

SUBMISSION ON CROWD SOURCED EQUITY FUNDING DISCUSSION PAPER

As stakeholders with interests in crowd funding, Pozible Pty Ltd and Clearpoint Counsel Pty Ltd jointly submit the following responses to the Crowd Sourced Equity Funding (“**Equity Crowd Funding**”) Discussion Paper released in September 2013 by the Corporations and Markets Advisory Committee.

We support the use of Equity Crowd Funding as an important tool for funding small businesses with potential to grow.

Pozible

Pozible has provided Australia’s largest crowdfunding platform since 2010 in terms of funds raised and the number of projects hosted. The platform was developed to help people raise funds, realise their aspirations and make great things possible. It has been used with great success as a community-building tool for creative projects and ideas.

Crowdfunding with Pozible is a way for motivated project creators to access funding beyond ‘official’ channels by talking directly to switched-on consumers, fans, peers and like-minded strangers.

Pozible currently advertises projects that comply with their platform terms and conditions. People are able to support different projects by pledging a sum of money which is paid once the declared target is met. In return project creators offer contributors non-financial rewards matching the level of funds pledged.

Clearpoint Counsel

Clearpoint Counsel is a Melbourne based law firm. It is engaged to work with many small businesses and start-ups alongside listed companies and other clients.

Members of our team have used crowd funding to fund projects in the past and also have deep experience with raising money through more traditional mechanisms such stock exchanges.

Crowd funding grows business

As crowd sourced funding methods become increasingly well established internationally as an option for funding small enterprises, enabling such funding methods is in the interest of the Australian economy. This is especially true in the recent economic climate where more traditional methods of raising equity have been difficult to access.

Small business can be a vibrant source of innovation as part of a healthy economic ecosystem. Small business is also a major source of employment. Failure to introduce amendments to the current legislative regime would disadvantage Australian businesses compared to other jurisdictions that are moving to facilitate Equity Crowd Funding.

Crowdfunding in Australia

Reward based Crowdfunding ('RBCF') has experienced 400%-500% growth per year since 2010. We estimate RBCF mechanisms raised a total of \$20-25 million in Australia this year and \$1.4 million globally. Predictions are that funds raised bay way of CSEF will grow to far exceed funds raised through RBCF.

There are a number of key benefits of crowd funding that extend beyond simply raising funds. These include its ability to:

(i) Accelerate funding

Timeframes to raise funds and setup operations through reward based crowdfunding can be as short as 14 days. Pozible sets a maximum 60 days to run a campaign. In Australia, it can sometimes take at least 6 to 12 months to raise investment funds through business angels, and sophisticated investors. The risk of new ventures failing (especially innovative ventures) can be reduced if the timeframe and expense to raise investment is reduced i.e. Seedrs (UK CSEF platform) raised \$750,000 in 2 days.

(ii) Facilitate Marketing & Awareness

With crowd funding, stakeholders/supporters not only provide funding but also a voice, access to new networks and potentially new talent. Capping the number of investors will limit the effectiveness of these additional benefits.

(iii) Encourage Security & Online Profiling

Online communities and online social networks facilitated through platforms like Pozible are quickly becoming self regulating because the public can easily raise issues or feedback. Also, with the 'all-or-nothing' approach adopted by responsible crowd funding platforms (where

the creator must raise a desired target) - the risk of the issuer being unable to achieve the project for which funds are directed is significantly reduced.

Question 1: In principle, should any provision be made in the corporations legislation to accommodate or facilitate Equity Crowd Funding. If so, why, if not, why?

We submit that amendments should be made to the Corporations Act 2001 (*Cth*) ("**Corporations Act**") to accommodate Equity Crowd Funding. The current corporate fundraising framework is not designed to facilitate Equity Crowd Funding.

At present, the disclosure, licensing and compliance obligations attached to offers of shares are simply too onerous and expensive for the kind of small businesses that would rely on Equity Crowd Funding.

