

Crowd Sourced Equity Funding (CSEF) Submission – Deakin University

Thankyou for the opportunity to provide input into the Crowd Sourced Equity Funding (CSEF) submission. Deakin University has been steadily increasing its involvement in crowd funding primarily as a donation model through the “Research My World” project, a collaboration between Deakin and Pozible. We do however see enormous potential and benefits in the introduction CSEF for particularly the funding of research startups or projects.

1. *Is the main barrier to the use of CSEF in Australia a lack of a CSEF regulatory structure, or are there other barriers, such as a lack of sustainable investor demand?*

Whilst a more mature investment vehicle overseas (particularly the UK, Canada and the US), CSEF is still in its infancy in Australia. Whilst there is considerable early adopter interest that is outpacing the regulation of crowdfunding, it would be reasonable to assume that a normal market adoption model is being followed; with fuller participation following legislative and regulatory development to reduce real and perceived risk by consumers and/or investors in the category.

Development of the category will and should be determined by market forces – the demand and risk appetite of investors, the reputation of intermediaries and issuers, and the efficiency and effectiveness of the online delivery platform. There are developing mechanisms that crowdfunding platforms (and other web based models) are using to address some of the risk/trust issues so legislation will not be the only answer. Furthermore there is a risk that the category could be over legislated and hence the benefits do not eventuate.

2. *Do the existing mechanisms of the managed investment scheme regime and the small scale personal offer exemption sufficiently facilitate online offers of equity in small companies?*

The value proposition of crowdfunding lies in capturing the full spectrum and resources of “the crowd” to broaden capital accessibility to a wide range of companies. Unjustifiable restrictions in investment caps or to sophisticated investors only will not enable the scale and diversity of the crowd to be captured. Managed investment funds are not well suited to the model as an inherent premise of crowdfunding is the closer connection of investors to investee companies, something that is less possible through managed investment schemes.

As the concept is relatively new, again, market forces will determine whether the existing mechanisms are appropriate and beneficial to growth of the crowdfunding category.

3. *Other than the restrictions identified above in relation to limitations on proprietary companies, public company compliance requirements and disclosure, are there any other barriers to the use of CSEF in Australia?*

The taxation system should not pose a disincentive to the development of crowdfunding. Taxation treatment of crowdsourced equities should be based upon an understanding of the drivers of investors, investee and intermediaries in the segment, and be globally competitive to mitigate geographic barriers to entry and exit.

Given the likelihood that both parties in a CSEF are going to be lower in financial sophistication there should also be consideration for provision of dispute resolution mechanisms or else this may also prove to erode trust and create a barrier.

4. *Should any CSEF regime focus on the financing needs of small businesses and start-ups only, or is there a broader fundraising role?*

Increased access to a diverse range of capital instruments – including crowdsourced debt or equity - is a sign of a mature and healthy financial system. Similarly, access to a range of financial instruments should be extended

to different demographics of the economy, through with some regulation to ensure that segments that have specialised capital requirements – such as small business, start-ups, technology, social and indigenous enterprises – are not disadvantaged.

In Australia, the development of crowdsourced debt is behind the development of crowdsourced equity, though the notable recent development of peer-to-peer lending is encouraging. As debt is still a preferred mechanism of lending amongst small business, regulatory mechanisms encouraging the development of this should be encouraged.

5. Do you consider that, compared to existing public company compliance costs, the exempt public company structure is necessary to facilitate CSEF in Australia?

The power of crowdfunding is in harnessing the power of the “crowd”- and as a result is expected to yield higher volume, lower value investments for companies. Given that the mechanism is primarily targeted at start-up and small enterprises to, at least, partially fill, a gap in capital funding – even small public companies will have few resources to self-administer or hire third party resources to maintain a share register, ongoing reporting or communications. An exempt public company structure with reduced costs is a viable alternative with investee caveats around capitalisation, headcount and/or fund raising caps.

6. To what extent would the requirement for CSEF issuers to be a public company, including an exempt public company, and the associated compliance costs limit the attractiveness of CSEF for small businesses and start-ups?

See answer in the context of status-quo and cost-benefit in Q7 below.

7. Compared to the status quo, are there risks that companies will use the exempt public company structure for regulatory arbitrage, and do these risks outweigh the benefits of the structure in facilitating CSEF?

There may be a risk that reduced disclosure requirements in exempt public companies may elevate risk to investors. The additional company structure may also increase complexity and administrative costs – see questions above. There is no available data to draw a reasonable cost-benefit conclusion.

8. Do you consider that the proposed caps and thresholds related to issuers are set at an appropriate level? Should any of the caps be aligned to be consistent with each other, and if so, which ones and at what level?

Yes.

9. Do CAMAC’s recommendations in relation to intermediary remuneration and investing in issuers present a significant barrier to intermediaries entering the CSEF market, or to companies seeking to raise relatively small amounts of funds using CSEF?

There may be initial issues around access or adoption, but the remuneration levels are not excessive such that market forces related to supply of investor funds and investee success should overcome any barriers associated with this.

10. Do the proposed investor caps adequately balance protecting investors and limiting investor choice, including maintaining investor confidence in CSEF and therefore its sustainability as a fundraising model?

