AUSTRALIAN INVESTMENT COUNCIL

20 December 2019

Senator Andrew Bragg
Chair
Select Committee on Financial Technology and Regulatory Technology
Po Box 6100
Parliament House
Canberra ACT 2600

Email: fintech.sen@aph.gov.au

Dear Senator Bragg,

The Australian Inquiry into Financial Technology and Regulatory Technology

Investment Council welcomes the opportunity to provide a submission to the Select Committee Inquiry on Financial Technology and Regulatory Technology.

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy each year. Our members are the standard-bearers of professional investment and include: private equity (**PE**), venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members are comprised of both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies every year. For the first time in history, Australian-based private equity and venture capital funds under management reached $30 billion in 2018, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Fund managers secured a total of $6.6 billion in new investment commitments in 2018, which means the industry now has a combined total of around $11 billion in equity capital available to be invested in the short-term.

The Australian Investment Council is supportive of policy initiatives and reforms that help to ensure our economy is competitive and that encourage the growth and expansion of businesses in the fintech and regtech sectors. In particular, we believe that priority should be given to the introduction of reforms that address barriers to greater levels of **PE**, **VC** and **PC** investment into Australian businesses.

We recognise that government has a role to play in facilitating an economy that continues to grow at a sustainable rate, and which creates jobs for the future through enabling a fully-functioning ecosystem for fintech and regtech companies. Our submission addresses a number of points raised in the *Issues Paper* including the need for a stable regulatory framework, supporting more research and development, attracting and retaining talent, and greater use of equity co-investment programs.

We look forward to participating in any future discussion about the themes set out in this submission as part of the inquiry's work in relation to the fintech and regtech sectors. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research

Yours sincerely

Yasser El-Ansary
Chief Executive

Introduction

The Australian Investment Council welcomes the opportunity to provide a submission to the Senate Select Committee's Inquiry on Financial Technology and Regulatory Technology.

The Council represents a broad range of private capital investors, including **PE**, **VC** and **PC** funds, who are all well-versed in the dynamic nature of new and innovative business models and the creation of new industries and markets that may not have existed historically.

In 2018 alone, Australian private capital funds secured a total of $6.6 billion in new funding commitments, which brings the amount of committed capital available to be invested into high growth potential Australian businesses to around $11 billion today.

When investing in businesses, including in the fintech and regtech areas, **VC** funds provide capital that is matched with highly valuable strategic and operational advice and guidance to the founders and management teams of those businesses. This model of working in partnership is often the 'x-factor' that can help innovative early stage businesses realise the domestic and global expansion ambitions they have for their venture. The expansion and growth of such businesses leads directly to more revenue and sales, greater levels of investment into innovative market-leading research and development, and ultimately, is the key driver behind the creation of new jobs.

VC has a track record of funding for fintech and regtech startups and early stage companies that are looking to build and bring to market innovative products, or develop novel solutions to old problems. These new companies are often cash-poor in the early phase of their lifecycle and must rely on a number of funding sources to get them to their next stage of growth, from which they can make significant contributions to the economy and employment. **VC** funding can be a critical enabler for firms making this transition.

In recent years, startups in Australia have experienced a period of rapid growth with the number increasing by 53% from 2015 to 2018, according to Venture Capital Startup Muster. Much of this growth has occurred in fintech and regtech.

According to Fintech Australia, 70% of fintech firms in Australia provide services to businesses in areas such as cyber security, fast payments, insurance and automated financial advice. These include companies such as Athena Home Loans, AfterPay, Judo Bank and Airwallex, which are amongst the top 100 fintech companies around the globe[1].

VC plays a critical role in funding fintech companies, particularly during the startup and early growth stages. A report by CB Insights[2] shows that **VC** funding for fintech companies increased by 396% from $69 million in 2017 to $343 million in 2018.

While **VC** funding for fintech companies has significantly increased over recent years, there is considerable room for growth.

The scope for further growth is also evident at a macro level across the entire spectrum of **VC** in Australia. When compared to other OECD nations, Australia is ranked 21st when it comes to **VC** investment as a percentage of GDP (0.025%). This compares to countries like the USA at 0.39% and Israel at 0.38%. See **Table 1**.

The future growth of deeper pools of **VC** funding will depend on the success of existing Australian startup and early stage businesses backed through **VC** investment, as well as ongoing growth in the pipeline of institutional-level asset class venture investment from large investors such as superannuation and pension funds.

