

Corporations and Markets Advisory Committee

Crowd sourced equity funding

Discussion Paper

Submission

David Fotheringham, Director Seaview Consulting

Suite 12, 333 Canterbury Road Victoria, 3126. www.SeaviewConsulting.com.au

Sent to john.kluver@camac.gov.au (cc camac@camac.gov.au) Date Friday 29th November

Contents

Key	2
Scope comments	2
Executive Summary	3
Introduction and background.....	6
Response to questions	8
Question 1	8
Question 2	8
Question 3	8
Question 4	9
Question 5	10
Question 6	10
Question 6(Cont.)	11
Question 6(Cont.)	12
Question 6 (Cont.)	13
Question 7	13
Question 8	14
Question 9	15
Question 10	15
Table 1 – Disclosures by issuer (promoter)	16
Table 2 – Preliminary & Ongoing due diligence by intermediaries on issues	17
Table 2 (Cont.)	18

Key

CSEF Crowd Sourced Equity Funding

CMAC Corporations and Markets Advisory Committee

AFSL Australian Financial Services Licence

TFN Tax File Number

LPC Large Proprietary Company

PC Public Company

MIS Managed Investment Scheme

Scope comments

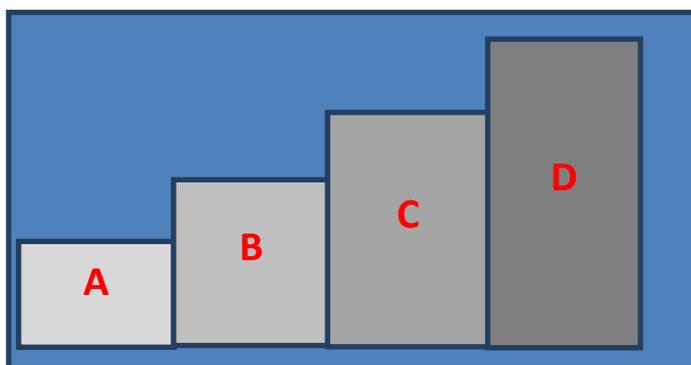
Par1.2 outlines the scope applicable to the review and while it is understood many aspects of the broader issues associated with crowd funding cannot be addressed, the writer believes the current scope restricts innovative thinking by

- 1) Limiting the review to the existing concepts in our regulatory framework
- 2) Limiting the concept of an intermediary to on-line portals only
- 3) Restricting investors to Australian residents and
- 4) By having a pre-conceived / traditional market view of the term “investor” rather than a broader view i.e. a supporter who is not necessarily looking for future financial gain.

This paper aims to provide additional commentary in regards to these matters and believes these deficiencies should be addressed in any final report or through further submissions to a preliminary draft report.

Furthermore, a decision on CSEF should not be delayed due to the current enquiries and reviews being conducted in relation to the wider financial services matters including the role of regulators.

The objective of CSEF is to support via large volume “small scale” investment a more accessible funding regime. By creating a new security type with limits and restrictions around the capital and investors this is considered achievable without significant alteration to the existing law.



