

Crowd Sourced Equity Funding

SUGGESTED APPROACH FAILS TO SOLVE THE SME FUNDING CRISIS

DAVID JORDAN



General Manager
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

About this submission

Solutions4Strategy is working with a number of organisations that are public listed, mutuals, co-operatives and proprietary companies who are in different phases of growth from start-up to requiring capital to fund growth. Our role is to drive profit and growth from innovation and to challenge the status quo to help companies compete in the digital and global economy.

It is of great concern that the consultation paper is not addressing the objective of CSEF as promised by the Honourable Bruce Billson to small business owners as a solution to solving the funding crisis for small business. The approach has become preoccupied with the regulation protecting investors from perceived and unqualified risks. The approach has lost sight of the purpose which was to enable growth and employment by opening up new investment pathways to the small business sector whose growth is being held back by a lack of access to capital. The current draft does not solve the funding crisis for small business.

The direction that Treasury has taken on CSEF is to counter act a paranoid fear of front page headlines from victims of collapses. What is of concern is that it is imagined and there is a lack of empirical evidence to define what those concerns are. The draft of CSEF legislation is to mitigate risks that have not been clearly defined and understood. We believe the wrong actions are being taken to solve the wrong problems.

We believe that before drafting legislation for CSEF, that more work has to been done to understand where the potential risks could come from and how they could be mitigated. We believe that it would have been far simpler to restrict CSEF from being used for certain high risk investments such as speculative investments (share trading and property trusts) instead of creating excessive red tape for everyone else to cover a small number of high risk investments. There is no discrimination of risk in the compliance process.

CSEF is a digital disruptor that is a critical component of reform required to enable Australian companies to compete on the international stage. Australian companies cannot afford to be held back by legislation of a past era designed for non-digital and non-global transactions. We believe it is not the most appropriate action to bend the current public listed company structure to meet this requirement.

We have not responded to the questions asked in the paper as believe this paper has gone down the wrong direction. We will be pushing for a senate inquiry to review the effectiveness of current legislation which is failing to protect investors and is undermining Australia's ability to grow GDP and employment.

Regards

David Jordan

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Investor protection strategies are causing more harm than good

The core focus of the CSEF legislation to protect investors from perceived risks is flawed and ineffective. There is growing evidence that current efforts to protect mom and dad investors has actually increased losses.

The unsophisticated investor rules have been designed for a past era where consumers were less educated and mom and dad investors were not responsible for saving for their own retirement. Circumstances have changed where current legislation is restricting investment diversity and creating concentration risk that increases the chance of mom and dad investors losing their money.

Unsophisticated investors are limited largely to cash, real estate and public listed shares for most of their investment. As a result mom and dads have most of their retirement savings concentrated in the share market where they suffer significant losses when the share market falls.

Whilst Treasury is worrying about investors losing millions in Storm Financial scenarios, investors suffered serious losses to pension savings from the \$60B share market fall. The Government is to blame because it regulated to restrict investors from being able to diversify their investments and hence the legislation has failed to protect investors.

We believe that the logic behind investor protection regulation should be urgently reviewed in the light that it is causing more harm than good. It is not protecting investors and all it is doing is stopping economic growth. If we changed the dynamics of investor protection, then the CSEF legislation would be a different beast, hence why we believe there needs to be an inquiry.

Legislating for imagined risk rather than evidence based risk

We have been in considerable discussions over the past three years with various organisations over the funding crisis for small businesses. What we have observed is that they are basing their decisions on imagined risk rather than evidence based risk.

For example the major banks are justifying charging small businesses 20% interest rates on credit cards as they are an assumed high risk. However UBS analysts identified that Banks bad debts at the end of 2014 were at a near-20-year low of just 0.15% cent of assets. The evidence is not backing the assumed risks stated by the banks.

Has Treasury done research on how much investors have lost in small business? Has it identified the type of businesses that fail, the sectors that fail and the reasons for failing. We believe that the evidence challenges a number of myths around investment risk.

When challenging why Australia should not free up some of the investment rules, the examples given are activities that are still legal in current legislation. A common example is Storm Financial where pensioners lost their homes through debt leveraging to buy shares. Ironically this is still a valid investment for unsophisticated investors. Hence we are placing restrictions on CSEF and unsophisticated investors to prevent financial disasters such as Storm Financial that are still legal retail investments under existing legislation. This is irrational.

