Business Council of Co-operatives and Mutuals

BUSINESS COUNCIL
OF CO-OPERATIVES AND MUTUALS

Corporations Amendment (Crowd-sourced Funding) Bill 2015

Submission

February 2016

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop

Cover Letter

The Business Council of Co-operatives and Mutuals is the national representative body for the co-operative and mutual business sector in Australia. BCCM welcomes the opportunity to make a submission on the Corporations Amendment (Crowd-sourced Funding) Bill 2015.

There are currently in excess of 1700 co-operative and mutual entities (CMEs) operating in Australia. These businesses operate in diverse sectors of the economy, from agriculture, health care, social services, disability services, motoring services, banking and finance, housing and bulk purchasing and retail. They represent in excess of 14.8 million memberships, and eight in ten adult Australians are members of at least one CME.

The CME sector is a strong contributor to the Australian economy, not least because all profits are reinvested to benefit members, meaning that profits stay within Australia. The combined turnover for the Top 100 Australian CMEs for FY2013/14 was just under $27.9 billion, with combined assets of around $111.46 billion. When the top 10 member-owned superannuation funds are included in these aggregate figures, the combined annual turnover for the period was around $107.4 billion. This represents a 14% increase in annual turnover for the Top 100 CMEs on the previous year. This growth was particularly strong across co-operatives in the agribusiness and purchasing/shared services area, as well as in health insurance and motoring services.

Co-operative and mutual businesses have a different purpose from other businesses: they exist to serve their members rather than to reward capital investors. Co-operative and mutual organisations are social enterprises that are formed by people to pursue shared objectives. They strive to deliver both social and economic benefits.

Despite this different purpose, they operate in the same market as investor driven companies. Many of them are small to medium enterprises and many are new or ‘start up’ businesses in emerging enterprises and innovative, dynamic sectors.

The Corporations Amendment (Crowd-sourced Funding) Bill 2015 will directly impact co-operative organisations that are incorporated as companies under a co-operative style constitution as well as an impact on the issue of securities by co-operatives incorporated under state and territory law.

The attached submission makes comment on the Bill from the perspective of both organisational models.

The BCCM is happy to provide further information or consultation on the arguments raised in its submission.

Business Council of Co-operatives and Mutuals

5 February 2016

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop

1. Executive Summary

A regulatory regime that facilitates crowd sourced funding for the co-operative and mutual sector is a welcome development.

Capital funding for these organisations is traditionally difficult to access other than through grants, philanthropy or retained earnings for existing enterprises. Crowd sourced funding not only presents an accessible and legitimate funding source for these enterprises, it also provides an avenue for retail investors to support enterprises or causes that they believe in.

The capital funding needs of CMEs are set out in the submission of the BCCM to the current Senate inquiry into co-operatives, mutuals and member-owned firms (Senate Economics References Committee reporting 17 March 2016).[1]

Recent experience in the United Kingdom through issues of Community Shares by co-operative and community benefit societies is positive proof of the success of crowd sourced equity funding to revitalise communities, encourage innovative start-ups and provide a 'safe' entrée for community investment.

The Business Council of Co-operatives and Mutuals does not support the current draft amendments for Crowd-sourced Funding (CSF amendments) because they:

A. do not serve the capital needs of small or start up enterprises, particularly co-operative or social enterprise models and
B. impose unwarranted regulatory imposts on the disclosure regime for the offer of securities by co-operatives governed by state and territory laws.

2. Key recommendations

The BCCM recommends that the regime to facilitate the issue of securities through crowd funding platforms under Chapter 6D of the Corporations Act should

- remove the conditions on the number of investors permitted under a small scale offer under s708(1) Corporations Act and associated restrictions on advertising such offers,
- remove the requirement for CSF intermediaries to hold an Australian Financial Services Licence,
- impose minimum disclosure standards for small scale offers to retail investors,
- develop best practice guidelines and certification for CSF offers,
- relax the 50 shareholder limit for proprietary companies, and
- provide for minimum standards of reporting to shareholders under a CSF offer, with transition provisions to public company status.

