



Comments on the Corporations Amendment (Crowd-sourced Funding) Bill 2016 [Provisions]

Submitted 6 January 2017

by

Fat Hen Ventures Pty Ltd

Pursuant to an invitation to comment from the Committee
Secretary of the Senate Economics Legislation Committee





This paper is provided in response to a request by the Senate Economics Legislation Committee (“Committee”) to our company for comments on the provisions of the Corporations Amendment (Crowd-sourced Funding) Bill 2016.

We have been advised that the Committee is due to report to the Senate by 13 February 2017 and the Committee would like to receive submissions by 9 January 2017.

As an experienced, full service early stage funding group with a large retail investor base, we are well placed and keenly interested to see the best CSF model deployed in Australia. We have spent a great deal of time evaluating CSF platforms around the world and have responded to all Treasury feedback requests, attended the 4 recent RoundTable meetings in Sydney, provided input into the CAMAC paper and recommendation 18 from the Financial System Inquiry Final Report. We have also had several one on one discussions with Treasury officials.

We have developed a platform (currently in beta mode) along the lines of a CSF style platform and we are in the process of getting CSF-aspirant companies “CSF-ready” in contemplation of the Bill passing both Houses and being enacted by mid-year. It is pleasing to see that our two recommendations – i.e. increasing the revenue / gross asset eligibility cap from \$5 million to \$25 million and reducing the cooling off period from five working days to 48 hours, have been adopted into the 2016 Bill.

While there may be benefit from some further “tweaking” of the Bill as suggested in this paper and other feedback you receive, we are, in favour of the Bill as is being submitted to the Houses for approval. The priority is to get a CSF regime up and running in this country as soon as possible to deliver on the Innovation Statement and make it easier for fast growing / emerging companies to access capital in a more efficient manner. Australia is behind many other countries in relation to CSF and part of Australia’s economic outcomes depends on a CSF regime being in place. Australia will lose fast growth enterprises to jurisdictions with CSF if we delay much longer. We congratulate the efforts that have gone into drafting the Bill.

Once the legislation is in place and running smoothly, we would be happy to see the Government assess extending the CSF legalisation to proprietary companies but such a “stage two” movement would need to be coupled with major changes to Corporations Act (i.e. extending the current 50 non-employee cap and Offer logistics etc) and therefore it is our strong recommendation to get the current Bill into legislation soonest with a genuine intention to assess Pty Ltd company application some time thereafter.

We trust this submission is helpful to the Committee’s deliberations on the finetuning of the CSF legislation for Australia. We acknowledge the input to this submission from our strategic alliance partners, retail investors and SMEs we are assisting and we look forward to the Bill being enacted into law this year.

Signed by the board of Directors of Fat Hen Ventures Pty Ltd as an authorised release,

Jeffrey Broun
Managing Director

Tony Adcock
Chairman

Robert Swift
Director

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Comments on the Corporations Amendment (Crowd-sourced Funding) Bill 2016 ("CSF Bill")

Key observations ("KO")

KO #1 - CSF – the name

Crowd-sourced Funding ("CSF") – the CSF reference may be confusing for several reasons:

- a) The regime currently being put in place within the Corporations Act 2001 framework is specifically related to offering equity in public companies and thus the word equity should, in our opinion, be included as the reference and title for the legislation. We understand that the word "equity" was dropped as a debt CSF regime may be introduced at a later stage – however even various government departments are referring to the draft legalisation as equity crowd sourced funding or crowd sourced equity funding. It may be helpful to subscribers to know if an issue is "crowd sourced equity funding" or "crowd sourced debt funding.";
- b) There are many "crowd funding" (CF) platforms here and in the world and most are not for equity so there may be a high level of confusion by the public markets between the CSF framework and non-equity crowd funding regimes; and
- c) Most of the world knows the term "equity crowd funding" i.e. ECF and therefore it would be easier to call it Equity Crowd Funding (ECF) or revert to the previous phraseology used by the federal government of Crowd Sourced Equity Funding (CSEF).