Yes. Please see response to Q9 above.

11. Are there any other elements of CAMAC’s proposed model that result in an imbalance between facilitating the use of CSEF by issuers and maintaining an appropriate level of investor protection, or any other elements that should be included?

No. Deakin University emphasise that appropriate advertising and liability controls on false or misleading statements on the issuers are critical.

12. Do you consider it is important that the Australian and New Zealand CSEF models are aligned? If so, is it necessary for this to be achieved through the implementation of similar CSEF frameworks, or would it be more appropriate for CSEF to be considered under the Trans-Tasman mutual recognition framework?

No. In principal, the primary channel of communication and delivery for crowdfunding is online, and as such (in a sense), geographically borderless. There is no compelling investment or economic rationale for why Australia would align our investment model with New Zealand above any other global crowdfunding model – Australia is a net exporter of trade and other financial investment instruments to New Zealand, not vice versa. Trans-Tasman currencies are not harmonised. Many other forms of business regulation also remain separate, and are likely to remain so, despite a high degree of trans-Tasman banking harmonisation.

13. Do you consider that voluntary investor caps and requiring increased disclosure where investors contribute larger amounts of funds appropriately balances investor protection against investor choice and flexibility for issuers?

Yes. Please see response to Q9 above.

14. What level of direction should there be on the amount of disclosure required for different voluntary investor caps?

No further comment.

15. How likely is it that the obstacles to CSEF that exist under the status quo would drive potential issuers, intermediaries and investors to move to jurisdictions that have implemented CSEF regimes?

It is difficult to answer as there are many variables contribute to such as decision, such as economic, business and social conditions, stakeholder business strategies, global investor sophistication, jurisdictional taxation issues, etc. However introducing CSEF investment in Australia would help reduce investors moving to other jurisdictions. Being an online platform may also mitigate many jurisdictional issues.

16. What are the costs and benefits of each of the three options discussed in this consultation paper?

Deakin University is not able to estimate costs and benefits of the three proposed options.

17. Are the estimated compliance costs for the CAMAC and New Zealand models presented in the appendix accurate?

Deakin University is unable to comment on the compliance costs for domestic or international crowdfunding models.

18. How many issuers, intermediaries and investors would be the expected take up online equity fundraising in Australia under the status quo, the CAMAC model and the New Zealand model?

Deakin University is unable to estimate market outcomes for any proposed or competitive crowdfunding models.

19. Are there particular elements of the New Zealand model that should be incorporated into the CAMAC model, or vice versa?

Design of the Australian crowdfunding model should be based upon satisfying the needs of critical value chain stakeholders, both locally and internationally, of significant influence, critical mass and scale. If this includes

New Zealand investees and intermediaries, their needs should be considered in model design. We have no particular suggestions as to the value judgement of the New Zealand regulatory model, as in a sense, it is very new as well, and any issues around market acceptance will also drive changes to their regulation. Additionally, the New Zealand model may be targeting - or find acceptance with - a completely different niche of investees than the Australian model, thus negating the need for process or cost parity.

There may be better value in benchmarking with overseas models where there are not only similarities in market structure and industry need, but larger, established investment in- and out-flows that may augment the rapid development of crowdfunding in Australia (for example, the US, UK, Singapore & Hong Kong; where legislated regulation or proposed regulatory models exist).

20. *Are there particular elements of models implemented in other jurisdictions that would be desirable to incorporate into any final CSEF framework?*

There are some desirable aspects of US and proposed Canadian legislation. Taken from the example of US legislation and from the proposed Canadian legislation; that there be consideration of excluding investment companies whose presence will not facilitate the correct and free functioning of, what is, a new financial instrument with completely different market drivers, targets, risks and returns.

Additionally, from the US legislation for reasons of risk mitigation and investor protection, which companies without a business plan or a plan to only merge or acquire an unspecified company should be excluded.

21. *Do the issues outlined in this consultation paper also apply to crowd-sourced debt funding? Is there value in Extending a CSEF regime to debt products?*

Deakin University believes that any frameworks that consider crowdsourced equity funding should also incorporate crowdsourced debt, since both instruments are highly important sources of capital to start-up, small and social enterprises. Most importantly, several peer-to-peer lenders are already operating in Australia, creating potentially favourable market conditions for crowdsourced debt instruments to enter and prosper.

22. *To what extent would the frameworks for equity proposed in this discussion paper be consistent with debt? Products?*

The carefully considered controls and requirements of all stakeholders and associated processes suggested in the CAMAC crowdsourced equity funding model, should with small changes, be applicable to crowdsourced debt funding.

23. *would any of the options discussed in this paper, or any other issues, impede the development of a secondary Market for CSEF securities?*

The traceability and scale of secondary markets for both crowdsourced debt and equity require careful consideration, particularly on administration, regulatory implementation and enforcement, privacy and cost control. However it is recognised that secondary markets for both securities are necessary to maintain instrument liquidity.

If the equity purchased is not ordinary shares, then the non-existent market for the equity is a fundamental problem – even if the notional value of the equity increases, there may be no way to on-sell it and realise any capital gain, or to simply just to back out of the investment should the need arise.