

CAMAC Report on Crowd Sourced Equity Funding

VentureCrowd Response

1. Summary

- (a) The CAMAC report on crowd sourced equity funding (**CSEF**) released during May 2014 has recommended that CSEF should be broadly permitted in Australia and has recommended changes to the Corporations Act to facilitate it.
- (b) CAMAC considered the following 4 options for legal reform in Australia:
 - (i) Option 1 adjust the current regulatory structure for proprietary companies
 - (ii) Option 2 confine CSEF offers to limited classes of investors
 - (iii) Option 3 amend the fundraising provisions for public companies
 - (iv) Option 4 introduce a regulatory regime specifically designed for CSEF.
- (c) CAMAC's has recommended that Option 4 is implemented as follows:
 - (i) **corporate form of issuers**: create a new category of public company, known as an 'exempt public company', for startups wishing to raise equity funding through CSEF.
 - (ii) **fundraising**: issuers, intermediaries and crowd investors to comply with new regulations.

2. CAMAC's main recommendations

- (a) For an issuer¹ to raise funds through CSEF:
 - (i) the issuer is required to become a new category of company known as an "exempt public company" for a limited period and by doing so is exempt from certain compliance obligations imposed on other public companies. The issuer is, however, subject to enhanced disclosure requirements relating to the rights attaching to the shares being offered to crowd investors;
 - (ii) the issuer is permitted to determine its own equity structure and what shares it will offer through the CSEF so long as the rights attaching to different classes of shares that can or have been issued are fully disclosed to investors in a standard template format – an offer through the CSEF may only be for one class of shares and must be of previously unissued shares;
 - (iii) the issuer is permitted to only offer its shares to crowd investors through one online intermediary with the terms of the offer set out in a standard template offer document;

¹ The CAMAC report refers to a startup company seeking finance as an "issuer" and a crowd funding platform as an "intermediary" and that terminology is used in this paper also.

- (iv) the issuer is not permitted to raise more than \$2 million through CSEF in any 12 month period (does not include any funds raised under the sophisticated investors' exemption in section 708 of the Corporations Act but does include funds raised in the period through CSEF by any entity in the same issuer group); and
 - (v) the issuer will be responsible for disclosure and any breaches. The intermediary would be entitled to publish the offer document, and would only be liable if in possession of actual knowledge of some material misrepresentation or omission or of issuer fraud.
- (b) The intermediary's responsibilities in CSEF include:
- (i) holding a licence issued by ASIC to operate an online CSEF;
 - (ii) conducting limited due diligence checks on issuers and their management prior to publishing the issuer's equity offer on its website;
 - (iii) providing a generic CSEF risk warning to crowd investors, and seeking a risk acknowledgement from each investor, before any share acquisition by that investor;
 - (iv) receiving self-certification from each crowd investor that the investor has not breached any investment cap;
 - (v) maintaining dispute resolution procedures for issuers and investors and disclosing the availability of these;
 - (vi) not holding any interest in any issuer who is offering shares through the intermediary's online portal; and
 - (vii) disclosing fees the intermediary is being paid and not being remunerated according to the amount of funds raised by the issuer through the intermediary's website.
- (c) Investors participating in CSEF:
- (i) may invest no more than \$2,500 in any particular CSEF issuer in any 12 month period and may not invest more than \$10,000 in total in all CSEF issuers in that same period;
 - (ii) must sign an acknowledgement of risk and certify that they are within the investor caps before investing; and
 - (iii) have the benefit of a cooling off period and other withdrawal rights once they have entered an acquisition agreement.

3. **VentureCrowd's response**

- (a) VentureCrowd:
- (i) supports the introduction of a new regulatory regime for CSEF that allows a much broader cross-section of the Australian population to invest in startups; and
 - (ii) therefore welcomes the CAMAC Report on crowd sourced equity funding.
- (b) That said, certain elements of CAMAC's recommendations appear to significantly increase the burden involved for startups in raising capital through CSEF.

