2. Add a new licensing regime similar to an AFSL for CSEF platforms to operate.
3. Create a regime for the operation of CSEF companies including limiting the amount of money that can be raised through CSEF and create a reporting regime for CSEF companies.

## **Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate CSEF?**

The current system is inflexible and only allows limited crowd sourced funding for donation or reward. CSEF is currently unfeasible due to the limitations of our corporations law. Whilst legislative changes are relatively

## 2. What is CSEF and why should it be introduced?

### 2.1. Crowdfunding generally

Crowdfunding is a subset of **crowdsourcing**—which generally refers to where tasks are outsourced from a firm to the general public over the internet in the expectation that individuals will make a valuable contribution to the firm’s production process at little or no cost to the firm.<sup>1</sup> **Crowdfunding** in particular refers to the process of soliciting funds from a large number of people using online tools.<sup>2</sup>

Crowdfunding has four main types: donation-based, reward-based, lending-based and equity-based.<sup>3</sup> **Donation-based** crowdfunding involves soliciting donations from funders for a cause they support. This has few complications as no rewards are promised in exchange for funds. Donations are generally given due to support for the idea behind the venture or the mission that it intends to carry out.<sup>4</sup>

**Reward-based** crowdfunding offers some form of non-financial benefit in return for investment—such as access to a new product, especially early or at a discount;<sup>5</sup> participation in a community; or some form of social status, such as being perceived as an ‘early adopter’.<sup>6</sup>

**Lending-based** crowdfunding entails the issuance of debt or bonds in exchange for the investment. **Equity-based** crowdfunding, aka ‘crowd-

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<sup>1</sup> Paul Belleflamme, Thomas Lambert and Armin Schwienbacher, 'Crowdfunding: An Industrial Organization Perspective' (Paper presented at the Digital Business Models: Understanding Strategies, Paris, 25-6 June 2010),3.

<sup>2</sup> Blakeley C Davis and Justin W Webb, 'Crowd-Funding of Entrepreneurial Ventures: Getting the Right Combination of Signals' (2012) 32(3) *Frontiers of Entrepreneurship Research* 1, 4.

<sup>3</sup> See generally, Gerrit KC Ahlers et al, 'Signaling in Equity Crowdfunding' (SSRN working paper series 2161587, October 14, 2012), 6-7.

<sup>4</sup> Ajay Agrawi, Christian Catalini and Avi Goldfarb, 'Some Simple Economics of Crowdfunding' (Working Paper University of Toronto, June 1 2013), 15; Omar M Lehner, 'Crowdfunding social ventures: a model and research agenda' (2013) *Venture Capital*, 7.

<sup>5</sup> Agrawi et al, above n4, 14.

<sup>6</sup> Ibid, 15.

sourced equity funding' ('**CSEF**'), is a form of crowdfunding in which the funds are solicited by some form of venture in exchange for an equity stake in that venture.

Current Australian law makes it very difficult for either equity or lending-based crowdfunding to operate.<sup>7</sup> This submission will argue that it would be beneficial to facilitate both of these sorts of funding. These should be collectively referred to as 'crowd-sourced security funding', but for the sake of convenience, this submission will assume that both are encompassed by the term 'CSEF'.

## **2.2. Crowdfunding successes**

Even without equity offerings, crowdfunding has been increasing the opportunities for startups both in Australia and globally. For example, San Francisco-based games developer Double Fine Inc failed to raise traditional funding for a new video game, so turned to crowdfunding and raised over USD3 million from over 87,000 investors.<sup>8</sup>

The 'Pebble epaper watch' seems to have been the most successful crowdfunded venture yet. The watch's inventor, Eric Migicovsky, had raised USD 375,000 from angel investors, but was USD100,000 short of the amount required for a production run. On 11 April 2012, he turned to crowdfunding website Kickstarter to raise the additional funds. This crowdfunding was rewards-based—investors would receive one watch for each \$120 donated. He raised the required capital in two hours, and eventually closed his campaign after 37 days, having raised over USD 10 million and committed to produce 85,000 watches.<sup>9</sup>

On Australian crowdfunding platform Pozible, Melbourne-based reality dress up game event Patient O raised \$243,480 from crowdfunding in late 2012, and news website NewMatilda.com raised \$175,838 to relaunch in 2010.<sup>10</sup>

What equity-based crowdfunding does exist in Australia has been predominantly through the Australian Small Scale Offerings Board ('**ASSOB**'), which has been offering a highly limited form of crowd-sourced equity funding since 2006. As of November 2013, it has raised \$135 million.

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<sup>7</sup> 'Crowd sourced equity funding', (Discussion Paper No Corporations and Markets Advisory Committee, Commonwealth, September 2013), 17-29.

<sup>8</sup> Davis and Webb, above n2,, 7.

<sup>9</sup> Agrawi et al, above n4, 2-3.

<sup>10</sup> Alberto Colla and Terence Wong, 'Crowd funding — should Australia embrace the growing crowd?', *Keeping Good Companies (Governance Institute of Australia)*, April 2013, 154, 155.