The BCCM recommends that state and territory co-operatives be excluded from the impact of the proposed CSF regime, in particular:

- s708(20) Corporations Act should be amended so as to exclude the operation of Chapter 6D to offers of securities by state and territory co-operatives wherever the offer is made and
- any regime in respect of crowd sourced funding for securities be expressed to not apply to offers of securities by state and territory co-operatives.

[1] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop

3. The proposed CSF amendments do not serve the needs of small or start up enterprises, particularly co-operative or social enterprise models.

Crowd sourced fundraising provisions to facilitate the issue of securities is part of the Government's 2015/16 Budget commitment to help small business and stimulate job creation, particularly in innovative fields. As such it should take into consideration the existing nature, scope and experience of crowd sourced funding and recognise its ability to provide low cost finance with minimal or acceptable risk to retail investors.

As drafted, the proposed CSF amendments establish a regime

- with potentially high costs for raising small amounts of capital
- that is aimed at capital raising amounts in excess of the needs of small businesses and social enterprises
- that does not recognise retail investor motivations or intelligence and
- that excludes common entity types established for small business or social enterprise purposes.

Crowd funding has its genesis in appeals to large numbers of people to donate or risk small amounts for a project that they believe has a strong social purpose or that is worth supporting because it is innovative. Typical participants in crowd funding campaigns make judgements about whether they want to invest in the proposed project and how much they are willing to lose either because the commitment is a donation or it is a pre-payment for a product or service.

Crowd funding has emerged as a legitimate means for small business and start-ups, especially social enterprises to access modest amounts of funding to commence an enterprise or take their enterprise to the next level. New jobs are created through small business, particularly in rural and regional areas.

By enabling members of the crowd to establish an ongoing relationship with such a start-up or social enterprise through issuing securities, a CSF regime would provide retail investors with another avenue to support the enterprises that they believe in.

Crowd funding creates 'communities of supporters' who have different motivations for investing in an enterprise and who also are conservatively self-limiting because of the nature of the enterprise. These motivations are not the same as an investor motivation in the securities market. To extend crowd funding techniques to the securities market, a regime that balances cost to the enterprise and investor protection should recognise these features of investor motivation and risk appetite.

The proposed CSF amendments do not recognise the scale of crowd sourced funding campaigns, they present a high cost and overregulated regime that fails to recognise the retail investor motivation and the enterprises in this market.

A potentially high cost regime for raising capital:

- The CSF offer document (s738J) is likely to be in the nature of a prospectus, albeit without past financial information for start ups. The exact contents of the document are not yet known, the inclusion of requirements for consents for expert statements (s738M) complex requirements for the lodgement of replacement offer and disclosure documents

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop

and attendant criminal and civil liability for defective disclosure (s738Y) similar in format to prospectus requirements, suggest regulatory overkill and attendant preparation costs.

- Lodgement with a CSF intermediary who must be the holder of an Australian Financial Services license limits the available platforms to high cost intermediaries. The CSF intermediary has a number of gatekeeper obligations (s738Q) requiring identity checks, good character checks, checks about the propensity of persons to mislead and checks that it is an eligible offer. These provisions effectively shift ASIC responsibility to the CSF intermediary and will serve to justify a high lodgement cost or commission for any CSF offer.
- Ongoing communication obligations (s738ZA) are mandated for CSF offers via the intermediary's platform along with obligations as to accuracy and disclosure, which may tend to elevate the disclosure required to a type of continuous disclosure by opening up the possibility for questions and answers regarding financial forecasts. Maintaining this level of supervision by the CSF intermediary is likely to add to the potential cost of a CSF offer.

Aimed at capital raising amounts in excess of the needs of small businesses and social enterprises

An examination of a range of crowd funding platforms already operating in Australia indicates that entrepreneurs seeking funding through this means are seeking sums less than $2million and that persons who give money under these campaigns risk very small amounts ranging from a few dollars to perhaps $1000.

Experience in the United Kingdom demonstrates the link between crowd funding and small scale offers of community shares to retail investors. It is clear from the 2014 Inside the Market Report published by the Community Shares Unit that it is possible to provide a simple cost effective and safe scheme for retail investors to support small businesses through an internet platform.[2]

Offers of community shares are confined to co-operative organisations within the social enterprise sector. The analysis of these share offers indicates an average offer to the market of £600,000 ($AUS1.6million) with a minimum investment of between £10 and £500 ($AUS19 - $AUS967).