- (c) VentureCrowd believes that any reforms made to allow CSEF must ensure that the friction currently associated with startups raising capital is reduced while ensuring that investors are both educated in the risks of investing in this sector and protected from substantial loss of capital.
- (d) VentureCrowd supports the investor-based provisions recommended by CAMAC that effectively allow all Australians to participate in CSEF with safeguards imposed on the amount that can be invested by unsophisticated investors.
- (e) VentureCrowd strongly supports the CAMAC recommendations on the regulation of intermediaries. In addition, VentureCrowd believes that any intermediary must demonstrate a strong commitment to education for investors of the risks involved in investing in startups including the benefits that flow from investing in a diversified portfolio to spread the risks.
- (f) There are three key aspects of the CAMAC recommendations, however, that have the potential to limit the success of CSEF in Australia and should be reconsidered before any legislative change is considered:
 - (i) The requirements for issuers to become public companies;
 - (ii) The absence of measures to address the managed investment scheme regime; and
 - (iii) The restrictions on intermediaries' business and revenue models.

These are each dealt with in turn below.

4. Requirement to become public companies

- (a) VentureCrowd does not agree that issuers should be required to become public companies (exempt or otherwise) in order to take advantage of CSEF.
- (b) This is a significant and unnecessary burden to impose on these fledgling businesses. In our view, the regulatory problems identified by CAMAC can be dealt with by exemptions and do not require the imposition of additional burden on startups.
- (c) VentureCrowd believes that the administrative and financial burden of becoming a public company far outweighs any perceived benefits to enhance investor protection, and that the proposed dispensation of some compliance obligations for companies in the 'exempt public company' category is token at best.
- (d) This requirement, if adopted, is likely to be prohibitive for many issuers and is likely to compromise the adoption of CSEF in Australia by startups.

5. Managed investment scheme rules

- (a) In our experience, it is administratively prohibitive for issuers to manage a lengthy shareholder registry which contains dozens of small shareholders.
- (b) Any legislative amendment to facilitate CSEF should allow the market to develop different models for addressing this issue.

- (c) In our view, the best means of ensuring that an issuer does not have dozens of new and small investors through CSEF is to ensure that intermediaries employ a collective investment vehicle (such as a trust) by which the issuer receives all investments through a single investor.
- (d) This model has the additional benefit of ensuring the intermediary remains involved in the investment after the equity funding is complete, ensuring ongoing oversight of the investment and the alignment of interests of crowd investors and the intermediary.
- (e) For a collective investment model to be possible, amendments to the managed investment schemes regime contained in chapter 5C of the Corporations Act should be considered.
- (f) Those amendments should include an exemption from the registration requirement for a managed investment scheme established for the purpose of a CSEF campaign.

6. Restrictions on intermediaries' business and revenue models

- (a) The CAMAC Report recommends that intermediaries should be prohibited from:
 - (i) having an interest in an issuer; or
 - (ii) being paid in shares of an issuer or according to the amount of funds raised.
- (b) VentureCrowd considers these proposed prohibitions on intermediaries to be unnecessary and unhelpful to the policy objectives. The prohibition against an intermediary having an interest in the issuer is counterintuitive. Investment in early stage companies has a unique risk/reward, correlation, liquidity and transaction profile which operators of CSEF platforms should be required to understand.
- (c) In order for intermediaries to properly vet issuers and provide education tools to crowd investors, it follows that the intermediaries themselves should be well versed in the nuances of this asset class.
- (d) VentureCrowd also believes that it would be advantageous to the development of a robust CSEF sector in Australia for CSEF platforms to be established by angel groups and other venture capital investors who have this experience and knowledge. Those potential operators may, from time to time, have interests in issuers who may require CSEF.
- (e) In our view, this dynamic should not be seen as a mischief to be addressed, rather it should be seen as an element of comfort for crowd investors (ie, having a trusted existing investor in the issuer) and an alignment of the interests of the issuer and the crowd investors (ie, the success of the issuer increases the value of both the intermediary's interest and the crowd investors' interest).
- (f) Further, this type of structure effectively back-ends the rewards for an intermediary, aligning it more with a long-term performance based reward. The same argument can be made in support of allowing intermediaries to be *paid* in shares of the issuer.
- (g) In relation to the prohibition against intermediaries being paid according to the amount of funds raised, it is important to recognize that this type of fee structure is quite standard for capital raising services. The less raised, the less an issuer pays. There is no material mischief this prohibition seeks to address, however it does have the effect of compromising the revenue

model options available to CSEF intermediaries, which is also likely to compromise the willingness of operators to establish CSEF platforms.

For any enquiries, please contact:

Tim Heasley
Managing Director, VentureCrowd
tim@artesianinvest.com
m: 0412 483 002