A) New – CSEF / Start-up funding Company B) Proprietary Company

C) Large Proprietary Company D) Public Company

Executive Summary

- Utilise existing framework but amend existing laws to accommodate CSEF.
- Generally, the Canadian authorities approach to CSEF is considered more appropriate except in regards to intermediaries, where the US approach is considered more beneficial.
- Some concepts from other jurisdictions have also been incorporated into the suggested solution.
- **Suggestion: Introduce a new type of company (e.g. Start-up Limited "SU Ltd) that carries with a simple capital structure with restrictions to enable multiple individuals to support (invest) in that entity up to specific monetary limits.**
- The definition of a Public Company (PC) would need to be altered or a new classification established due to the volume of members under a CSEF capital rising breaching the current definition for a public company.
- The new company type (e.g. Start-up Limited "SU Ltd") would only support a simple capital structure, and would be restricted to 3 years and/or maximum of \$5m in capital before being converted to either a Large Proprietary Company (new definition required) or Public Company (new definition required).
- The transfer of equity in the new company type would be restricted during the initial 3 year start-up period.
- The offer document to be used would clearly state the risks involved (including the lack of transferability of the investment, that opportunity is high risk and it is possible some or ALL funds invested may be lost) and that there would be limited recourse available to investors.
- The maximum amount able to be raise on the initial offer would be limited e.g. \$1m in any 6 month period, with each investor limited to \$2,000 per offer document, except for those identified as a sophisticated investor. Note: recommend changes to the qualification criteria for a sophisticated investor to reflect knowledge and skill rather than restricted to asset or income.
- A seed investor being a sophisticated investor must subscribe to at least 5-10% of the capital (in each offer document); this approach assists in ensuring the initial offer is priced appropriately.
- The rules around small scale personal offers for existing company types (i.e. \$2m, 12 months, max 20 investors) should stay initially, however, these limitations should be reviewed after the success or otherwise of the new equity raising provisions and changes to the definition of a sophisticated investor. In addition, similar rules for the new company type should exist e.g. \$2m in 12 month but there would be no limit on number of shareholders. A total \$5m in capital should be imposed before a company must revert to either a LPC or PC.
- The new company type would have restrictions on the entity structure and changes to capital structure would be limited until the entity progressed from start-up to a either a LPC or PC.
- The 50 shareholder limit for defining a proprietary company must be altered or a new category created to recognise that an entity that commenced through the new company type will have more than 50 members. An option may be necessary to distinguish this by reference to a "Large Proprietary Start Up Company".
- The amount able to be invested by an individual should be limited to a specific dollar amount e.g. \$2,000 (for each offer document) and there would be a restriction on transferring equity acquired while the entity remained in the start-up period (i.e. 3 years).
- Cumulative limits on the total amount invested are NOT considered necessary as the cost to implement and monitor would be difficult to justify given and there are sufficient other restrictions and protections proposed. Each offer document would assess separately.
- Existing businesses may still utilise the new company type to raise funds for new start-up ventures but would be restricted to raising capital in a new entity within the rules mentioned above.

- No special or additional taxation rules should be necessary; the new structure can work within the existing tax legislation.
- Restrictions around the manner and size of further equity are required to prevent manipulation and dilution of initial supporters/investors.
- Funds raised can either be debt or equity, although limiting to equity only IS recommended.
- The use of a managed investment scheme is NOT recommended.
- Participation should be open to any person across the globe provided this does not breach any local jurisdiction of the country of the investor.
- Only an intermediary should be able to raise money for the new entity type using the CSEF provisions, however, that intermediary should NOT be restricted to platform operators only.
- An intermediary should be subject to an AFS Licence and be either an existing licensed market participant broker or be approved as a CSEF Portal/Platform provider. As the intermediary is only collecting initial interests in a single issue supported by an offer document and is not facilitating a secondary market an Australian Market Licence (AML) is not considered necessary, only an AFSL.
- Both types of AFSL holders (Existing broker and a platform operator) would be responsible for enforcing the specific disclosure rules for the new investment type and ASIC would be responsible for monitoring compliance to these and ongoing disclosures by the intermediary.
- A model that facilitates access to capital beyond a web based platform will open up more avenues to raise capital, support a struggling stock broking industry, increase competition, and enable access to an existing pool of qualified professionals to support capital raisings.
- A wider avenue to capital beyond an internet portal is likely to improve the adoption of CSEF provisions as a source of funds for start-ups.
- The intermediary under its AFSL would be subject to meeting requirements around management capability, technology, accounting, compliance monitoring, PI cover (guarantee / minimum capital).
- Existing annual AFSL audits would assist reduce the risk of fraud at an intermediary.
- It is NOT feasible for intermediaries to be responsible for testing a supporter/investors understanding of investment risk as this subjective.
- An intermediary must be responsible for is collecting evidence that the investor is aware and acknowledges the investment is high risk, there are restrictions on the transferability of the investment, the investor may lose some or all of their invested capital, AND that the investor is able to afford this loss if it eventuates.
- It is NOT recommend the intermediary is in any way rewarded by the long-term success of a project, as this may imply an endorsement of the potential success of the project.
- The intermediary's responsibilities should be limited to validate compliance to minimum disclosure, facilitate capital rising and ensure ongoing compliance.
- An intermediary should be held accountable to assess and enforce the completeness and accuracy of the disclosures in the offer document and manage the identification and investment limits proposed.
- Intermediaries should be responsible for monitoring fraudulent applications, restrict access to capital raised until capital rising is completed.
- To help mitigate the risk of fraud, all promoters should be responsible for lodging personal guarantees to an amount proportional to the capital being raised to assist with recovery in the event of fraud.
- The should be limited ability to sue an intermediary promoting a start –up entity except for negligence or dishonesty.