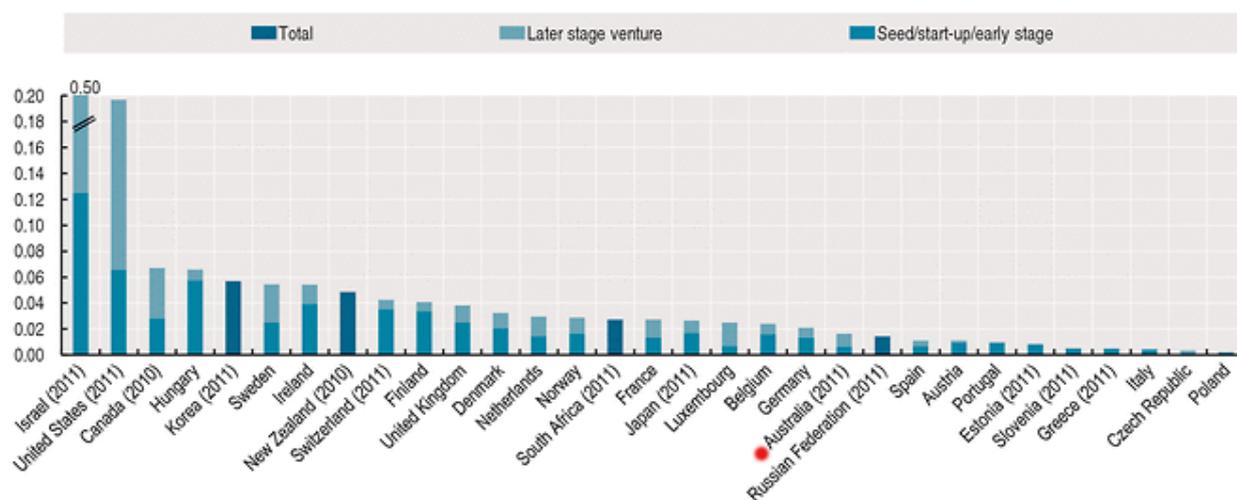
As of April 2012, when it had raised \$125 million, it was the largest CSEF platform in the world.<sup>11</sup>

This success has been achieved in spite of the limitations placed on ASSOBY by the Australian funding restrictions—which have compelled ASSOBY to somewhat perversely solicit funding offerings from within companies’ existing social networks rather than on the internet at large, and also imposes onerous disclosure requirements.<sup>12</sup>

The fact that Pozible and the ASSOBY have both thrived even in Australia’s adverse regulatory environment clearly indicates that crowdfunding has a future in this country. We can only imagine what would be possible if they did not have to face the barriers that have been inadvertently thrown in their path by a system which was not designed with crowdfunding in mind.

### 2.3. Crowdfunding and the flow of capital

It is well recognised in the economic literature that new ventures tend to struggle to raise capital in their early stages.<sup>13</sup> Raising capital is particularly hard in Australia, which ranks substantially below other OECD countries in terms of venture capital raised relative to GDP.



Venture capital as a proportion of GDP in OECD countries in 2011/12.<sup>14</sup>

<sup>11</sup> Ahlers, above n3, 11.

<sup>12</sup> *How Does ASSOBY Work?*, <<http://www.assob.com.au/entrepreneurs.asp?page=3>>.

<sup>13</sup> Lehner, above n4, 4.; see generally, Andy Cosh, Douglas Cumming and Alan Hughes, 'Outside Entrepreneurial Capital' (2009) 119(540) *The Economic Journal* 1494; Armin Schwienbacher, 'A theoretical analysis of optimal financing strategies for different types of capital-constrained entrepreneurs' (2007) 22(753) *Journal of Business Venturing*.

<sup>14</sup> OECD, 'Access to finance: Venture capital', *Economics at a Glance* <[http://www.oecd-ilibrary.org/sites/entrepreneur\\_aag-2013-en/06/03/g6-](http://www.oecd-ilibrary.org/sites/entrepreneur_aag-2013-en/06/03/g6-)

Crowdfunding provides a means to address this issue by reducing the cost of investment in a number of ways.

First, the internet has reduced the cost of matching funders to entrepreneurs across distances and between social groups.<sup>15</sup>

Second, it is evident from the successes of non-security based forms of crowdfunding that small investors will donate money to ventures for no financial return. As outlined above, these donors derive non-pecuniary benefits from doing so. It follows that CSSF investors would be partially compensated through the provision of those same benefits. This would allow issuers to ‘bundle’ securities with these non-pecuniary rewards, and therefore reduce the expected return on investment and, consequently, lower the price of capital.<sup>16</sup>

For example, consider a hypothetical startup venture in an industry in which the expected return on investment is 10%. That startup has an innovative product which is well-suited to crowdfunding. Instead of delivering a 10% return to each investor, the venture could issue bonds at a 5% rate of return, bundled with the opportunity to be ‘early adopters’ of the product and the social benefits from being a part of the community of investors.

Social ventures in particular tend to have difficulty finding funding from traditional sources. These ventures struggle to convince funders of their competence and skill due to the disparities in the goals, terminology and organisational structures between the not-for-profit industry and the investment finance industry.<sup>17</sup> On the other hand, crowdfunding is inherently advantageous for not-for-profit companies over for-profit companies.<sup>18</sup> This result is intuitive as where people are giving money for a cause and not necessarily expecting a large return, they would be more likely to donate to a cause that is important to them.

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9.html?contentType=&itemId=/content/chapter/entrepreneur\_aag-2013-27-en&containerItemId=/content/serial/22266941&accessItemIds=/content/book/entrepreneur\_aag-2013-en&mimeType=text/html>.

<sup>15</sup> Agrawi et al, above n4, 11.

<sup>16</sup> Ibid., 11-2.

<sup>17</sup> Lehner, above n4, 1.; note that ‘social entrepreneurs’ are generally more trustworthy than others— Ibid, 4.

<sup>18</sup> Belleflamme et al, above n1,21-8 attempts to explain this from a rational choice perspective.

It follows that CSEF for unsophisticated small investors might substantially increase the flow of capital to not-for-profit and social ventures, without detracting from existing finance.