The aim of any law reform should be to develop a balanced regime that provides some protection to investors and encourages confident investment, while at the same time recognising what Equity Crowd Funding investors actually expect and the realities of Equity Crowd Funding which is characterised by low level investment by a large number of investors.

Question 2: Should any such provision:

(i) Take the form of some variation of the small scale offering exemption,

A modified version of the small scale offering exemption contained in section 708(1) of the Corporations Act could be employed as a starting point for accommodating Equity Crowd Funding. While increasing the number of investors permitted under the small scale offer exemption to 100 would help, it would be preferable to have as high a cap as possible on the permitted number of investors, as many responders to applications for crowd funding contribute small sums.

The limitation of the section 708 exemption to personal offers would also need to be amended for it to have application to Equity Crowd Funding.

(ii) Confine Equity Crowd Funding 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,

Limiting investment in Equity Crowd Funding to sophisticated, experienced investors restricts the scope of Equity Crowd Funding significantly. Projects that seek to raise funds through Crowdfunding

often have different objectives than those that raise substantial amounts from a small number of sophisticated investors.

Confining Equity Crowd Funding to sophisticated investors limits the social and economic utility of Equity Crowd Funding which is used as way for businesses to gauge public support for an idea or enterprise before fully investing in it and for investors to participate in a company in a small way or contribute to ideas they think are worthy or philanthropic.

(iii) Adopt some other approach (such as discussed in Section 7.3, below).

We submit that a variation of the existing small scale offer exemption should be used as a starting point to enable Equity Crowd Funding, however a stand- alone regulatory regime may be another option for accommodating the particular requirements of Equity Crowd Funding while preserving the existing regime for other forms of capital raising. Any new regime must have the effect of reducing compliance costs of for small businesses utilising Equity Crowd Funding.

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

(i) Proprietary Companies

(ii) Public Companies

The existing rules around proprietary and public companies could create difficulties for crowd funding in that issuer companies will be required to comply with the public company reporting rules once the 50 shareholders limit is reached. This is an added expense which may not reflect the equity that would be raised from having additional shareholders.

We suggest consideration be given to whether the rules should be amended to allow greater numbers of shareholders before the public company requirements are triggered.

If this is not practical we consider that issuers could be required to comply with the existing reporting requirements if other costs associated with disclosure and due diligence were managed.

(iii) Managed investment schemes.

While managed investment schemes could be a useful tool the costs of setting up a registered managed investment scheme are prohibitive for a small company seeking funds.

Question 4: What provision if any, should be made for each of the following matters as they concern Equity Crowd Funding issuers.

(i) Types of issuer

It would be preferable to have no limit to the type of issuer. Restricting the use of Equity Crowd Funding by the type of issuer creates difficulties around defining the different classes of companies eligible. Instead a limit could be placed on the amount of funds that an issuer can raise through Equity Crowd Funding.

(ii) Types of permitted securities

Investors will be able to determine through their own assessment whether a class of shares offered by an issuer fits with their expectations and investment needs. A description of the class of shares submitted in the disclosure documents and a general disclosure statement detailing the generic risks of investment and Equity Crowd Funding will help investors to make informed decisions on whether they wish to subscribe for any particular security.

(iii) Maximum funds that an issuer may raise

A maximum limit on funds raised could be modelled around the existing small scale personal offers exemption. In keeping with the existing exemption, issuers could be limited to raising a maximum of \$2 million over a 12 month period. This was the limit implemented in the New Zealand Equity Crowd Funding regulatory regime. Alternatively the ASSOB Class Order could be used as a model by capping the amount to be raised in a 12 month period to \$5 million.

(iv) Disclosure by the issuer to investors

Small, start-up businesses are unlikely to have sophisticated financial arrangements. We suggest a similar level of disclosure to the United States regime should be followed which requires issuers to submit:

- a description of their business;
- business plans with goals and fundraising targets;
- financial statements if any, certified by either officer of issuer, accountant or auditor depending on amount raised;
- names and descriptions of owners and shareholders with above 20% holding;
- intended use of proceeds including remuneration of owners/directors; and
- information on the securities – class, rights, prices, maybe anti-dilution guarantees etc and resale restrictions.