- There should be a requirement on the new entity type to provide quarterly updates, (link reporting obligation to quarterly BAS lodgement cycle) and those quarterly updates should be reviewed by a professional accountant or a qualified auditor (depending on size) including a reconciliation of actual spend to the proposed application of funds in the original offer document.
- The concept that equity could be offered / set-aside in exchange for other contributions beyond monetary contributions should be considered / addressed. In a CSEF environment a supporter of a project may offer services or other support in exchange for equity, as the service is delivered payment in the form of new equity issues should be possible within the framework and financial limits.
- Modern databases, advancement in social media marketing strategies and polling capabilities now enable the effective management of client lists. The management of a large number of shareholders is not considered a major concern. Modern databases and electronic communication tools will enable registers to be managed efficiently and effectively and therefore this should not be seen as a reason not to implement a CSEF solution.
- The promotion of a CSEF opportunity does not prevent an external outside offer (from sophisticated investor) being made prior to a capital raising being finalised on a CSEF platform. In fact the volume of interest generated on the CSEF platform provides an indication of the likely success of the venture and may assist in raising additional capital from sophisticated investors.
- Alter current restrictions on who can invest by altering the suitability criteria to be based on RG146 and also allow for existing provisions to be retained

Introduction and background

This paper refers to a person willing to invest in a CSEF as a **supporter** (and not an investor) the reason for this interpretation is essential in understanding the reasoning behind the recommendations made in this paper.

The traditional capital markets view of the goals of an investor is unlikely to match the objectives and reasoning behind a supporters decision to provide funding support.

This distinction is a key physiological difference and one the committee must first acknowledge and appreciate before they can provide and constructive decision on the way to move forward.

Within some clear constraints (outlined in this document) the writer supports the introduction a new type of equity classification, that enables a wider group of people to invest to a small specified limit based on an offer document that has less initial disclosure requirements, but supported by initial and ongoing reporting obligations.

The writer encourages the committee to consider and acknowledge that our existing regime around capital raisings is outdated and has not adjusted for the advancements in technology, people's access to information, people's wealth, spending power and improved financial literacy.

The current system, due to its restrictions in the ability to invest being based on a person's income and/or asset size creates a bias towards the wealthy and denies access to people of sufficient means accesses to new opportunities. Neither an income or asset measures actually supports the proposition that an individual is more capable of making an effective or better investment decision than someone below the stated limits. The approach may protect an individual from financial loss but we do not impose such restrictions on individuals in regards to lotteries or gambling. A balance needs to be struck between allowing individuals to support an opportunity they believe in and denying them this right purely because of their income or asset base.

Australia is a country with an aging population and population growth being supported by immigration. Many migrants and young people do not have the financial position to meet arbitrary income and asset limits yet they have other knowledge and skills that enable them to make effective investment decisions. By preventing or limiting these people from participating in early stage businesses significantly limits the amount of capital being invested and restricts these people improving their financial position.

The writer encourages the committee to investigate a solution that facilitates an individual's rights to choose to support an opportunity and to prevent a "nanny state" mentality of assuming a person is incapable of making an investment decision unless they meet certain criteria or have access to a prospectus, a prospectus that is often made illegible due to the volume of information presented and the constant disclaimers around risk.

It is essential a viable solution is found to assist promote innovation and bridge the funding gap between start-up and "investor ready" entities and to overcoming the preferential access to new opportunities for the wealthy. Supporting innovation is not solely the responsibility for the government or a right only available to the rich. The right to support an idea is a right for everyone.