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[1] KPMG 2019 Fintech 100: Leading Global fintech innovators

[2] CB Insights Fintech Trends in 2019

Table 1

VC investment as a % of GDP	
0.025%	Australia
0.38%	Israel
0.39%	US
0.06%	OECD average
0.21%	OECD top 5 average

Australia is ranked 21st out of 30 OECD nations when it comes to VC investment as a percentage of GDP growth.

Source: Entrepreneurship at a Glance, OECD 2018

Currently, the vast majority of domestic VC funding is raised from Australian investors. However, as fintech continues to grow and mature, foreign sources of capital may become as important to the companies that benefit from venture funding, as it already is for private equity and other sectors of the economy.

The right policy settings will be essential for a smooth transition to the next phase of funding growth and to support the continued growth in fintech and regtech investment domestically.

To this end, the Australian Investment Council provides a range of policy recommendations for this parliamentary inquiry to consider. Our submission addresses the key themes of:

1. Stable Regulatory Framework
2. Research and Development,
3. Skills and Talent, and
4. Equity Co-Investment.

1. Stable Regulatory Framework

Australian jobs and industry rely on a steady flow of foreign capital to support investment into growing businesses across all sectors of the economy. Australia's demand for capital continues to be greater than the domestic supply and as a result, Australia will remain a net importer of capital – consistent with historical patterns over the last three decades. Private capital firms are an important vehicle for attracting domestic and foreign capital into the local market to help fund ongoing investments into high-potential Australian business that will drive economic growth and new job creation.

Despite our nation's impressive continued economic growth, Australia remains a mid-level economic player in a global context. Because of that, Australia remains an attractive – but optional – investment destination for many large offshore-based institutional investors. Differences to international practices, or unexpected policy changes, typically make Australia a less attractive investment location in the eyes of those offshore institutional investors. The global marketplace to attract offshore investment into Australia is highly competitive. Smaller and more dynamic jurisdictions have the potential to out-manoeuvre Australia when given an opportunity.

One area of policy that constrains Australia's capacity to more effectively compete for capital from offshore investors relates to some features of our existing legal and tax policy infrastructure. The framework for private capital investment into Australia is broadly inconsistent with international best practice in a number of areas. The unique features of Australia's current policy typically lead to the introduction of complex concepts and structures, which can have a direct negative effect on the nation's capacity to attract higher levels of foreign investment. One of the principal areas of focus here relates to Australia's suite of collective investment vehicles (**CIVs**), which are not currently competitive with other similar markets offshore (further detail is included below).

Further, ASIC's new product intervention powers, designed to protect consumers from excessive fees, could also have the indirect effect of introducing greater risks for investors into innovative fintech and regtech companies, which ultimately impacts on the ability of those businesses to raise capital from investors. The broad nature of the intervention powers could prevent some legitimate fintech products from going to market and stifle the innovation and growth potential of some businesses.

Policy and regulatory settings in Australia are often challenged by the rapid pace of change evident in the fintech and regtech sectors. By their nature, fintech and regtech companies are nimble and adaptable to market changes and demands. They require policies and regulations that facilitate and manage growth and product innovation, rather than get in the way of it.

Our specific recommendations below provide practical policy solutions to boost Australia's capacity to attract investment into these sectors from domestic and offshore sources. We believe these changes will help Australian fintech and regtech businesses to grow and create meaningful scale industries that can make a major contribution to economic growth and new job creation.

Collective Investment Vehicles

One area where Australia's approach is inconsistent with international practice is its existing framework for **CIVs.** These vehicles are an important structure to facilitate the aggregation and pooling of capital to be invested into Australian start-up and scale-up businesses.

Private capital funds make a material contribution to the Australian economy and Australian unlisted business investments. It is important to note that around 64% of commitments to Australian PE funds[3] typically come from offshore investors, all of which flows through some form of CIV based in Australia. The importance of a world-class competitive CIV regime is highly important to building and expanding on the pool of capital that can be attracted into fintech and regtech businesses. A number of large international investors have identified that the current structure of Australian CIVs is a material deterrent for investing more into Australia. As a result, these international investors are making decisions to invest in jurisdictions that have CIV regimes they are more familiar with. This means Australia misses out on significant volumes of capital simply because our policy infrastructure is not as competitive and consistent with global practices as it should be.