This disclosure statement would be hosted by the relevant crowd funding intermediary's website for all potential investors to access. Issuers may also wish to require investors to sign up to a shareholders' agreement to include matters such as drag along rights. If so this would need to be provided to investors.

Some argue that disclosure requirements for Equity Crowd Funding should be heavier to reflect the high risk of such investments. In general however, investors would be aware of the risks involved in small business.

A general statement detailing the risks involved in Equity Crowd Funding and in investing generally could be used to warn investors that are not financially sophisticated. This could be made available on the intermediary website.

(v) Controls on the advertising by the issuer

Public advertising is a necessary aspect of the Equity Crowd Funding concept. However advertising of Equity Crowd Funding schemes could be controlled by requiring that issuers only advertise on approved crowd funding intermediary sites which would have a proforma warning on the website as to general risks involved in Equity Crown Funding.

If some form of due diligence or quality control is required, this could perhaps be done by non-platform provider sponsor intermediaries (such as investment bankers, accountants or corporate advisers with relevant financial skills). Issuers could submit the required disclosure documents though such an intermediary before the offer can be advertised.

Existing exemptions should remain available. For example issuers should still able to make select offers to sophisticated investors under section 708 of the Corporations Act outside of and in addition to crowd funding mechanisms.

(vi) Liability of issuers

Issuers of Equity Crowd Funding securities should be subject to the same liability as other issuers under Ch 6D of the Corporations Act for misleading or deceptive statements in an offering document. The standard defence of reasonable inquiry should apply. However it may be necessary to take into account the level of business experience when assessing what is reasonable in the circumstances.

(vii) Ban on secondary market

As mentioned in the consultation paper, the purpose of crowd sourced funding is to raise funding. However there is no reason given why the securities in Equity Crowd Funding schemes should not be permitted to be on sold at some point. This would allow an investor to realise his or her investment.

Question 5: In the Equity Crowd Funding context, what changes, if any, should be made, and for what reasons, to the current licensing requirements applicable to intermediaries?

We submit that intermediaries should be approved by ASIC as crowd funding platforms rather than being required to obtain a financial services or financial market licence. Exemptions from market licencing requirements already exist in cases where the Minister is satisfied that the regulatory costs of complying with a financial market licence substantially outweigh the benefits from regulation. However requiring a ministerial decision could politicise the process and is likely to be overly onerous.

Obtaining a financial market licence would likewise be too onerous and difficult to obtain for Equity Crowd Funding platform providers despite the flexibility of the Minister's powers on the face of the Corporations Act.

If there is a specific approval mechanism for Equity Crowd Funding intermediaries then changes to the existing licencing requirements are not needed. There is room for the use of independent sponsors to perform limited due diligence. This could be an additional service offered by some intermediaries or it could be a general requirement. The sponsors would need to be covered by appropriate Australia Financial Services licences.

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

(i) Permitted types of intermediary

(a) Should Equity Crowd Funding intermediaries be required to be registered/licensed in some manner?

Intermediaries providing crowd funding platforms should be approved by ASIC as funding portals for the purpose of Equity Crowd Funding. It is important that there is a neutral responsible body between issuers and investors. Intermediary sponsors could be used to help the company perform its documentation and gain investor interest. These

sponsors (such as investment banks) may need to have an appropriate form of Australian financial services licence.

(b) What financial, human technology and risk management capabilities should an intermediary have to carry out its role?

We have submitted that crowd funding platforms should not be required to carry out full due diligence investigations into issuers as this would require specialised financial qualifications and extensive costs and resources. It would be more efficient and economic in the circumstances of Equity Crowd Funding to require disclosure from issuers. Requirements regarding financial, human technology and risk management capabilities should therefore be kept to a minimum, maybe proof of solvency and a requirement that the managing staff demonstrate midlevel business experience. Sponsors may require a different type of expertise.