Advancements driven by the creation of the internet and GPS have enabled developments of new services, productivity tools, information portals, games and many other new products and services. Through access to funding, innovation in these areas will continue to create new jobs and income streams for. Australia

must grow its global export income through innovation by supporting new ideas especially as our manufacturing competitive advantage is being diminishing by developing companies.

Due to the internet's global reach, globalisation of markets, improvements in market research, new market channels, and significant improvements in the speed to markets, the cost to launch has reduced significantly resulting in a smaller amount of initial capital being required to launch an idea globally. By diversifying this risk across a wide group of supporters the chances of success increase due to the powerful impact of social media driven by these initial supporters/investors. The current legislation restricts innovators from sourcing early stage funding from knowledgeable and skilled supporters by imposing a member limit and/or financial limit on who can invest.

Few, if any, real effective laws exist to prevent people from gambling excessively or beyond their limits. Few, if any, real effective laws exist to prevent people from buying lottery tickets beyond their means. While it is prudent to put limits in place, it is critical individuals have access to an opportunity that they understand and believe in. We allow people to set up a self-managed super fund and make investment decisions on a range of products without any effective controls over their investment capabilities or suitability to their needs.

The concept of crowd funding should not be linked solely to a "platform" or "website" access.

A controlled / licensed environment is considered necessary but the concept of utilising CSEF should be made available to existing AFSL holders licenced to offer securities i.e. stockbrokers. These businesses have in place the necessary systems and controls to manage a capital raising without the need to establish a web based platform.

The risk of a CSEF/Start-up project should be clear due to the nature of the equity you are investing in, the disclosures and acknowledgements that are made and the exposure limited to the individual investor limits imposed.

To suggest that only bankers, business angels & private equity personal should determine the allocation of capital to start-ups would continue to deny suitable people access to potential growth opportunities and continue to support the manipulation of the innovative promoters by bankers, business angles and private equity by exploiting their need to access finance. Interested supporters aim to bring much more than just financial contributions, in fact, there potential to assist promote the service/product across social media can't be underestimated. A well-managed CSEF intermediary will introduce effective completion to what is currently a protected / closed shop environment.

Response to questions

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

1 YES.

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).

2

- i) The small scale offering should be reviewed in light of changes recommended in this paper i.e. introducing a new company type and adjusting the definitions for Public and Private Companies.
- ii) Definitely NOT. As outlined in this paper an asset/income based approach is not considered appropriate, an educational based approach should be adopted rather than an asset based i.e. utilise the existing RG 146 qualification as an appropriate measure.
- iii) YES.

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

- (i) proprietary companies
- (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) Either Change definition to remove focus on member limits or introduce a new classification acknowledging that an entity initially formed via the new entity type proposed will have greater than 50 members.
- ii) Focus only on asset size and or income.
- iii) The use of MIS for start-ups is NOT recommended.

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 (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’)
- (ii) **types of permitted securities:** what classes of securities of the issuer should be able to be offered through CSEF
- (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
- (iv) **disclosure by the issuer to investors:** what disclosures should issuers have to provide to investors
- (v) **controls on advertising by the issuer:** what controls, if any, should there be on advertising by an issuer
- (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
- (vii) **ban on a secondary market:** should CSEF be limited to new issues, excluding on-selling of existing securities
- (viii) **any other matter?**

4

- i) YES. The application of the funds raised must not be for investment, acquisition of other entities or for fund management / investment vehicle purposes.
- ii) Limited to simple structure – refer Canadian proposal.
- iii) \$2,000,000 initially \$5,000,000 in aggregate before compulsory transition to a redefined definition of Large Proprietary or Public company.
- iv) refer Table 1.
- v) All advertising must direct people to either an approved CSEF platform or an existing broker to receive the final offer document in an approved format. Advertising must not make any suggestion about earnings or future distributions. The offer document must highlight it is a capital raising for a start-up / speculative project and is subject CSEF rules (as defined).
- vi) Document meets CSEF disclosure requirements, advertising rules, ongoing disclosure for false, misleading statements. Any fraud or breaches of director’s duty would be addressed under existing laws.
- vii) YES – During the suggested start-up transition period (3 years) no secondary market, approved transfers for no changes in beneficial owner and to facilitate death or family law matters.
- viii) Refer to other comments in this document.