The current public listed rules allowed HIH to happen, Bond, OneTel to occur. Right now NewSat the CEO is not paying tax and suing the company around large salaries, whilst the company is fighting for

survival. Small business is tarred as being reckless and unprofessional whilst public companies are painted as safer and this is a false image. This is not a balanced view, yet legislation is based on this perception.

Australia Government has become pre-occupied with “over” protecting investors from themselves in relation to imagined and perceived risks.

It is our opinion that before applying such restrictions in legislation that first efforts are taken to research actual risks that the legislation should cope with. At the moment the legislation is using a sledge hammer to crack a walnut where there are few benefits whilst it is causing serious harm to our ability to fund growth and employment. This should also be part of a senate inquiry.

Separating risky speculative investments from working capital

We have identified that there is a failure to segregate types of risks in policy decisions. When devising regulation to protect investors, it is a one size fits all approach. This is creating unnecessary red tape for most investments in order to protect against risks that apply to specific investments.

When considering where investors have been burnt when investing in legitimate investment it has revolved around speculative investments. The Storm Financial, Opes Prime, Commonwealth Bank investment troubles and most other headline investment losses have revolved around investments that speculate on properties or speculate on shares.

Significant red tape exists to mitigate against losses from speculative investments where people are being roped into get rich quick schemes on the assumption that property prices and share prices will continue to rise.

Alternatively investment in working capital that is being used to build factories, employ skilled staff, design products there is substance to these activities. Most of these activities have measured risk, have more conservative growth expectation. This is a completely different risk category to speculative investments.

As it stands, high risk speculative investments are still legal options for unsophisticated investors and the headline disaster will still continue. Mean time small business are denied the working capital required for lower risk business building activities.

Rather than creating a layer of red tape to cover all types of investment, we believe that speculative investments should not have access to CSEF. The key to crowdfunding is to create working capital for businesses that create jobs, grow GDP and grow exports. Using crowdfunding to gamble on the property and share markets is not in line with the objectives and is creating complexity to manage. Just remove them from the equation.

Property Investors and Foreign Investors using crowdfunding to bypass APRA, ASIC and ATO restrictions

Instead of promising to solve the small business crisis, the planned legislation is going to open a loophole for property investors and foreign investors to bypass APRA, ASIC and ATO restrictions that have been set up to prevent systemic risk.

CrowdfundUP, DomaCom and a number of other organisations are creating a means to bypass the restrictions. There are a number of these organisations that are allowing foreign investors to invest in property that bypasses foreign investor restrictions.

Whilst the current planned legislation is designed to prevent headline disasters, it is actually allowing high risk perspective ventures such as these to launch and these are more likely going to become headline stories down the track.

Startups regard the Public Listed model of CSEF as unviable and unworkable

In a network meeting of parties interested in this legislation, the view was that this model will not work and Treasury will have to go back to the drawing board.

The key here is that small businesses are looking for fund raisings in the \$400K mark from crowd funding. The public listed model proposed would only be effective when fund raising over a million dollars.

The idea of crowdfunding is to raise small levels of funding cheaply and quickly to enable small business to gain momentum in growth. The current legislation is setting the bar of complexity and cost too high to cover perceived and imagined risks.

Business frustrated that Australian Legislation is falling behind the rest of the world

Whilst many leading nations in the world have already established crowd funding legislation that is far more flexible and catering to the needs of the business community, Australia is still far behind. Australia's nanny state approach to legislation is drowning business in red tape for little benefit. Our global competitors are not being hindered by such legislation.

Australian businesses are having to move offshore to attract funding. Already Australian businesses are looking at New Zealand as their regulatory environment is not so severe.

Response to the papers questions

This legislation has been rushed and in the process the pendulum has swung too far to investor protection. We suspect that little change will go through with the legislation and that we will have to wait a couple of years to review the model to something that will work. Setting us years behind our neighbours.

Rather than responding to the questions about structure for proprietary companies, we would ask Treasury to actually sit down with small businesses and actually get to understand the real problems they are facing. Despite the best intent of those involved in drafting this legislation, we suspect few if any have lived in the shoes of a small business owner. Few have been awake late at night trying to work out how to pay salaries. Few have worked 7 days a week using sweat capital to drive business. Few have had to sell to customers and deal with investors and employs who all have different objectives. Without empathy in how hard it is to do business in Australia, how can good policy be designed.

Investors need to be informed and there needs to be controls, however if we crush small business then investors, employees and tax revenue are all losers. Small business are not the enemy, please look more at how to help small business in drafting future legislation than restricting them.