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SUBMISSION TO THE CAMA Review of CSEF.

Confidential only as to the name of submitter, otherwise can be published.

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

1) Yes, the limit on the number of individual shareholders for private companies should be increased to accommodate the likely implementation of CSEFs. The remainder of the provisions in Corporations legislation are likely fine but issues such as flexibility with the provision of notices and form of notices for General Meetings should also be considered for change to accommodate faster board and corporate decision making.

2) (i) No

   (ii) No, this would defeat the purpose

   (iii) Yes, see broad comments above

> **Question 3** In the CSEF context, what changes, if any, should be made, and for what reasons, to the regulation of:
>
> (i) proprietary companies
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> (ii) public companies
>
> (iii) managed investment schemes. In considering (c), should the disclosure obligations of issuers to investors differ, in principle, if investors are investing directly (as equity holders in the issuer) or indirectly (through acquiring an interest in a managed investment scheme) and if so, how and why?

3) (i) Limit on the number of members expanded, notices for decisions and shareholder vote provisions be allowed to be more flexible and electronic (this can pose its own issues) to enable operation of CSEF in the first place and to allow the board of directors of a Pty Ltd to conduct affairs efficiently.

There should be some consideration given to a "representative" entity that attempts to protect the interests of investors, operating in a similar fashion to a cross between an ombudsman and Legal Aid or Government Grant Case Officer, possibly accounting-driven, to efficiently oversee and intervene if required. Funding for this service should be provided through the CSEF set-up process.

(ii) No

(iii) Possibly if worked through a hybrid mentioned in 3(i). The primary issue is assuring independence of the "ombudsman" so that they are not dependent on the company for funds.

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

5) (i) **types of issuer:** should there be restrictions on the classes of issuers permitted to employ CSEF (for instance, investment companies are excluded from the CSEF provisions of the US JOBS Act. In Italy, CSEF is confined to designated 'innovative start-ups')

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

7) (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

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

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

10) (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

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

12) (viii) **any other matter?**

4) Provisions should ensure clear separation of entity funding, and will likely become murky when companies succeed and need to transform.

5) (i) Some scale provision should likely apply

6) (ii) All types including hybrids – innovation is essential

7) (iii) Some scale provision should likely apply - $5m or $10m maximum

8) (iv) Maximum disclosure similar to current requirements with the same onus on directors. It is essential to be able to deal with "hidden promises".

9) (vi) Controls would go hand in hand with the maximum ceiling, so likely none.

10) (vi) Full liability should apply.

11) (vii) New issues only. The asymmetry of information is too great for anything else.

12) (viii) Many ☺

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?

13) It is unclear if an intermediary market similar to the current business broker operations is well suited to this model because the incentives between the promoter and the intermediary are aligned, and together, are potentially in conflict with the investors.

An intermediary model based on management of the transactions in return for a fee for service, as opposed to a % of money raised model would likely be more in the interests of investors. Else, the model will resemble Dotcom V2 on steroids.

Use could be made of the existing online stockbroking platforms, for example, where most trades are on a $ per trade basis.

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
- (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

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

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

(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

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

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

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

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

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

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

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

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

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

(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

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

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

(iv) **any other matter?**

6 (i) (a) Yes

6 (i) (b) Similar to online stockbroking platforms – the cost of building and operating these has fallen greatly over the last 15 years and they can almost be purchased and operated out of the box.

6 (i) (c) as above

6 (i) (d) Yes, but it makes more sense to make this an independent arrangement (see answer to 3 above) as arbitration and dispute resolution would require entity-specific knowledge.

6 (ii) (a) None – cannot pick these in advance
6 (ii) (b) The proposed proposed "ombudsman" should manage this – likely quarterly reviews similar to those imposed on the Dotcoms some years back by ASX (re-use templates).
6 (ii) (c) A cut down version of ASX requirements made practical – this should not fall onto the intermediary to complete – most of the intent of the IPO requirements should be kept including the escrow of shares of the promoters/founders
6 (II) (d) In the proposed model, the independent "ombudsman" would be the responsible party for managing claims for losses against the promoters/founders
6 (ii) (e) Same as above – most common losses not generally catered for are promoters/founders running off with the business or product if it is successful – which can be dome in a number of sophisticated ways without the investors getting their fair return
6 (1) (f) None in the model above
6 (1) (g) The entire transaction should be confirmed, and all investors allowed a 30 day cooling down period prior to funds access

6 (iii) (a) Identity check
6 (iii) (b) Pass on the IM
6 (iii) (c) This should fall onto the ombudsman
6 (iii) (d) No advice should be offered. Plain English but not misleading (e.g. relevant) risks advice should be part of IM
6 (iii) (e) No
6 (iii) (f) Standard Trust arrangements
6 (iii) (g) See concept of "ombudsman" in 3 above
6 (iii) (h) See broader concept above including appeals or complaints about the "ombudsman"
6 (iii) (i) Intermediaries should get no commission – see broader concept above
6 (iii) (j) Secondary source of information posting – like a "free ASIC" document search website

Question 7 In the CSEF 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.

7 (i) None – all hybrids, convertibles and the likes should be allowed
7 (ii) Apart from transparent trusts and individuals/entities, other investments should not be accepted
7 (iii) Requires proper treatment in Plain English document describing impact of specific being offered (not the old style advice documents covering a huge range of unrelated risks in complicated legal talk)

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

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

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

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

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

(xi) **any other matter?**

8 (i) In general, No
8 (ii) No – limiting this to sophisticated investors would be pointless
8 (iii) Yes – something proportional to the investment and capped at $10k, $20k or $50k
8 (iv) Absolutely
8 (v) Absolutely – 30 days or possibly 21 days
8 (vi) No – the terms should be specific and this avoids a range of complications
8 (vii) Absolutely – no resale
8 (viii) See comments above – ASX style Dotcom quarterly cash and activity reporting
8 (iX) Full recourse from promoters/founders/directors
8 (x) Standard Law, but aggregated through the "ombudsman"

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?

9) Depends on the form

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

10) Poor behaviour by founders/promoters in the case of success!