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?

- 5 The use of the AFS Licensing regime is recommended. An AFSL holder would be required to meet existing standards around systems, procedures, skills, compliance and be subject to external review. The need for any capital requirements or security bond is considered necessary to ensure only appropriate resourced and funded businesses act as intermediaries and offers some protection in the event an intermediary acts dishonestly. However, these should not be onerous and should be able to be addressed by guarantees and other forms of security.
- An intermediary should not be limited to web based providers and should include existing market participants due to their ability to stay involved with a business and support it in accessing additional funding in the future. Existing market participants have infrastructure and systems in place to support CSEF immediately.

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

6

i)

- a) YES – refer 5. And commentary in paper.
- b) Utilise expectations of market participants, for web based providers there should be additional requirements around technology and data security.
- c) The allocation policy and management of oversubscriptions should be outlined in the offer document and managed by the intermediary.
- d) YES, to minimise the need to create new procedures, external dispute bodies such as FOS should be utilised. However, bodies such as FOS should issue guidelines on their role and how claims will be assessed. The starting position is that an issuer should not be liable to support the initial challenge for loss and the burden of proof for claims of misrepresentation sits with the investor. Given the nature of the new type of investment i.e. speculative start-up, recourse for financial loss is limited to claims of dishonesty, false or misleading statements as such the accuser should fund their initial claim and the claim.

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

- (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

6

ii)

- a) Funds to be applied to investment purposes, funds management or trading in securities.
- b) Refer Table 2.
- c) Refer Table 2.
- d) Fully liable, initially decided via an external dispute body but subject to judicial review.
- e) To be assessed by regulator and managed by enforceable undertaking if due to diligence, subject to judicial review.
- f) The writer supports the right for the intermediary to take a financial interest in the capital raising provided such interest is less than 10% and the investment is not used to determine the price of the offering (i.e. an independent sophisticated investor is still required to determine pricing).
- g) All funds should be managed through a trust account subject to audit.

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

- (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

6

iii)

- a) Proof of ID. Submission (validation) of TFN for Australian Investors. For foreigners evidence of Tax registration details consistent with identify of applicant.
- b) Validate contents of offer document confirming it is accurate and disclosures their initial and ongoing fees or any financial interest they have either directly or through a related party.
- c) Limited to capturing applicants ID and certification collection i.e. investors has not breached any limits imposed, acknowledge risk and is warn of the consequences for false statements
- d) Adequately covered under existing advice rules such as Best Interest, Statement of Advice or Record of Advice. Advisor must be qualified. Possible implications for accountants advising businesses to be addressed.
- e) Normal advertising controls around truth and accuracy - Refer to comments on advertising.
- f) Must use a trust account.
- g) The assumption here is the platform must manage this. The intermediary should ensure the issuer has these capabilities but the issuer should not necessarily be responsible except for communication facilitated or managed through their systems whether they are a CSEF platform or not.
- h) Should form part of the offer document and the limited recourse available should be highlighted and the applicant acknowledges prior to transaction occurring.
- i) Full disclosure, full transparency on all transaction initially and ongoing with intermediary or a related party should be continually disclosed.
- j) None - If provided by and AFSL holder subject to oversight and audit including their technology platform.

Question 6 (Cont.)

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

- (iv) **any other matter?**

6

- iv) Intermediaries should not be restricted to an electronic platform.

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) Separate capital raisings with separate offer / disclosure documents.
- ii) Address by disclosure but application process would require information to facilitate accurate recording.
- iii) Refer Canadian proposal, limited options, simplicity and clarity of rights critical to the success of a CSEF model.