These differences continue to exist despite the Government announcing in the 2016 Federal Budget – consistent with the recommendations of the 2009 Johnson Review into Australia as a Financial Centre – it would introduce two new CIVs to grow Australia's capacity to attract inbound investment into our economy. These two CIVs, known as a corporate collective investment vehicle and a limited partnership collective investment vehicle, and are yet to be implemented. We understand that work on the Limited Partnership CIV is yet to even commence.

Recommendation 1
Fast-track the implementation of the new LP CIV regime
Consistent with the government's 2016 commitment, we recommend that steps be taken to fast-track the introduction of a new Limited Partnership **CIV** that aligns with international best practice. A target start date of 1 July 2021 should be set.

Venture Capital Limited Partnerships

In a move supporting investment into Australian businesses, the government implemented changes to early stage venture capital limited partnerships (**ESVCLPs**) and venture capital limited partnerships (**VCLPs**) on

[3] For FY2013-2017.

1 July 2016. These changes were broadly supported by Australia's private capital investment sector. However, due to the speed with which they were introduced, there are a number of areas where technical and interpretative amendments and clarifications regarding these investment vehicles are necessary.

There is a range of uncertainties and inefficiencies regarding the current VCLP and **ESVCLP** regimes. An example of some of the uncertainties with the current regime include the tax treatment of investments whose value increases to exceed $250 million. It remains unclear if these investments remain exempt from 'excess' gains, under sections 51-54 and 118-408 of the Income Tax Assessment Act 1997 (Cth) or, if such an investment is sold out of a ESVCLP, as it may no longer be 'early stage' due to the company expanding and maturing, if such a transfer triggers a crystallisation event and (through application of Part IVA, the general anti-avoidance rule) a tax liability.

Providing clarity and certainty on the framework for **VCLPs** and **ESVCLPs** and making them competitive with other jurisdictions will be attractive to early-stage investors considering medium and long-term investments into Australian businesses in key sectors such as fintech and regtech.

There are around 15 separate technical and interpretative issues that exist around the current **ESVCLP** and **VCLP** regimes, and we can provide the Inquiry with further detail about all of the specific issues if required as part of this review.

Recommendation 2
Improve existing VCLP and ESVCLP vehicles

Implement technical amendments to modify the operation of Australia's **ESVCLP** and **VCLP** regimes to provide a stable regulatory framework which better supports medium and long-term investment into Australian businesses in the fintech and regtech sectors

2. Research and Development

The Research and Development (**R&D**) Tax Incentive is a critically important policy that drives large parts of Australia's innovation ecosystem. The **R&D** Tax Incentive encourages considerable investment into the development of new products and services across countless sectors of the economy, which is essential for the economic transition that we need to make towards a more knowledge-based high value-add market. The R&D Tax Incentive regime is a strong and compelling commercial driver for attracting offshore R&D programs to relocate to Australia and undertake their activities here. This has the effect of helping to transfer knowledge and skills into the local market.

On 5 December 2019, the Research and Development Tax Incentive Bill was tabled in parliament. While it marked an important step forward in providing certainty to businesses about the future direction of Australia's **R&D** tax incentive, certain definitions used in the legislation are likely to continue to create uncertainty on the eligibility criteria for R&D tax incentives.

One area of concern for all early stage businesses – including in the fintech and regtech sectors – is the proposed introduction of a $4 million cap on **R&D** refundable credits for businesses with turnovers of up to $20 million. While the Council has accepted the government's desire to implement such a significant change to the policy of the regime, it is likely to be the case that the introduction of a cap in this way will have potentially significant consequences for the capacity of early stage ventures to continue to invest large amounts of capital into R&D activities in Australia.

Recommendation 3
No further changes to the R&D tax incentive

The Government commit to and support earlier innovation reforms and measures that have had a net benefit to the innovation ecosystem, including making no further cuts or changes to the **R&D** tax incentive regime.

Public transparency measures are also proposed in the Bill which will require the Commissioner of Taxation to publish information about **R&D** entities that have claimed notional deductions for **R&D** activities, including the amount claimed within two years following the end of the relevant financial year. These changes could have the effect of diminishing the appeal of the program, and result in a loss of commercial in confidence information that could impact on the competitiveness of early stage businesses who are often seeking to build scale in niche areas of the market.

Under the current regime, there have also been numerous examples of inconsistencies where claims that were initially accepted were later rejected by the Australian Taxation Office. This *about-turn* on eligibility has had a material effect on many early stage businesses, who have relied on their access to **R&D** tax incentive refundable offsets in order to fund ongoing cashflow investment into **R&D** activities.