The proposed CSF amendments are in addition to the s708(1) exception for small scale offers. This would result in a three tier fundraising regime:

a. Up to $2million – no disclosure and no advertising along with the 20 investor/12 month limits.
b. $2million to $5million – disclosure and two supervisory functions – CSF intermediary and ASIC
c. Over $5million – standard disclosure via prospectus.

The CSF amendments favour wholesale investors. There is no investment cap on wholesale investors, resulting possibly in an ability for a CSF offer to be taken up by a small number of 'sophisticated' investors thereby raising the bar under the s708 (7) exception to $5million through a CSF intermediary.

[2] Attachment A

Given that the majority of crowd funding campaigns in Australia and the Community Share Offer experience in the UK tend to be less than $2million, it appears that the CSF amendments do not focus on amounts up to $2million that would provide reasonable start up or growth capital for small businesses or social enterprises.

Amendments do not recognise retail investor motivations or intelligence in the crowd funding market

Crowd funding creates 'communities of supporters' who have different motivations for investing in an enterprise and who also are conservatively self-limiting because of the nature of the enterprise. These motivations are not the same as an investor motivation in the securities market. To extend crowd funding techniques to the securities market, a disclosure regime should recognise these features of investor motivation and risk appetite.

Persons who participate in crowd funding campaigns limit their exposure to risk by limiting the amount they are prepared to either give away or lose. Typical investment amounts are very small.

Community Share offers by co-operative entities in the United Kingdom rely on the establishment of best practice disclosure guidelines and the development of accredited advisors. For capital raising up to $2million, it appears acceptable that potential investors can make their own decisions based upon what information they may require from the offering entity. The 20 prospective shareholders in a small scale offer under s708(1) may or may not have effective bargaining power to demand information before investing, as this may depend upon the minimum investment amount. Securities in these offers would be relatively illiquid and the investor will face risk of loss.

Investor protection policy should balance the amount of disclosure required in accordance with the investor risk whilst taking into account the ability of an investor to demand information both prior to investment and after the investment.

The protection of retail investors in a crowd funding context should also recognise that investor motivation may depend more clearly on a desire to support an enterprise rather than financial return.

The CSF amendments leave a disclosure 'gap' for small retail investors (in offers up to $2million) and do not address investor motivation.

The CSF regime excludes common entity types established for small business or social enterprise purposes.

- The majority of small businesses are proprietary companies and they are not eligible entities under the CSF regime (s738H). Proprietary companies may already raise up to $2million using the exceptions under s708 (small scale offers, sophisticated investors or financial adviser offers), however, they are prohibited from advertising any such offers (s734 Corporations Act).
- Proprietary companies are highly restricted from seeking capital by the restrictions on small scale offers, the prohibition on advertising and the limit to 50 non-employee shareholders (s113 Corporations Act). Yet this company form is the first choice for small business.
- The amendments do not indicate whether they will apply to only equity or debt capital instruments as this is a matter for regulation. The Minister's Second Reading Speech

refers to the amendments as enabling the issue of equity. If there is to be an appropriate relaxation of the disclosure regime, it should apply to both equity and debt as small business should legitimately be able to access capital of both types, and investors should have the choice of investing in debt with a consequent return of their investment over time, particularly if the market in shares in small entities is illiquid.

The BCCM is of the view that a CSF regime should be simple, cost effective and responsive to investor motivation for capital fundraising within the context of small scale offers in s708 of the Corporations Act.

Crowd sourced funding offers of securities can be readily accommodated under the disclosure exceptions in s708(1) by

a. removing the restrictions on the number of investors,
b. removing advertising restrictions for small scale offer,
c. providing for minimum disclosure and developing best practice standards,
d. removing the requirement for a CSF intermediary to hold a financial services licence,
e. enabling CSF offers of equity and debt securities,
f. prescribing an investor cap commensurate with typical or equivalent crowd funding campaigns,
g. providing an exception to the 50 shareholder limit for proprietary companies that make a CSF offer,
h. provide for reporting to shareholders of unaudited financial statements including information as to the progress or purpose of the capital raised via the CSF offer,

If the small business enterprise grows, then there could be other triggers that would require the proprietary company to become a public company.