## **2.4. Crowdsourcing through crowdfunding**

Crowdfunding can reduce labour costs by allowing ventures to crowdsource various roles which would otherwise be required to be conducted by employees. For example, the response of the 'crowd' to a venture provides an indication its future success, and can serve as both market research and marketing.<sup>19</sup> The crowd can also provide input on the product design and the business plan.<sup>20</sup>

In one survey of crowdfunded ventures, 85% of respondents indicated that they engaged in crowdfunding partially as a means of gaining public attention, and 60% also did so to obtain feedback on their product or service.<sup>21</sup>

It is important to note that, whilst a potential source of valuable advice, the 'crowd' will be inherently noisy and volatile.<sup>22</sup> Also, lower disclosure requirements and a relative lack of experience from people outside the traditional business community engaging in entrepreneurial activities may cause crowdfunded ventures to be riskier than traditional investments.<sup>23</sup> The diffused nature of crowdfunding may also make it difficult for investors to hold the management to account.<sup>24</sup>

These risks are mitigated somewhat as the internet dramatically reduces the cost of shareholder coordination.<sup>25</sup> Online communities have already developed ways of gauging the prospective success of a crowdfunded venture. They follow the advice of other investors and external media outlets, and also pay attention to the apparent quality of the product, any discounts offered with the product, and the managerial experience within the startup's management.<sup>26</sup> Similarly, a vigilant 'crowd' of investors can be an excellent means for detecting fraud.<sup>27</sup> When added to the other benefits from crowdsourcing, this would no doubt outweigh the costs in some cases at least.

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<sup>19</sup> Agrawi et al, above n4, 12.; Lehner, above n4, 7.

<sup>20</sup> Agrawi et al, above n4, 13-4.

<sup>21</sup> Belleflamme et al, above n1,6.

<sup>22</sup> Agrawi et al, above n4, 17-8.

<sup>23</sup> Ibid., 19.

<sup>24</sup> Ibid., 21.

<sup>25</sup> Andrew A Schwartz, 'Crowdfunding Securities' (2013) 88(3) *Notre Dame Law Review* 1457, 1478.

<sup>26</sup> See generally, Davis and Webb, above n2,.

<sup>27</sup> See, Agrawi et al, above n4, 28.

Type of Crowdsourcing	Description
Participation of consumers in product development and configuration	Companies ask for comments and suggestions on current and future products
Product design	Companies ask to develop a whole new product from A to Z
Competitive bids on specifically defined tasks or problems	Companies ask to give a solution to unsolved problems
Permanent open calls	Companies ask for any new information or documentation
Community reporting	Same as before apart that the work is done by a known community instead
Product rating by consumers and consumer profiling	Companies ask for product reviews and opinions for other users to see
Customer-to-customer support	Companies ask customers to help other customers and use it for consumer knowledge and product design

*Different sources of crowdsourcing*<sup>28</sup>

## 2.5. A more equitable system

In the current financial environment, investment in non-publicly listed companies is the preserve of the most wealthy Australians. The costs associated with investing in securities generally bar all but wealthy financiers from investing in startup firms other than those owned by friends and family.<sup>29</sup> Consequently, traditional sources of finance favour people who live in industrial areas and have wealthy connections.<sup>30</sup>

Other factors also lock people from less wealthy areas out of financing. In areas with fewer bank branches, it is costly for banks to personally assess a venture's credit risk, meaning that the bank instead relies on standard risk profiling models, which are almost invariably biased against people from disadvantaged areas. The distance from bank branches may also limit individuals' awareness of their financial options, meaning that less credit is sought.<sup>31</sup> Additionally, people who live outside of traditional financial circles will often lack the 'social capital' to obtain financing.<sup>32</sup>

In other words, lower and middle class Australians are being shut out from investing in the next big success story.

<sup>28</sup> Table source: Armin Schwienbacher and Benjamin Larralde, 'Crowdfunding of Small Entrepreneurial Ventures', *Handbook of Entrepreneurial Finance* (Oxford University Press, 2010) Version available at <http://ssrn.com/abstract=1699183>, 6.

<sup>29</sup> Cf, Schwartz, above n25, 1474.

<sup>30</sup> Ibid, 1468.

<sup>31</sup> Lisa T Alexander, 'Cyberfinancing for Economic Justice' (2013) 4 *William & Mary Business Law Review* 309, 319.

<sup>32</sup> Ibid., 320.

This is a substantial loss to Australia. It is a loss for the startups that stand to benefit from additional investment; it is a loss for the potential investors, who are denied the returns that their investments would bring; and it is a loss to all society as the system prevents discretionary income from being put to productive use.

Crowdfunding has the potential to change this. Online funding platforms substantially reduce the cost of matching ventures to investors.<sup>33</sup> The most significant implication of this is geographic—in general, crowdfunders tend to be located further from entrepreneurs than traditional funding sources.<sup>34</sup> Accordingly, crowdfunded ventures are less dependant on their physical location and preexisting social circles than traditionally financed ventures—investment can be highly geographically dispersed, and ventures can be established outside of areas in which their industries have traditionally been concentrated.<sup>35</sup>

Indeed, empirical research has shown that areas with low access to other capital sources—such as with fewer bank branches and with lower house prices—tend to have higher rates of crowdsourced ventures; and this affects in particular ventures which are not ‘location dependent’.<sup>36</sup> Entrepreneurs do tend to be people with high levels of skills and education, but they derive greater benefit from crowdfunding if they do not have easy access to credit.<sup>37</sup>

It follows that facilitating CSEF in Australia would likely increase the overall flow of capital and create opportunities for less privileged Australians to access capital and to invest in startup ventures.

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<sup>33</sup> Schwartz, above n25, 1468.

<sup>34</sup> Keongtae Kim and Il-Horn Hann, 'Does Crowdfunding Democratize Access to Capital? A Geographical Analysis' (Working Paper Robert H Smith School of Business, University of Maryland, October 1, 2013) 13.

<sup>35</sup> See, Agrawi et al, above n4, 34-6.; Lehner, above n4, 8.

<sup>36</sup> Kim and Han, above n34, 14-6. ‘Location dependent’ refers to ventures like theatres, restaurants or parties as opposed to ‘location independent’ ventures such as software and technology. See also, Giancarlo Giudici, Massimiliano Guerini and Cristina Rossi-Lamastra, 'Why Crowdfunding Projects can Succeed: The Role of Proponents' Individual and Territorial Social Capital' (SSRN working paper series 2255944, 24 April 2013).