According to the CAMAC report Crowd-Sourced Equity Funding:

"There is no legal definition of [crowd-sourced equity funding]. However, in practice, the concept refers to a form of corporate fundraising that envisages start-up or other smaller companies (issuers) obtaining seed or other capital through small equity investments from relatively large numbers of investors, with online portals (intermediaries) publicising and facilitating these equity offers to online users (the crowd)."

This observation is a minor matter from our perspective – more to ensure the Senate Committee is aware of generally accepted equity based crowd funding regimes elsewhere.

KO#2 – Eligible CSF Company and reporting

We welcome the revision to the asset / revenue threshold being lifted to:

- a) the consolidated gross assets of the issuer and any related parties must be less than \$25 million at the time the company is determining its eligibility to crowd fund ('gross assets test'). [Schedule 1, Part 1, item 14, paragraph 738H(2)(a)]; and
- b) the company and any related parties must also have consolidated annual revenue of less than \$25 million ('turnover test'). [Schedule 1, Part 1, item 14, paragraph 738H(2)(b)]

This will make the CSF regime much more relevant to territory in need of CSF.

Most Private Equity and VC Firms now have a \$10m minimum investment sum with many adopting a \$20m minimum investment per investee. In fact, AVCAL's research shows that the average PE-backed business in Australia has an annual turnover of \$195 million.

It is the unlisted companies with revenue / assets to \$50m that battle to access equity capital for growth of up to \$5m. This is a drag on the ability of the Australian economy to stimulate growth and employment so it is pleasing to see the \$25m limit – hopefully it can be reviewed up to \$50m in the coming years.



Some people may say the banks and PE firms can cover this requirement but the reality is the banks often are unable to fund all the working capital needs of SMEs – the banks may play a role in the funding but there is often a gap of \$1m to \$5m and that is the ideal opportunity to engage with the retail markets (the crowd) to help such companies expand.

We welcome the customised disclosure requirements and exemptions from audit in certain circumstances.

Also, we do not see it as a major challenge for companies needing to convert to public status or be public to engage with the CSF regime – for a Pty Ltd company it is only a \$76 ASIC fee for the lodgements of the 205C and adopting a new constitution which are freely available from law firm knowledge centres for ~ \$500.

In our opinion there has been too much scaremongering about the cost of companies to convert to public.

We feel the following observations may be use to the Senate Economic Committee:

- a) we are comfortable with the requirements to be a public unlisted company to access CSF and presumably the Government will review how the CSF regime goes and then assess whether proprietary limited companies should or could come within the framework sometime in 2018 or as required;
- b) we would like to stress the vigilance required IF companies try by “creative means” to reduce their gross asset base to < \$25m in breach of Australian Accounting Standards – some companies whose turnover is <\$25m and where they have largely intangible assets on their balance sheet may be tempted to write down or off intangible assets to get within the \$25m cap. It is important in our opinion for the Intermediary and possibly ASIC to review any sudden write down of assets to comply with the asset test for CSF. We believe it is important for CSF-aspirant companies to adopt Australian Accounting Standards in any event to ensure readers of a CSF Offer are properly informed about the profit and loss and balance sheet of the Issuer company;
- c) We are comfortable with the amendments setting the ‘issuer cap’ at \$5 million in any 12-month period with a regulation-making power to adjust the cap in the future in light of the experience with CSF. [Schedule 1, Part 1, item 14, subsection 738G (2)]
- d) We understand that the securities that are the subject of the CSF offer must be securities of a class prescribed in the regulations. [Schedule 1, Part 1, item 14, paragraph 738G(1)(c)]. Whilst we have the regulations from the (old) 2015 Bill we of course would like to see the Regs for the 2016 Bill. We understand the Government has indicated that only fully-paid ordinary shares would be subject to crowd-funding when the regime commences. This will ensure that there are appropriate limits on the securities made available under crowd-funding as the regime commences and begins to develop. As the CSF regime is new and is expected to evolve quickly, there is a need to have the flexibility to quickly adjust the type of securities that are eligible for crowd-funding.