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

The New Zealand Equity Crowd Funding regulations regarding intermediary platform providers provide a useful model in requiring that intermediaries disclose the processes by which issuers and investors access the service, the processes for matching of issuers and investors to a service fairly, where applicable, the process of handling investment funds and processes and checks to avoid price manipulation.

(d) Should an intermediary be required to have an internal dispute resolution mechanism and be a member of an external dispute body, such as the Financial Services Ombudsman?

A dispute resolution service could be available to investors who have a complaint against Issuers. This could be a third party service. Platform providers are not best placed to take a dispute resolution role.

(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 Equity Crowd Funding?

Intermediaries providing crowd funding platforms should not be required to conduct screening or vetting. It may be appropriate to require issuing companies raising money

to have a licenced sponsor (who might have financial or other relevant experience such as stockbrokers, accountants or corporate advisors). The sponsor could then carry out due diligence investigations. Where preliminary checks by a sponsor indicate that the issuer may be involved in fraudulent or reckless practices eg if the directors have been bankrupt or have been banned or disqualified from directing a company, then the intermediary should refuse to sponsor the issuer. Another approach, perhaps an alternative, would be to permit use of the exemption by a company that has a major sophisticated investor who is not related to the founders who has invested on the same basis as offered on the crowd funding platform.

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

A sponsor could undertake preliminary searches on ASIC registers of the issuer's management to ensure that they are not banned or disqualified persons. Sponsors should also make sure financial statements are properly certified as appropriate in light of the amount of funds raised (see our comments on proposed disclosure).

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

It may be too much of a burden to require sponsors of any type to make a judgement on the viability of different issuers. The sponsor should not be liable for any losses due to business mismanagement by the issuer. The disclosure documents required by issuers should provide investors with information to make a determination of the risk and potential reward involved themselves.

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

Intermediaries should not be held liable for investor losses. Issuers should be liable for misstatements. It would be too much of a burden on intermediaries to be liable for something they could have little control over and for which the issuer should have primary responsibility.

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

As above, the issuer should be liable and not the intermediary provider to the crowd funding platform.

- (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 might these situations best be dealt with?**

We have described the purpose of the intermediary providing the crowd funding platform as being a neutral portal.

- (g) What controls should be placed on issuers having access to funds raised through a Equity Crowd Funding model?**

It would be good practice for investors to pledge an amount which will only be transferred to the issuer once a predetermined target investment level is reached. In this way, the investor can be confident that their money will only be committed if the company receives the full funding it indicated was required for the particular project or scheme. The intermediary will either have pre-authorised credit card deductions arranged or hold the monies on trust until the minimum amount necessary to undertake the project for which money is being raised is intended.

- (iii) Intermediary matters related to investors:**

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

Intermediaries providing crowd funding platforms should not be required to conduct screening or vetting, however Investors could be required to complete a basic questionnaire relating to the fundamentals of investing in securities and the principles of Equity Crowd Funding. Ultimately it is the responsibility of investors to inform themselves of the merits of making an investment in a crowd funding offer.

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

Intermediaries providing crowd funding platforms should be required to place a general statement relating to the risks involved in Equity Crowd Funding on their website. This would not contain any advice on specific projects/issuers. Specific disclosures relating to

the financial circumstances of individual issuers should be the responsibility of the issuers.

(c) What measures if any should intermediaries be required to ensure that any investment limits are not breached?

Intermediaries could obtain an agreement from the issuer stating that they will comply with any ceiling on funds raised. Intermediaries providing the crowd funding platform could design software that prevents further subscription after the ceiling is reached.

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

Intermediaries should be prevented from offering advice to investors unless they hold an Australian Financial Services licence that permits this.

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

Intermediaries providing a crowd funding portal should be able to advertise their website as a crowd funding platform.