<sup>37</sup> Kim and Han, above n34, 17.

# Our proposed scheme

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**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?**

A self contained regulatory regime is the most appropriate method for ensuring CSEF will operate as designed with the right balance between regulation and freedom to access capital markets. Some amendments to the Corporations Act will be required.

We propose that a new Part be added to the *Corporations Act* providing a self-contained scheme. To facilitate this additional amendments to other discrete sections of the Corporations Act should be incorporated to account for otherwise inconsistent areas of the legislation.

The Part should begin by specifying its goals as follows:

- a. to enable small proprietary companies to obtain financing by issuing securities through crowdfunding intermediaries;
- b. to minimise the cost of regulatory compliance for both issuers and intermediaries;
- c. to protect the interests of investors.

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

- (i) take the form of some variation of the small scale offering exemption**
- (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**
- (iii) adopt some other approach (such as discussed in Section 7.3, below).**

We submit that the provision should take the form of a small scale offering exemption, as well as incorporating the amendments discussed below. Restricting the class of investors to sophisticated investors would continue to lock the majority of Australians out of investment in startups and would perpetuate the access to capital issues outlined above for non-profit and high-tech ventures, as well as for people who live outside of financial hubs. In addition, it would preclude the ‘crowdsource’ benefits of crowdfunding.

### **3. Corporate structure**

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

**(i) proprietary companies**

To facilitate CSEF by proprietary companies, issuers must be able to offer shares to more than the 50 non-employee shareholders to which they are currently limited under section 113 of the Corporations Act. This necessitates a new exemption to s 113 to allow proprietary companies to issue shares through CSEF to more than 50 no-employee shareholders, provided that other requirements are met.

As outlined above, we envision that CSEF will predominantly assist small, initial stage businesses. These will lack the funds or the infrastructure required to register or operate as public companies, in large part because of the prohibitive costs of regulation faced by those companies. These startups would therefore be precluded by s 113 from issuing capital to more than 50 non-employee shareholders, rendering CSEF all but redundant.

It follows that small startup ventures—the class of companies with the greatest potential to benefit from CSEF—would not have access to CSEF unless s 113 is amended. Without these changes, CSEF would not be able to facilitate growth of SME.

**(ii) public companies**

It is not necessary to amend the current regulatory regime pertaining to public companies, as they can raise sufficient capital by listing on an approved stock exchange.

**(iii) managed investment schemes.**

MIS provide a viable way to ensure that companies can offer securities to investors without the investors obtaining a direct shareholding. However, MIS is likely to be impractical for small companies attempting to employ CSEF, due to the regulatory burden imposed on both the entity offering securities and the Responsible Entity (RE) by the regulatory scheme in the Corporations Act.

Should an MIS be used for CSEF, the intermediary would assume a significant portion of the associated risks and therefore would constitute the RE and would therefore be obliged to hold an AFSL. In order to comply with the requirements for an AFSL, an intermediary must comply with the capital liquidity and ongoing reporting requirements set out in Chapter 7 of the

Corporations Act. The consequent compliance costs would effectively prohibit all but sophisticated entities from becoming intermediaries.

**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?**

Where an issuer wishes to issue securities through an MIS and the intermediary is an appropriate RE, the disclosure obligations of the issuer should not differ from those that would apply if it were issuing direct interests in the company. This would once again place an onerous burden on intermediaries and therefore would render it unlikely that intermediaries would choose to facilitate the issuance of securities in this fashion.

## **4. Issuers**

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

- (i) take the form of some variation of the small scale offering exemption**
- (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**
- (iii) adopt some other approach (such as discussed in Section 7.3, below).**

We submit that the provision should take the form of a small scale offering exemption, also incorporating amendments to the Corporations Act to ensure that CSEF is appropriately accounted for.

Restricting the class of investors able to engage in CSEF to sophisticated investors would continue to lock the majority of Australians out of investment in startups. This would create nothing more than a new advertising forum and would not permit CSEF to open up the equity markets as it has the potential to. Such a restriction would perpetuate the access to capital issues outlined above for non-profit and high-tech ventures, as well as for people who live outside of financial hubs.

**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?**

We submit that only proprietary companies should be permitted to become issuers. Whilst issuers are likely to be small proprietary companies, we do not propose a limit on the size of companies able to access this market.

We submit that the following entities must be specifically prohibited from acting as issuers:

1. Pooled investment or private equity funds,
2. Banks,
3. Superannuation funds, and
4. Any other AFSL holder or entity acting as an ADI, custodian or depository service.

The prohibition on such entities acting as issuers would prevent these entities from using CFSLs to circumventing other disclosure requirements under the *Corporations Act*; and would thereby ensure CFSL is used solely for the purposes for which it was designed, rather than to increase the ability of other companies to invest.

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

Issuers should be able to offer:

1. Shares,
2. Debt in the form of corporate bonds, and
3. Basic stock options.

More complex financial products must be specifically excluded from CSEF funding. These should include:

1. Derivatives (other than basic stock options),
2. Contracts for difference, and
3. Any asset backed securities.

This exclusion will ensure that the risks associated with CSEF are minimised.

The class of shares offered should not be restricted. Nevertheless, the following information must be provided:

1. The intermediary must include a general statement of the types of securities on offer.
2. An issuer must include a statement detailing the type of investment and associated rights.
3. Both the intermediary and the issuer must encourage the issuer to seek independent advice prior to their investment.

**(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?**

In keeping with the overall scheme of the *Corporations Act*, we submit that an issuer's funding through CSEF and small-scale personal offers will be capped at \$2 million per annum. This follows the limit placed in the USA under the JOBS Act and brings it into line with our current small-scale offer limitations.

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

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

We submit that Australia should follow the American model regarding advertising securities for CSEF. In this model, advertising by the issuer is prohibited unless it is for the sole purpose of directing potential investors to the intermediary. This will ensure that the prohibitions on advertising for securities are not breached by issuers.