Whilst this approach is acceptable to us, we would stress that there will need to be vigilance (hopefully by the Intermediary) that CSF Offer companies will not circumvent the interest of such CSF shareholders by having options on issue or convertible securities or different class shares that may undermine the interests of the ordinary shareholders and particularly those ordinary shareholders who come on board under a CSF Offer via the Intermediary platform.



This is particularly the case where the need to hold an AGM is removed – we believe that notwithstanding the company not being required to hold an AGM under section 250N, the directors would need to call a general meeting under circumstances where, for example, pursuant to an amended subsection 249D (1), on the request of CSF originating members with at least 5 per cent of the votes that may be cast at the general meeting. This at least would give the CSF originating ord shareholders an avenue to call an AGM where the test is 5% of the CSF originating ord shareholders NOT based on all ord shareholding where there may be a dominate “in-house” or related ord shareholder.

- e) In relation to exempting the need for audited financial reports where they satisfy the general eligibility criteria to claim the concessions and as at the end of the current financial year, the company has raised less than \$1 million from all CSF offers and is within the 5 years. [Schedule 2, item 6, subsection 301(5)], we believe it is very important for the company to prepare its unaudited financial statements in these circumstances still fully complying with Acceptable Australian Accounting Standards for that size organisation. Areas such as impairment testing etc are extremely important and hopefully the directors of the company will have sufficient experience to test these areas at the time of signing and reporting.

We believe that when shareholders take up shares in a CSF Issuer company that they should advise their email address for servicing of reports and notices – it is very easy for a company to have an email broadcast group and we do not believe simply posting reports on their web site is in shareholders’ best interest.

Whist we realise the Bill provides that a company that satisfies the general eligibility criteria to claim the concessions at the end of the financial year only needs to provide its annual reports via a website and does not need to notify shareholders of alternative ways of receiving the reports. [Schedule 2, items 7 and 8, subsections 314(1) and 314(1AF)] - similar for providing its concise financial report to shareholders by making the report available on a website, we feel it is a simple process to email shareholders and hopefully this concession can be removed from the Bill.

KO#3 CSF Offer

Under the CSF regime, a CSF offer document must be prepared in relation to each CSF offer and must contain all the information specified in the regulations including matters such as information about the company and its business, the securities on offer, how the proceeds from the CSF offer will be used etc.

As we noted we only have the Regs from the previous Bill.

Given the fact that many of the CSF Issuers will be start ups / early stage with grand plans but lacking the fuel in the tank and depth of commercial expertise to navigate the strategic plan, we believe Issuers as part of their Prescribed disclosure requirements (or at least in an ASIC Guidance Note (“GN”)), should have at the beginning of any CSF Offer document, a Key Information Page (**KIP**) with mandatory matters to be included in the KIP prescribed in the Regulations or GN. We attach a draft KIP for your review. It is more a key page of the main matters that any Issuer should include as a matter of course. Readers often do not have time to sift through a lengthy CSF Offer document hence the observation of having a Key Information Page or Key Point Summary to ensure readers fully understand the status of the company. The KIP should be an essential part of any disclosure document.

Too many times for instance you see “the company has a patent on the xyz.” That sounds good BUT what patents, what countries, when do they expire, have there been any objections lodged, who actually holds the patent, who actually owns the IP etc.



These are critical matters required by the reader to make an informed investment decision. Retail investors subscribing for say \$2,000 of shares will not have the ability or budget to perform any sort of due diligence for the small contribution and hence the importance of a discipline by the Issuer to have a KIP in the same format with the same checklist items dealt with.

Same for “we expect by FY18 to be making \$10m EBIT” Yes BUT what they do not say is that to get that profit level they will need to raise a further \$10m in equity – i.e. will the company most likely need to raise further funding – does the subscriber to the current round know this?