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) No
- ii) Yes. The sophisticated investor involvement will assist in pricing the security being offered. Most start-up opportunities are speculative and will be priced based on market opportunities if deemed a successful prospect. A critical requirement of this approach is that the founding sophisticated investor does not get any preferential access or pricing to any capital, benefit or additional capital rose beyond those available to all initial investors.
- iii) Yes. \$2000.
- iv) Yes, positive acknowledgment to each specific question and not hidden in single acknowledgement.
- v) No. Suggestion over complicates matter, an alternative is to require a pre-registration, offer document provided and option to invest open two days later. This could be easily managed by technology.
- vi) No.
- vii) Yes. No transfers except for situations where there is no change in beneficial owner, death, or family law direction.
- viii) Refer Table 2.
- ix) Dispute resolution process (e.g. FOS) and then judicial (although a class action would be the most likely be the most efficient and effective appropriate).
- x) None, part of the initial decision to invest and this risk adequately and continually highlighted.
- xi) Respect a person's right to support and initiative they believe in and most likely understand because of their interest and knowledge, remove current system where access to opportunity is limited to a privileged few.

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 I believe it will require a combination of both. A separate self-contained regime will assist people understand the new regime without being confused by a clumsy attempt to integrate new provisions into laws that didn't support many of the concepts being explored. Equally, changes will be required to existing terms and stated limits in order to support a progressive capital raising system.

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

10

- i) Refer Executive Summary at start of this document

Table 1 – Disclosures by issuer (promoter)

MINIMUM Descriptions in SU CESF Document

- Target Amount
- Minimum amount to be raised (Statutory minimum \$50,000)
- Maximum Amount to be raised (Statutory maximum \$5,000,000)
- Minimum Amount per Shareholder(Statutory minimum \$1)
- Maximum amount per Shareholder (Statutory limit \$2,000 – sophisticated investors excluded)
- Capital Structure, promoters and intermediaries interest, distribution policy
- Treatment of oversubscription and the allocation process
- Voting rights – all equal simple ordinary share capital structure
- Purpose of capital rising
- A description of the market and revenue opportunity but NO financial projections
- Initial balance sheet – pro-forma balance sheet
- Board & Business Experience & Professional Qualifications (minimum of three and independent chairman & majority independent)
- Details of the application of funds
- Any related payments to be made to a promoter to be disclosed, otherwise an offence
- Management (if any)
- Risk Disclosure – Start-up risk, liquidity, investment, etc

Table 2 – Preliminary & Ongoing due diligence by intermediaries on issues

Pre – due diligence

- Verification of promoters & their history included in offer document
- Verification of ownership and charges against any asset included in balance sheet
- Source a founding investor for 5-10% of capital and used to establish initial ownership % on offer
- Police checks on senior staff
- Offer document is compliant
- Financial systems in place, registrations in place, accountant and /or auditor appointed

Ongoing

- Ensure reporting is put in place
- Quarterly reporting of Revenue & Expenses to format in initial offer document while utilising new company type
- Certified by an officer & an accountant verified by an auditor if over \$500,000 (special wording and expectations on level of review to be determined and agreed with profession)
- Annual statements certified by officer and an auditor

NOTE: Initially a light touch review process is recommended but the ability to change if there is evidence this approach is not effective in protecting investors

NOTE: There must be provisions created that have consequences for non-compliance including the removal of directors and the appointment of the intermediary to arrange for elections to appoint new directors.

Table 2 (Cont.)

RISK MITIGATION

- Limits in size of offering and an individual's exposure
- Not an investment fund / vehicle or a financial product
- Identification of investors
- CSEF via approved intermediaries with appropriate control procedures and in accordance with a specific form (to be defined). I.e. ensure disclosures are clear and comments outside this document cannot be relied on (address chat room/board posts)
- Disclosures and acceptance by supporter/investor funds are being placed in a highly speculative project and is likely some or all of the capital may be lost
- Recovery limited to breach of law in regards by promoters and officers
- Ban on secondary market until status of entity moves from the new type into one of the other acceptable type
- Compliance certificate to be signed by promoter prior to any advertising, managed by intermediary
- Possible requirements to have a seed investor who is sophisticated investor or corporation with at least 5-10% and in effect provides some validity to the pricing of the security