In many instances, issuers will use other forms of social media to promote their venture. This is consistent with the idea that the crowd exists as a conglomerate of internet based investors who are generally technologically astute and use their 'virtual' and 'actual' networks to communicate. If such 'advertising' is disallowed then the benefits of the 'crowd' cannot be fully embraced.

## **5. Intermediaries**

To prevent fraudulent conduct and ensure that issuers and investors are satisfied in the stability of their investments and capital, the JOBS Act allows both registered brokers and registered intermediaries to engage in crowd sourcing.<sup>38</sup>

A successful platform will need to maximise the size and number of successful projects and generate positive media attention. A platform on which fraud is rife and most startups fail would probably not last long.<sup>39</sup>

### **5.1. Licencing**

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<sup>38</sup> JOBS Act s4(a)(6).

<sup>39</sup> See, Agrawi *et al*, above n4, 19.

**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?**

At first glance, to act as an intermediary offering securities, an intermediary must hold an Australian Financial Services Licence (AFSL).<sup>40</sup>As mentioned above, we feel that the requirements for obtaining and complying with an AFSL are currently far too onerous for crowdfunding intermediaries—largely due to the limited use of such a licence in crowdfunding purposes. Instead, we suggest that like in the US JOBS Act, both AFSL holders and a new class of registered intermediaries should be able to offer securities. The requirements to hold an intermediary licence are detailed below.

**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):**

**(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?**

These matters are dealt with in 5.2 Registered Intermediary below.

**(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?**

Whilst an internal dispute resolution mechanism would be ideal, such a mechanism is unlikely to be appropriate given that investors must be aware of the risks involved in such investment. As such, where an investor believes that an intermediary has breached their duties, they will have recourse to ASIC or the financial services ombudsman. Nevertheless, should an intermediary feel that such a mechanism would be appropriate they are encouraged to include this on an ‘opt-in’ basis.

## **5.2. Registered Intermediary**

We submit that a registered intermediary licence should be created to regulate the entities which run CSEF through online portals. This will be similar to an AFSL however will have less onerous reporting requirements and not require

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<sup>40</sup> *Corporations Act 2001* (Cth) s

a key person, in exchange for a limitation on their dealings to only CSEF purposes.

To receive a licence a registered intermediary must:

1. Run an online platform for the purpose of providing CSEF;
2. Be able to pay its debts as and when they become due and payable;<sup>41</sup>
3. Either have total assets that exceed liabilities as shown on their most recent balance sheet, or have adjusted assets that exceed liabilities;<sup>42</sup>
4. Must have at least \$2 million net tangible assets to cover the trustee facilities that they operate,<sup>43</sup>
5. Insurance of at least \$2 million (see section **Error! Reference source not found.**)and
6. Comply with any other requirements such as submitting forms or applications as may be required by ASIC or the regulations for the purposes of applying for a CSEF licence.

In addition to ensuring that it maintains the requisite approval criteria, a registered intermediary must also submit annual audited financial statements to ASIC.

A registered intermediary must not:

1. Give financial advice;
2. Deal in securities in any way other than as directed for CSEF purposes;
3. Operate an MIS as an RE;

Given that crowdfunding is dependent on an online community, and investors use the medium of the ‘crowd’ an intermediary must use an online platform. This is consistent with the recommendations of the SEC.<sup>44</sup> In addition, this online platform must allow investors to form a ‘crowd’ by hosting platforms on which potential registered investors can discuss the merits of the various online investments. The role of the intermediary is “to bring the issuer and the potential investors together and to provide safeguards to potential investors.”<sup>45</sup>

### **5.3. Relationship with issuers**

**(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?**

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<sup>41</sup> This is similar to rule 13 of PF 209.

<sup>42</sup> Ibid.

<sup>43</sup> Again, this is akin to rule 19B of PF 209, however has been adjusted to account for limitation on the amount that issuers can raise through CSEF.

<sup>44</sup> SEC paper p66430-66431.

<sup>45</sup> SEC p66430.

With the exceptions noted above in **Error! Bookmark not defined. Error! Reference source not found.**, we submit, that it should be at the discretion of intermediaries to ascertain which entities should be allowed to use their platform. Due to the commission relationship, it will be in the commercial interests of intermediaries to only permit high-quality projects.

**(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?**

Aside from the specific disclosure requirements mentioned above in **Error! Reference source not found.**, we submit that any criteria for preliminary and ongoing due diligence checks should be set at the discretion of the intermediaries, bearing in mind their duty to ensure that the investors are well informed.

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

When an issuer uses an intermediary's platform they must agree:

1. The target amount to be raised;
2. The time for the raising;
3. The method of dealing with over or under subscription.

As stated above, by statute, until an issuer has received subscriptions for the greater of either \$10,000 or 10% of the amount to be raised, the issuer is unable to receive the funds. This protects the interests of the investors in the fund as it ensures that the issuer receives a sufficient amount of capital to fulfil the business needs.

Similarly, an oversubscription of the greater of 10% or \$10,000.00 (providing such an oversubscription will not be in excess of the \$2 million cap on capital raising) is the maximum that an issuer can recoup.

Prior to the final date of funding, or any later date set in the case of an under subscription, such funds are to be held by the intermediary on trust for the issuer. Each issuer's funds must be held in a separate trust account for the issuer, to be released at the ascertained date, provided the requisite amount of funds has been received.

Under this new proposal, investors must be alerted by the intermediary as to these limits at the time of investing. They must also receive notice in the following circumstances:

1. when the 10% threshold has been met,
2. once the target amount is met,
3. at the final date of funding,
4. or if there is to be any change to the final date or amount of funding,
5. any other matter deemed relevant for the purposes of keeping investors adequately informed of their investment.