The KIP is an accurate page/s responding to pre-set guidance questions without any hype or omission. It would also make the Intermediaries’ job easier as the CSF Issuer (Directors) would be warranting such KIP information as true and accurate with the rest of the CSF Offer. Otherwise we are comfortable with the CSF Offer process proposed and the Intermediary’s role.

We are also supportive of the Minister having enhanced powers to exempt some emerging and specialised financial markets — such as intermediaries operating facilities for secondary trading in CSF interests — from some or all of the requirements in parts 7.2, 7.2A, 7.3 and 7.5 – this should provide for a more effective, efficient, and flexible regulatory regime.

We also support the Bill providing the Minister with additional exemption powers to provide financial markets and clearing and settlement facilities, and their operators, with exemptions from specified parts of the AML and clearing and settlement facility licensing regimes.

In our opinion, it will be the Intermediary with the best depth of expertise, sophistication and corporate finance track record that succeeds and we look forward to providing leadership in this area as we seek to have an AFSL licenced CSF operator endorsement.

KO#4 Regulations

Whilst not having the Regs supporting the 2016 Bill, we understand the old draft Regs will be substantially the same.

4.01 – statements

In Clause 2 of the old Reg 6D.3A.04 we believe has a major omission in that cl 2 only mentions that in Section 1 of the CSF offer document it must contain the most recent consolidated statement of financial position of the offering company in respect of a financial year prepared in accordance with relevant accounting principles.

A statement of financial position relates to AAS 36 **Statement of Financial Position** covering simply the Balance Sheet. It is vital the reader of any Offer document sees the complete financial statements which includes the Statement of Financial Performance per AAS 1018 and in fact the financial statements presented should be as encapsulated in AASB 101 Presentation of Financial Statements for the most recent financial year.

Also if the last financial statements are more than 6 months out of date, then a financial summary being the Statement of Financial Position and the Statement of Financial Performance should be presented current to within 60 days of the issue date of the CSF Offer document – i.e. if the CSF Offer document is dated 31 May 2017, then the Statement of Financial Position and the Statement of Financial Performance must be at least dated 31 March 2017.

This is most reasonable otherwise readers are making decisions to invest in May 2017 based on outdated financial statements at 30 June 16 which would be out of date and may be meaningless to making an informed decision.



4.02 forecasts

The Bill and old Regulations are silent on forecasts. Many of the emerging companies undertaking a CSF round will be a start up or early stage company many with minimal or no revenue but high hopes of being a great success and becoming a large employer to help Australia build solid foundations from the resources that are above the ground.

Most companies will not be able to reasonably forecast revenues / expenses consistent with RG170 Prospective Financial Information or INFO 214 and directors will not want the exposure BUT readers should be able to understand the application of funds and what the company is striving to achieve.

Prospective investors would most likely want some sort of investment horizon and revenue profile over the next few years – i.e. is this a company that will slowly build revenue and EBIT or is the company looking to design the next “must have” app and sell it for \$100m in two years?

It may be that the KIP per the GN will be able to convey a feeling of timeframe and further funding requirements – simply to ensure there is no mis-matching of expectations between the investor and the Issuer.

4.03 definition of Manager

(old) Regulation 6D.3A.04

At clause 6D.3A.04 1 (d) we suggest some clarification around:

(d) the names of each of the following persons, as well as his or her skills and experience relevant to the management of the offering company:

- (i) each director of the offering company, and any person proposed by the offering company to be a director of the offering company;
- (ii) each other officer of the offering company, and any person proposed by the offering company to be an officer of the offering company;
- (iii) each **manager** of the offering company, and any person proposed by the offering company to be a manager of the offering company;

The word “**manager**” is not defined and in the CORPORATIONS ACT 2001 the definition of Manager is referred from S9 to S90 which covers Receivers and Managers – it may be useful to elaborate on “manager” as someone who has a manager role in the organisation such as CEO, COO, CTO etc or where a start-up – the key people in the company.