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop

4. The CSF amendments impose unwarranted regulatory imposts on the disclosure regime for the offer of securities by co-operatives governed by state and territory laws.

Proposed CSF amendments will affect co-operatives in the following circumstances:

a. When a co-operative offers any type of security to persons outside its jurisdiction of incorporation – s708(20) Corporations Act and s12 Co-operatives National Law (interstate offers),
b. When a co-operative offers debt securities to the public within its jurisdiction of incorporation – s337 Co-operatives National Law applying Chapter 6D Corporations Act (debenture offers).

a. Interstate offers

The disclosure requirements of Chapter 6D of the Corporations Act apply to offers made by co-operatives because of regulatory arrangements settled between the Commonwealth and States in 2002 in respect of control of corporations and financial markets.

Much has changed since that time. States and Territories agreed to uniform laws for co-operatives – the Co-operatives National Law – including uniform laws for disclosure in any offer of securities. The Co-operatives National Law also provides for mutual recognition of co-operatives across borders, uniform administration and reciprocal powers to deal with breaches of the law.

In short, residents in one state or territory have the benefit of the same disclosure requirements for the offer of securities as residents in other states or territories. Disclosure in respect of the offer of shares is tailored to co-operative shares, which are significantly different to company shares. Disclosure in respect of the offer of debentures and CCUs is identical to that required for the issue of debt securities by companies.

Notwithstanding this uniformity, co-operatives that make offers to persons outside their jurisdiction of incorporation are subject to disclosure requirements under both the Co-operatives National Law and the Corporations Act. This means that a co-operative must pay two lodgement fees and be subject to supervision or control in this activity by two separate regulators.

The issue of dual regulatory imposts as a barrier to the co-operative sector is currently under review by the Senate Economic References Committee[3]

The BCCM recommends the removal of this dual regulatory impost on interstate offers of co-operative securities. The requirement to comply with Chapter 6D (including any CSF amendments) of the Corporations Act is anti-competitive and inappropriate for the issue of securities, particularly membership shares, under the Co-operatives National Law Scheme.

b. Debenture offers

A co-operative may offer debentures or Co-operative Capital Units (CCUs) to the public. The disclosure requirements for such an offer are prescribed in s337 of the Co-operatives National Law which applies Chapter 6D of the Corporations Act.

[3] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives

Any amendments to Chapter 6D through the passage of CSF amendments will immediately apply to co-operatives.

Offers of debentures and CCUs to the public by co-operative sector have been rare and would not generally exceed $2million in total.

Whilst legislation for co-operatives is a matter for states and territories, the inter government agreement underpinning the scheme for amending the Co-operatives National Law requires agreement at Ministerial level through the COAG Legislative and Governance Forum on Consumer Affairs. This will necessarily involve a significant lag time for jurisdictions to respond to the impact of automatic application of any proposed the CSF amendments.

Imposing the CSF regime as currently drafted on debt securities issued by co-operatives would impose an unwarranted cost and regulatory burden in circumstances where there is already adequate investor protection.

For the same reasons that the proposed CSF regime is not appropriate for small business, the BCCM submits that it is not appropriate for co-operatives incorporated under state law.

It is suggested that any CSF amendments to Chapter 6D be drafted in such a way that they do not apply to state incorporated bodies so that state legislatures may adequately consider the appropriateness of such measures within the context of the co-operative sector.

5. Summary recommendations

The BCCM recommends that state and territory co-operatives be excluded from the impact of the proposed CSF regime, in particular:

- s708(20) Corporations Act should be amended so as to exclude the operation of Chapter 6D to offers of securities by state and territory co-operatives wherever the offer is made and
- any regime in respect of crowd sourced funding for securities be expressed to not apply to offers of securities by state and territory co-operatives.

GPO Box 5166
Sydney, NSW, 2001
ACN 148863932

02 9239 5915
info@bccm.info
www.bccm.coop