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

There will likely be a need for intermediaries providing crowd funding portals to be able to hold funds until the minimum required investment is obtained.

We recommend that investors pledge a certain amount which is either pre-authorised from a credit card or held on trust and transferred to the issuer once a set target is met. If funds are held on trust then intermediaries may be required to complete a basic course on trustee responsibilities.

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

As suggested in the consultation paper, it may be beneficial for issuers and investors to communicate through discussion forums to obtain more information and the responses would be available on the Crowd Funding website to all users. Intermediaries should not be required to monitor such discussion forums and provision of such forums should not be a mandatory part of providing a crowd funding platform.

- (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.**

An intermediary could be required to provide this information on their website.

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

A simple statement of what fees are taken by the intermediary should be sufficient. This should be disclosed on the website or in the disclosure statement for sponsors.

- (j) What, if any additional services should intermediaries provide to enhance investor protection.**

Sponsors could take a role working with the company to ensure some level of quality. This would be different from the portal provider intermediary.

Question 7: In the Equity Crowd Funding context, what provision if any, should be made for investors to 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. A related question is whether disclosure, alone, would suffice.**

The disclosure statement content which we have recommended should explain these matters to the extent relevant.

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

- (i) Permitted types of investor**

As discussed above, investors could be asked to demonstrate a basic understanding of investing in securities by passing an online test.

- (ii) Threshold sophisticated investor involvement (Italy only)**

Requiring threshold sophisticated involvement as the only way to access crowd funding seems like an unnecessarily difficult criterion for small start-up enterprises who may not have proceeded far enough with their project/idea to attract sophisticated investors. Instead there could be a system where funds are only transferred from investors to issuers once a certain trigger funds target has been pledged.

(iii) Maximum funds that each investor can contribute

Regulating the amount a person can invest with Equity Crowd Funding issuers presents difficulties in compliance. If a limit was to be imposed, the most practical and effective measure would be to limit the amount an investor can invest in one issuer over the period of 12 months. Otherwise there would have to be a centralised intermediary system that was able to monitor the number of issuers an investor had invested in and the amount invested. A cap based on a person's income is too difficult for the issuer to verify.

(iv) Risk acknowledgement by the investor

An investor could be required to acknowledge the risks involved in Equity Crowd Funding.

(v) Cooling off rights

An investor should have a standard cooling off period of 10 working days in which he or she can require money to be returned. Investors would be made aware of this right at the time of investment.

(vi) Subsequent withdrawal rights (Italy only)

To extend withdrawal rights beyond a short cooling off period would unnecessarily create uncertainty for issuers. Especially if investors are aiming to achieve a certain target before funds are able to be transferred.

(vii) Resale restrictions

The purpose of crowd sourced funding is to raise funds. However there is no reason why the securities subscribed for should not be allowed to be on-sold at some point. The existing 12 month onsale timing provision could be used to regulate this.

(viii) Ongoing Reporting

Issuers could be required to disclose to investors annually through the intermediary platform or on its own website. Documents required could include financial statements (if a public company), and

comments by the managing director on the company's performance relative to the stated objectives and plans. If the company is a public company the existing reporting requirements will be sufficient.

(ix) Losses

The current legislation provides sufficient recourse for losses related to inadequate disclosure.

(x) Remedies for losses resulting from poor management

Directors are personally liable to the company for breaches of director duties. However business choices made in good faith and which were open to a reasonable person taking reasonable care, should not give rise to a right to recourse by shareholders.

Question 9: Should any accommodation for Equity Crowd Funding 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?

As discussed above, we submit that incremental adjustments to the existing provisions would potentially be the simplest way to facilitate Equity Crowd Funding. In particular we suggest that the existing small scale offers exemption be expanded to allow for higher numbers of investors. If a stand-alone regime is implemented it would be important that the regime is informed by the principles of the existing regulatory regime.

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

N/A

Closing Remarks

We would be happy to meet with you to discuss our views if that could assist.

Yours faithfully,

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