Also we believe for each person noted per clause 6D.3A.04 1 (d) above, there should be the following additional information provided for each named person:

- a) Are they employed by the company on a written contract or on a consulting basis?
- b) If employed – details to be provided about the tenure of such appointment, remuneration and any incentives or bonuses including any share plans, or share incentives or options plan, termination provisions, restraint of trade etc
- c) If on a consulting contract, note the terms of the contract, hourly or daily rate, any share or option entitlements, non-conflict terms, and what the termination notice is



Conclusion

We trust these comments on the 2016 Bill assist in your efforts to finetune the draft legislation and set it on its course through the Parliament. The Bill has our approval for enacting.

Equity crowd funding in the UK and US started a few years ago, from a small base, and today ECF has become a major mainstream business in these countries with formalised and organised platforms and value upside being realised and returned to shareholders for re-investing.

As we look to the listed markets with a bearish outlook through 2017/18, it would seem CSF, if done properly, and assisting growth orientated emerging companies, could become a new investment class for the broader investment community.

If you require anything further please contact the writers anytime,

Yours sincerely

Robert Swift
Director

Jeffrey Broun
Managing Director
Fat Hen Ventures Ltd

Director

Tony Adcock
Chairman

refer over page for the draft KIP



Draft Key Information Page (KIP)



SAMPLE: Key Information Page (KIP)

The idea is to have a consistent approach re Key Information for all companies issuing a CSF Offer document.

We believe the Key Information requirement could be either set out as part of the Regs OR a ASIC Guidance Note

The actual key information can be agreed by ASIC and industry over the next few months – this is a suggestion only for discussion purposes.

Key Information Page	<i>answers</i>	<i>Ref page of CSF doc</i>
<i>Date company incorporated</i>		
<i>Names of the directors</i>		
<i>Name of coy sec</i>		
<i>ABN</i>		
<i>Shares on hand now ord / pref / convertible</i>		
<i>Shares being issued now</i>		
<i>Amount payable per share</i>		
<i>Amount being raised – Minimum subscription required to meet objectives outlined in CSF Offer document</i>		
<i>Maximum amount to be raised and use of Funds over Min Sub</i>		
<i>Key terms for all classes of shares issued – voting rights and any other restrictions etc. Also, key terms for any preference shares and / or convertible debt or notes including related party disclosure</i>		
<i>Nature of business and how has business been operating for?</i>		
<i>Latest Financial Reports are included (Y/N)</i>		
<i>All liabilities clearly show security details (if any), repayment dates, interest rate and any other relevant matters</i>		
<i>Has the company adopted Australian Accounting Standards – if not is there any potential adverse adjustments that would be required if the company applied relevant Accounting Standard</i>		
<i>Names of key individuals and how engaged</i>		
<i>All material contracts have been noted in Section XX</i>		
<i>Notes on any related party agreements / arrangements</i>		
<i>Patent details – country / objections / expiry date</i>		
<i>If any forecasts in the Offer document – directors believe them to be achievable from the current round of funding or are they premised on further funding required</i>		
<i>Key risks to the investment being made contained in Section XX</i>		
<i>Reporting plan for shareholders – by email or web site only</i>		
<i>Where is copy of constitution available from</i>		
<i>All PAYG and GST and superannuation returns up to date and lodged</i>		
<i>Related party disclosures</i>		
<i>Are there any critical licenses or permits that need to be obtained or are in place and what is the tenure of such</i>		
<i>Does the company have comprehensive insurances in place</i>		
<i>All key employees under ESA's and paid commercial rates</i>		
<i>Owners or promoters remuneration arrangements</i>		
<i>Is a SWOT analysis included in the CSF Offer doc?</i>		
<i>Details of auditors / lawyers / tax advisers / IP advisers</i>		
<i>Banker details – do they have any security over the company</i>		
<i>Names of independent directors</i>		
<i>Any other information relevant to Issuer subscribers</i>		