

CROWD-SOURCED EQUITY FUNDING

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I make this submission both as an investor and as someone who has been involved in developing impact/social investment markets. I have previously worked on impact investment policy and product development with State Government in Australia (NSW) and the UK Government. The emerging global impact investment market is receiving significant attention worldwide. Impact investment includes crowd-sourced equity funding (CSEF) for organisations or projects to achieve social, cultural and/or environmental benefit. DEEWR published a report on impact investing called *IMPACT - Australia* in 2013, saying “the distinguishing feature of impact investing is the intention to achieve both a positive social, cultural and/or environmental benefit *and* some measure of financial return” (p. 2).

I personally invest in both impact and commercial investments, but would like it to be easier for me to invest a greater proportion of my portfolio in a larger number of impact investments. CSEF would allow me to use an efficient platform to invest small amounts in a diverse range of innovative social and environmental projects and organisations. I am currently unable to do this in Australia. Impact investment did not exist at the time of drafting current corporations legislation, so the legislation creates unintended barriers to these new forms of investment. These barriers must be examined and only kept in place if they are proportionate and necessary.

The recent growth in crowd funding is not only a response to the tightening of credit requirements since the global financial crisis (as suggested on page 10 of the discussion document), it is also part of a movement of democratising processes that have been traditionally controlled by intermediaries or middlemen and which have enabled concerned individuals to participate in a small way in impact investment. To some extent this trend has been fuelled by the internet and smartphone technology, but it is also a reaction to the failure of traditional financial and economic systems to foster innovation and thus meet the evolving needs of individuals and communities.

There is much in the discussion document about safeguarding investors from the risks of investment. It must also be recognised that there are benefits to investors in high-risk products that should be more widely accessible, particularly to those who wish to invest significantly smaller amounts. CSEF allows small investments to be aggregated, encouraging diverse portfolios and participation by a wider range of investors. I would like the CSEF review to result in regulatory changes that widen the retail investor base for impact investment. This would provide a larger community of support for innovation and foster both financial and social inclusion.

I restrict my response to those questions I can answer with confidence based on my experiences.

QUESTION 1 IN PRINCIPLE, SHOULD ANY PROVISION BE MADE IN THE CORPORATIONS LEGISLATION TO ACCOMMODATE OR FACILITATE CSEF. IF SO, WHY, IF NOT, WHY?

Yes, provision should be made in the corporations legislation to accommodate and facilitate CSEF.

Current corporations legislation creates barriers for CSEF that mean equity and debt cannot be raised by many small, innovative organisations that could benefit from this type of finance.

Crowd-sourced equity funding makes investment accessible to a wider range of investors and investees. It enables investment in innovative, high-risk projects and organisations by reducing the financial and impact risk by involving a much larger number of investors. Traditional finance products often manage risk by

requiring a 'track record' of similar activity, making it very difficult for innovative projects and organisations to get funded. Additionally, the regulatory burden for an organisation to offer financial products to retail investors is prohibitively high.

There is understandable reluctance and legislation against making complex investment products open to individual, retail investors. But the safeguards are not always logical:

- Anyone can give as much as they like to any charity (or in fact any person or organisation) that will accept their donation. There is no requirement for charities to check the annual income of the person donating or their understanding of the programs they are donating to. And yet if there is even the slightest suggestion that givers of funds may get this money back, it becomes an investment and they are immediately subject to heavy regulatory barriers.
- To safeguard investors from making an investment mistake, we often confine offers to sophisticated, experienced or professional investors and put a minimum investment threshold in place. So an investor is not allowed to risk \$100, but they are allowed to risk \$100,000. A maximum amount for high-risk investments would make more sense than a minimum, when deciding where regulations can be lifted or lightened.
- Commercial investors find Social Impact Bonds "a difficult investment because it is a small, illiquid product with no credit rating" (Australian Financial Review, 5 October 2013). They understand the way a certain number of products in the market work and to them a SIB is new and different. But to the average person on the street, all investments are to some extent a minefield. Most people will never read all the fine print, but will learn new products and systems as they go. Very few who enter into a mortgage understand all the terms and conditions – a fact exploited and revealed in the sub-prime mortgage collapse of 2008. CSEF which features a cap on the amount invested for instance would allow more investors to engage with more projects. In my experience, retail investors often find products like SIBs less alien and confronting than finance professionals.

QUESTION 2 SHOULD ANY SUCH PROVISION:

- (I) TAKE THE FORM OF SOME VARIATION OF THE SMALL SCALE OFFERING EXEMPTION AND/OR
- (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).

Depending on the changes made, option 2 (liberalising the small scale personal offers exemption from the fundraising provisions), option 4 (making targeted amendments to the existing regulatory structure for CSEF open to all investors) and option 5 (creating a self-contained statutory and compliance structure for CSEF open to all investors) in the discussion paper could result in the same set of CSEF regulations.

The desirable result would be that organisations could raise equity and debt through CSEF platforms in line with regulations that were proportionate to the offer and investment size. The current regulatory barrier is too high and thus prohibitive.

- (i) A variation to the small scale offering exemption should entail (a) lifting the ban on advertising, (b) removing the shareholder cap and (c) delimiting the number of investors that may invest annually. (b) and (c) will decrease the risk apportioned to any one investor/shareholder by increasing the number of investors. To manage risk, these changes could be accompanied by

limiting the amount which an investor could invest in any one CSEF in a 12 month period thus limiting the potential individual loss.

- (ii) Confining CSEF to sophisticated, experienced and professional investors limits the ability of retail investors to participate in investments that could be highly beneficial to them and their communities. This is not acceptable.
- (iii) Some other approach may be appropriate, but that would be determined by its detail and effect on the ground. The intention of many policy reforms is lost through implementation, so there is a risk that a more restrictive or inappropriate system is designed.

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

(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

(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*

(IV) **RISK ACKNOWLEDGEMENT BY THE INVESTOR:** SHOULD AN INVESTOR BE REQUIRED TO ACKNOWLEDGE THE RISKS INVOLVED IN CSEF

(V) **COOLING OFF RIGHTS:** SHOULD AN INVESTOR HAVE SOME RIGHT OF WITHDRAWAL AFTER ACCEPTING A CSEF OFFER

(VI) **SUBSEQUENT WITHDRAWAL RIGHTS (ITALY ONLY):** SHOULD AN INVESTOR HAVE SOME FURTHER WITHDRAWAL RIGHT SUBSEQUENT TO THE OFFER

- (i) No. It's not a good crowd if someone's not allowed to join it.
- (ii) No. Sophisticated investors are not necessarily suitable investors for all CSEF offers. The essence of a CSEF is that it appeals to the non-sophisticated investor.
- (iii) Perhaps this could be used as a trade-off for some other requirement or to encourage disclosure, while allowing very new organisations to participate e.g. if financial statements are not available, then the organisation can only raise a maximum of \$1000 from each investor.
- (iv) Yes, the investor should acknowledge that they accept the risk as long as it wasn't a deterrent – ticking the box to acknowledge something like this from Abundance Generation could be suitable: "As with any investment product there are risks. Part or all of your original invested capital may be at risk and any return on your investment depends on the success of the project invested in."
- (v) One week would be appropriate.
- (vi) No – this creates instability for the organisation raising funds.