## 5.4. Relationship with investors

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

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

We submit that all investors must be registered members of an intermediary before they are permitted to invest any funds in issuers on that intermediary's platform. Regarding the registration process, we submit that intermediaries should be required to ensure that all investors complete a basic questionnaire before registering on the platform.

Investors should be required to provide:

- Basic personal details—ie name, address, occupation, etc;
- Their personal financial circumstances, including annual income, level of debt, value of family home,
- Their Tax File Number.

These requirements mirror those set out by the SEC and will ensure that investors do not double

Investors should also be required to acknowledge that they are risking the loss of their investment.

These requirements should be subject to the regulations.

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

In addition to the Disclosure regime set out at **Error! Reference source not found.**, before committing to any investment, an investor must confirm that they are aware that they may lose their investment in its entirety. Such an acknowledgement must be prominently displayed separate to any other questionnaire. An investor will be prohibited from investing without acknowledging the risks of their investment.

In addition, general disclosure and risk statements must be advertised prominently on the intermediary's platform and a full risk disclosure statement must be made available by the intermediary stating that it does not constitute financial advice in any way. For more information see **Error! Reference source not found.** Disclosure regime.

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

As each investor is required to provide their TFN and their personal income on registration, this should not be difficult to monitor. This will ensure that the Intermediary and going further, the ATO, would be able to flag where an investor's limit has been breached.

The investment limits are as follows:

level of income	total assets	maximum investment per issuer	maximum investment per annum
up to \$100,000	\$1 million	\$1,000.00	\$5,000.00
up to \$150,000	\$1 million excluding family home	\$2,000.00	\$10,000.00
sophisticated investor for the purposes of s708(8)(c) of the Corporations Act		5% of annual income or net worth	10% of annual income or net worth

Note that these limits are based on the US JOBS Act and the Australian Corporations Act 2001.

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

Intermediaries like all other entities cannot provide investment advice unless they hold an AFSL. Instead, to ensure that investors are aware of the risks, we submit that disclaimers should be prominently displayed at the point of signing up and at the point of investing to ensure that the investor is aware that they are not being provided advice and should see independent advice.

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

In accordance with the restrictions on offering financial advice and facilitating secondary security markets, intermediaries should not be permitted to solicit any transactions other than those listed on their platform by issuers. The issuer will be responsible for directing the investor to their section on the platform, not the intermediary.

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

As explained above, in response to question (g) under 5.3 Relationship with issuers, intermediaries must hold investments on trust until a certain threshold or time limit is reached. Other than this, intermediaries should not be permitted to hold or manage investor funds unless they hold an AFSL.

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

Intermediaries should be required to provide investors with the following company details of the issuer:

1. company secretary,
2. directors,
3. senior management
4. if appropriate, the industry group,
5. the registered office, and
6. method of contacting the company.

In addition, the intermediary must provide an online discussion forum through which investors can pose questions to the issuer, the answers to which can be viewed by other investors as well as communicate with one another. The intermediary will be required to moderate comments to the extent that is reasonably possible to ensure that discussion is relevant to the purposes of investment and to prevent harassment and abuse.

## **6. Restrictions on investors**

**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 submit that to invest in a CSEF an investor must be:

1. A natural person, and
2. Above 18 years of age.

**(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 submit that such a requirement would substantially defeat the purpose of the proposed scheme and would perpetuate current obstacles to finance affecting large portions of the population.

**(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*.**

Additional requirements should be imposed on any investor investing more than \$500 in any individual issuer, and no investment should be made above \$2,000 in any one issuer by any one investor.

Investors should also be subject to individual caps on their total annual investment. Each investor should be assigned a class according to their financial circumstances, and appropriate limits should be placed on each class.

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

As explained above, the intermediary must require this before investment.

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

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

Disclosure is divided into initial disclosure and ongoing disclosure.

## **6.1. Initial disclosure**

We submit further that there should be some mandatory minimum standards of disclosure, which include the following:

1. The purpose for which funds will be used;
2. General limitations on investment and usage of information;
3. The nature of the company;
4. The company's management structure, including the names of all officers and their qualifications;
5. The issuer's business plan;
6. The issuer's projected income;
7. Where available, audited financial statements;
8. Any other relevant financial information; and
9. A statement of both general and specific risks.

This information must be made available first to the intermediary and second to the investors, in order to ensure that the investors are able to make educated investment decisions. Whilst the financial records from a start-up will not go very far,<sup>46</sup> the more informed an investor is, the more sound their investment decision will be.

This is likely to be subject to regulation by ASIC, however we submit that as these are initial stage companies that the same rigorous scrutiny applied to product disclosure statements and prospectuses should not be applied.

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<sup>46</sup> See, Blakeley C Davis and Justin W Webb, 'Crowd-Funding of Entrepreneurial Ventures: Getting the Right Combination of Signals' (2012) 32(3) *Frontiers of Entrepreneurship Research* 1, 3.

Instead, each investor must be made aware of the risks associated with the investment and must consent to the assumption of risks both upon subscribing to the intermediary and upon investing.

## 6.2. Ongoing disclosure

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

**(viii) reporting: what ongoing reporting should be made by the intermediary and/or issuers to investors in regards to their investment?**

To guard against prohibitive costs on issuers, we submit that it would not be appropriate to impose the same level of disclosure currently imposed on disclosing entities under Part 1.2A of the *Corporations Act*. Issuers would predominantly be small, initial or early stage companies and bearing such a burden would be far beyond their capabilities. To facilitate this we propose an addition sub-section to section 111AF which relates to securities held by 100 or more persons, excluding where those securities are held under a CSEF regime.

Whilst we do not believe that an issuer should be a disclosing entity, we propose that some degree of ongoing disclosure is essential to ensure that investors remain informed of their investment. The level of disclosure will be applied on the following graduated basis.

