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## **Submission on Discussion Paper: *Crowd sourced equity funding***

Dear Mr Kliver

Thank you for the opportunity to provide a submission on the Corporations and Markets Advisory Committee (**CAMAC**) discussion paper: *Crowd Sourced Equity Funding (Discussion Paper)*. Given global developments in the regulation of crowdfunding, it is appropriate and timely that CAMAC has been asked to undertake this review.

I am a part-time graduate research student in the Faculty of Law at Monash University, currently completing a Doctor of Juridical Science (**SJD**). I am also employed as a lawyer in the Melbourne office of Ashurst, practising in corporate, regulatory and financial services law.

To date, my research for the SJD has focused on the regulation of the Internet, and the implications of recent Internet-related technological developments on the regulation of financial services. Crowdfunding has been central to this work. An article I have recently written on crowdfunding (which was developed from a paper submitted for the SJD) has been accepted for publication and will be published in the next edition of the *Journal of Banking and Finance Law and Practice*. I also intend to write my SJD thesis on crowdfunding.

### **Reward and pre-payment models of crowdfunding**

Although the focus of CAMAC's review is on crowd sourced equity funding (**CSEF**), it seems that the opportunity of this review should be taken to consider whether any amendments to the *Corporations Act 2001* (Cth) (**Corporations Act**) (or other legislation) are necessary to support other models of crowdfunding as well.

One example arises in the context of the reward and pre-payment models of crowdfunding (discussed at 2.1.2 of the Discussion Paper). These models are currently the most common models of crowdfunding, used by websites like kickstarter.com (**Kickstarter**) and pozible.com (**Pozible**). Rather than offering shares or other securities in an entity (as is the case with CSEF), the reward and pre-payment models offer either a reward (ie something small like a cap or a t-shirt, or something larger like a specific thanks to the contributor on the inside of an album cover, or a mention in a movie's credits), or the actual product or service that the project creator is raising funds to produce.

### **Regulation of crowdfunded projects as managed investment schemes**

In certain circumstances, projects being funded under the reward and pre-payment models of crowdfunding could be regulated as managed investment schemes. ASIC has stated that such projects could be a managed investment scheme if the funds contributed are pooled or used in a common enterprise to produce financial benefits, or benefits consisting of interests in property for contributors, unless such benefits and interests are of nominal value and not financial products themselves.<sup>1</sup> Accordingly, all project creators must consider whether crowdfunding their project could mean that they are operating a managed investment scheme.

A review of the types of projects being funded on Kickstarter and Pozible suggests that rather than funding projects to manage a financial risk or make an investment, people generally support projects because they either identify with the project and its aims, or they would like to purchase the product or service being produced. On the basis that people do not generally regard these projects as investments in the conventional sense, it seems that regulating such projects as managed investment schemes is inappropriate.

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<sup>1</sup> Australian Securities and Investments Commission (**ASIC**), *12-196MR ASIC Guidance on crowd funding* (14 August 2012) <http://www.asic.gov.au/asic/asic.nsf/byheadline/12-196MR+ASIC+guidance+on+crowd+funding>.

There are considerable benefits to be obtained by the development of the reward and pre-payment models of crowdfunding. Producers of creative and artistic projects are using reward and pre-payment model crowdfunding successfully as an alternative source of revenue to government grants, due largely to the work of the Australia Council for the Arts and its partnership with Pozible to educate originators of creative projects about crowdfunding. Also, reward and pre-payment model crowdfunding has become a powerful way for startup businesses to test the market for their idea, obtain consumer feedback and raise capital at the same time. In order to exploit these benefits, any ambiguity as to whether projects adopting these crowdfunding models are managed investment schemes needs to be resolved. This ambiguity should be resolved by excluding such projects from the definition of “managed investment scheme” in the Corporations Act.

### **Merits of CSEF as an investment**

I agree with CAMAC’s comments in 2.1.4 of the Discussion Paper that even where projects are properly funded and administered, there is a risk that they will not be successfully completed. It could be argued that the structure of CSEF encourages offerings of inferior investment proposals as anyone with an idea and minimal resources can market an offering to a global audience of retail investors. Established capital raising structures have inherent filtering mechanisms (ie banks, angel investors, financially savvy relatives and wholesale investors) that help to ensure that only the most viable commercial enterprises are pursued and ultimately offered to the public as an investment. Crowdfunding effectively removes these filters.

A counter to this position is that because crowdfunding is fundamentally linked through social media, the crowd will keep promoters honest and weed out bad projects itself. However, such a process would necessarily involve a series of failures that, depending on the severity, the crowdfunding concept may or may not survive. Accordingly, it seems that the screening of projects and commercial enterprises should be an essential regulatory aim for CSEF.

### **Concluding remarks**

The regulation of crowdfunding is an important issue that, given the international appetite for its development, the Australian government should not ignore. In order to remain internationally competitive, Australia must have a considered policy on crowdfunding. Government should engage with all stakeholders (project creators, platforms and regulators), as the European Commission has recently<sup>2</sup> in order to understand the most appropriate way forward.

Thank you for the opportunity to provide a submission on this important issue. Please feel free to contact me should you wish to discuss this submission, or any other matter ([mattvitale@me.com](mailto:mattvitale@me.com) +61 410 458 075).

Yours sincerely

Matthew Vitale

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<sup>2</sup> See European Commission: Internal Market, “Crowdfunding: Untapping its potential, reducing the risks” (European Commission Workshop summary of discussion, Brussels, 3 June 2013) [http://ec.europa.eu/internal\\_market/conferences/2013/0603-crowdfunding-workshop/docs/minutes\\_en.pdf](http://ec.europa.eu/internal_market/conferences/2013/0603-crowdfunding-workshop/docs/minutes_en.pdf).