<b>Limit each investor can invest</b>	<b>Total funds raised</b>	<b>Disclosure required</b>
<\$500.00	\$100,000.00	Level 1
\$500.00>\$2,000.00	\$2,000,000.00	Level 2
>\$2,000.00	\$2,000,000.00	Level 3

Level 1 -Disclosure under level one will involve annual disclosure of short-form details of the company's financial situation.

Level 2 – Disclosure under Chapter 2M of the Corporations Act.

Level 3 – Entity will be a disclosing entity under Part 1.2A of the Corporations Act.

These three levels are designed to ensure that companies engaged in crowd sourcing give sufficient information on an ongoing basis to their investors and to ASIC. This will help prevent fraudulent conduct by the issuers and ensure accountability.

## 6.3. General Disclosure

**Question 7 In the CSEF context, what provision, if any, should be made in order that investors be made aware of:**

- (i) the differences between share and debt securities?**
- (ii) the difference between legal and beneficial interests in shares?**
- (iii) any classes of shares in the issuer and its implications for investors?**

The intermediary should be obliged under the new legislation to provide all potential investors with an explanation of the different financial products which are offered. This explanation should provide all information that an ordinary reasonable investor would require to understand their rights and obligations in relation to the securities.

This information will include:

1. Type of security;
2. Class of security;
3. Rights attaching to the type and class of security; and
4. Explanation of the difference between the legal and beneficial interest in a security.

The explanation must have the following features:

1. Be easily accessible, by any person who visits the online platform;
2. Provided in plain English; and
3. Be in at least size 12 point font; and
4. Prominently displayed at the point of offering securities and on the home page.

**A related question is whether disclosure, alone, would suffice.**

Such disclosure will only suffice to alert the investors to the inherent risks of CSEF. In addition, intermediaries should also be obliged to provide investors with a disclaimer recommending that they seek independent financial advice from an accredited advisor before making any serious financial decisions. This will ensure that investors make an independent assessment of the risks involved in CSEF or of investing in a particular issuer.

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

- (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?**

Investors should be informed of their right to make complaints to both the financial services ombudsman and ASIC. These two bodies will have oversight over the activities of an intermediary and so should be able to sufficiently discipline the intermediary as they see fit.

In addition, to protect investors, an intermediary must have professional indemnity insurance. We suggest that an intermediary should maintain an insurance policy covering professional indemnity and fraud by its officers that is both: appropriate having regard to the nature of the activities carried out by the licensee under the licence; and covers claims of \$2 million. This is similar to the requirement for RE under the AFSL Conditions however lowers the limit from \$5 million to \$2 million.<sup>47</sup> The lower level of coverage takes account of the cap on investments and the limit of investment by any individual investor.

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

An intermediary should be required to prominently display the percentage commission or any other fees that will be collected by them. This is to allow investors to make an educated investment decision based not only on the financial product and issuer but also on the intermediary used. The more transparent the disclosure, the more effective the crowd will be at sourcing the best investments and selecting the most appropriate intermediary.

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

We submit that no additional services would be necessary.

## **7. Compliance costs**

In general, it is necessary to minimise compliance costs—otherwise the regulatory changes will have little impact. Where the regulatory burden is too onerous, the aim of crowd-sourcing, to obtain funds from a large pool of investors are not maximised. For instance, in the US, the crowdsource-style loan brokering companies *Prosper* and *Lending Club* were established to service broad sections of the community. As regulatory oversight increased, they responded by narrowing their customer base. Now, they primarily serve borrowers who had access to traditional credit, thus defeating the purposes of crowd-sourcing.<sup>48</sup>

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<sup>47</sup> Pro Forma 209, Australian financial services licence conditions, updated November 2013, at p.16.

<sup>48</sup> Lisa T Alexander, 'Cyberfinancing for Economic Justice' (2013) 4 *William & Mary Business Law Review* 309, 345. These are 'peer-to-peer lending' sites, which connect borrowers to investors for the provision of small loans. This is distinct from

## **8. Restrictions on dealing with security**

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

**(v) cooling off rights: should an investor have some right of withdrawal after accepting a CSEF offer?**

We propose that the legislation will provide a mandatory cooling-off period of 3 days to allow investors time to re-evaluate their investment. To further protect investors, this period should be extended to 7 days or where the amount invested is above \$500.00.

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

**(vi) subsequent withdrawal rights (Italy only): should an investor have some further withdrawal right subsequent to the offer?**

Beyond the cooling off period, in the absence of fraud or some other conduct contrary to law, the investor should not have a right of withdrawal. Under our proposed scheme, the investor would be made sufficiently aware of the risks involved in CSEF such that it further withdrawal rights would not be required.

Not only are withdrawal rights unnecessary for investors, they would be detrimental to issuers. Permitting investors to withdraw investments at will would leave issuers without any certainty as to whether they would receive funds that they ostensibly raise. Further, if investors were able to withdraw their investments at will, CSEF issuers could be used as repositories of small amounts of money for short periods of time by persons fraudulently purporting to be investors.

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

**(vii) resale restrictions: should there be restrictions for some period on the on-sale of securities acquired through CSEF?**

On-sale of securities creates a secondary market. Under Australian law, in order to act as a market maker, an entity must be licensed by ASIC unless subject to an exemption.<sup>49</sup> To be licensed, the market maker must hold an

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crowdfunding as they only connect individuals to each other, they do not connect one borrower to a whole 'crowd' of lenders.

<sup>49</sup> *Corporations act 2001* (Cth) Ch 7.

AFSL and comply with ASIC's Market Integrity Rules.<sup>50</sup> Whilst an intermediary should not be restricted from holding an AFSL and applying to ASIC to be a market maker, a requirement that it does so in order to merely operate as an intermediary would impose a far higher burden than is appropriate. As noted by the SEC, only where an intermediary wishes to comply with this higher regulatory threshold should they be allowed to conduct a secondary market.<sup>51</sup>

This would not apply where the issuer approves of the on-sale of the securities.

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

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

We submit that, as in the US, investors should be prohibited from onselling existing securities for one year, subject to a number of specific exceptions, including: selling to friends and family; selling back to the issuer in the event of a buyback; and selling to a sophisticated investor. In addition, further sales must be on the same terms as the shares were acquired.

## 9. Cooling off

It is already standard on most platforms to prevent a startup from receiving funding until a certain threshold is reached.<sup>52</sup> In particular, ASSOBS requires a 10% deposit at the time of application and does not require full payment until a specified threshold of share sales has been reached.<sup>53</sup> In addition, we propose that the legislation will provide a mandatory cooling-off period of three business days to allow investors time to re-evaluate their investment. This period may be longer for certain types of investments, or where the amount invested is above a certain threshold.

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<sup>50</sup> ASIC, *Market supervision and surveillance* <https://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Market%20supervision%20and%20surveillance> updated 28 August 2013, accessed 8 December 2013.

<sup>51</sup> *Crowdfunding: Proposed Rules*, SEC Federal Register, 78(214), Tuesday 5 November 2013, p.66459.

<sup>52</sup> Agrawi et al, above n4, 31.

<sup>53</sup> Ahlers, above n3, 12.

## 10. Liability

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

**(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?**

All shareholders who obtain shares through CSEF will already be protected as shareholders under the Corporations Act and the Common Law. We submit that these extant protections are sufficient

Given we do not propose to increase the liability of the directors or controllers of the issuer, we do not propose any further defences. The directors should owe the same duty towards shareholders who obtained their shares through CSEF as they would to any shareholders.

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

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

Under the preexisting law, intermediaries would potentially be liable for misleading statements made by issuers. Under section 1041H of the Corporations Act a person will be liable for engaging on conduct that would be misleading or deceptive or likely to mislead or deceive.<sup>54</sup> This is a question of fact and degree as to whether the intermediary is responsible for misleading statements.<sup>55</sup>

In *ACCC v Google*,<sup>56</sup> the High Court determined that where a party has no control over the subject matter that is published on its website, it cannot be held responsible for any misleading statement therein. It follows that an intermediary would not be held liable for any information written by an issuer which it allows to be published but has no authorial input into. Conversely, where the intermediary has a greater deal of control over the publication of information originally provided by the issuer, it will be held responsible for the contents.<sup>57</sup>

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<sup>54</sup> *Corporations Act 2001* (Cth) s1041H (1).

<sup>55</sup> *Australian Competition and Consumer Commission v Google Inc.* [2013] HCA 1.

<sup>56</sup> *Australian Competition and Consumer Commission v Google Inc* [2013] HCA 1, [58]-[7] (French CJ, Crennan and Kiefel JJ)

<sup>57</sup> *Cf. Clarke v Nationwide News Pty Ltd* (2012) 201 FCR 389.

These laws could potentially impose on intermediaries the onerous burden of being strictly liable for content which they could not have reasonably known would be misleading or deceptive. Accordingly, we submit that there should be a defence inserted into s 1041H, providing that an intermediary will not be held liable for any misleading or deceptive statements published on its website where the statements were provided by an issuer and the intermediary could not reasonably have known that they were misleading or deceptive.

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

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

We submit that intermediaries should have a responsibility to the investors to make reasonable enquiries of issuers before permitting them to use their platform to ensure that the issuers are not engaging in fraudulent conduct.

To that end, the intermediary must receive regular audited financial statements from the issuer. In the event that an issuer has previously operated as a business, its financial statements for the proceeding 2 years—or if it has not operated for 2 years, then as far back as possible—must be given to the intermediary to ensure that they are a viable entity.

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

**(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?**

When considering conflicts of interest between an intermediary and the issuers using its platform, it is important to recognize that these are predominantly aligned. An intermediary will be successful to the extent that it attracts both a large pool of investors and a large pool of high-quality issuers. In order to achieve this, it is in the intermediary's interests that its ventures succeed.

Nevertheless, in order to prevent self-dealing, an intermediary should not be permitted to hold equity in or take any other legal or beneficial interest in any issuer using its platform. This will restrict the intermediary's interest to the success of the crowd-funding event and not to the success of the company as a

whole. Further, the officers and employees of an intermediary may be restricted from dealing with the equity of the issuer under statutory prohibitions of insider trading.<sup>58</sup> In order to ensure that CSEF is covered, CSEF should be included in the application of this division.<sup>59</sup>

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

**(ix) losses: what recourse should investors have in relation to losses resulting from inadequate disclosure?**

Investors must be made aware of the inherent risks of CSEF from the outset. As explained above, we submit that investors should be required to acknowledge that they are aware of these risks, both at the time of signing up to the intermediary and at the time of investing. Further, the amount that an individual investor may invest ought to be limited, in order to prevent unsophisticated investors jeopardising their livelihood.

With this in mind, we submit that there should be no specific recourse for investors in relation to losses beyond the current requirements of the Act. This investment is akin to investment in a proprietary company, not a public company and so the same high threshold should not be met.

Inadequate disclosure depends on the type of disclosure document and the time at which it was provided. As previously stated, issuers are required to provide a business plan, a copy of the constitution and shareholders agreement prior to using the platform. This information should not be subject to the same regulatory guidelines as such information provided under a product disclosure statement or a prospectus, which would be excessively costly.

Instead, we submit that issuers should have an obligation to provide ongoing financial information to shareholders on an annual basis. As set out above, the content and level of auditing of such information is dependent on the amount of money raised by the entity through CSEF. As with any financial statement, the issuer will have a duty to ensure that the statements are not misleading, which its investors can enforce through a class action.

**(x) remedies: what remedies should investor have in relation to losses results from poor management of the enterprise they invest in**

We submit that the remedies under the *Corporations Act* and the common law are sufficient in this instance.

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See, Corporations Act 2001 (Cth) Pt 7.11 Div 2A.  
Corporations Act 2001 (Cth) s 1042B1002.