Additionally, the narrow interpretation of “experiments” in the **R&D** tax incentive legislation has caused some confusion within the fintech industry. New fintech services are often created over the top of existing systems which could be interpreted as “not new or experimental” from an **R&D** perspective. However, fintech operates within long-established financial infrastructure. Broadening the definition of “experimental” to more accurately reflect the nature of the fintech industry would create certainty and drive research and innovation in the sector.

Recommendation 4
*Clarify definitions in **R&D** legislation*

The Government address recent uncertainty around the future settings of the **R&D** program. Steps should be taken to broaden the definition of “experiments” for fintech businesses, encompassing businesses that innovate on top of existing infrastructure and to provide clarity on which **R&D** claims are eligible to avoid potential disputes with the ATO.

3. Skills and Talent

To compete against the world’s best, we need to attract and retain the world’s best talent. This is particularly true for Australia as we are net importer of not only capital, but also highly skilled talent. Education reforms, particularly in **STEM** disciplines, will help build the next generation of local talent, but in the short-term, immigration reforms will help facilitate the entry of much needed specialist skills not available locally.

Skilled migration has been a key feature of Australia's migration system, playing an important role in generating economic growth for a number of successive decades. Australia has had a long history of supportive policies to attract business entrepreneurs. However, the rising global mobility of workers and heightened competition for talent means that it is important for Australia to have policy settings that are effective in attracting a critical mass of "new economy" skilled workers. These entrepreneurs will help generate new and sustainable business opportunities within the Australian economy into the future and every effort must be taken to attract and retain that talent.

The global search for talent is compounded by ever-more-rapid changes brought about by technology and innovation. Australia has to stay competitive if we want to attract and retain the best and brightest.

We support the government’s Global Talent – Sponsored and Independent Programs. While it is still early days in the lifecycle of these policies, we believe that they both represent a step in the right direction for our future. We also note the recently announced, Department of Employment, Skills, Small and Family Business, consultation on skilled migration occupations lists, which will play an important supporting role in identifying those specific niche skills that our national economy should prioritise in order to build our future growth.

Recommendation 5
Talent Visas

The Australian Investment Council believes that the Government should extend the talent visa program to enable employers to sponsor more than the current level of five entrepreneurs in the start-up stream.

As outlined in the *Australia 2030 Prosperity Through Innovation* report released by Innovation and Science Australia, growth in jobs and occupations requiring **STEM** skills are outstripping overall employment growth across the economy. While skilled migration will help to address skills shortages in the near future, building a workforce from within Australia with relevant **STEM** skills will contribute to employment and future economic growth.

Recommendation 6
Address future labour shortages

The Government address current labour shortages by funding institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital **STEM** skills.

In the longer term, building a pipeline of future employees with **STEM** skills from the Australian school system would help to increase the job prospects for Australians in the future.

Recommendation 7
*Fast-track the establishment of '**STEM** Schools'*

The Government embed **STEM** skills into the Australian School curriculum from primary school years through to tertiary education and fast-track the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

Australia has a strong record of attracting foreign students to our world-class tertiary education system. Many of these students arrive on visas that are valid for the duration of their studies, and then return to their home countries to develop their careers. This is a potential source of the skills needed to address labour shortages in the short to medium term.

Recommendation 8
Extend visas for foreign students

The Government extend visas for foreign students who graduate from Australian universities in disciplines where we have skills shortages, allowing them to stay and work in Australia to build a pipeline for our new, knowledge-based economy.

4. Equity co-investment

Some of the most promising developments for future economic growth are within the **VC** sector. These are companies at the early startup stage, as well as high-growth companies – those that have graduated from the startup phase and are now expanding their workforce, increasing sales growth and investing in significant research and development.

An extension of government equity co-investment initiatives into the fintech and regtech sectors could continue to foster local talent and nurture the growth of startups and scaleups. This type of co-investment could be modelled on the success of the Biomedical Translation Fund (**BTF**).

Recommendation 9
Encourage equity co-investment

Renewed consideration be given to government equity co-investment programs, modelled on the $500 million **BTF**. Such programs should be tailored to address partial market failures and be established to support the attraction of long-term potential capital from institutional investors.

Australia has seen a substantial growth in the number of corporates that have launched corporate venture capital (**CVC**) arms or innovation labs, marking the important role that large organisations can play in driving and nurturing Australia's innovation economy.

We believe that fintech and regtech startups and **SMEs** would greatly benefit from increased support from corporates and government through partnerships, grants and procurement.

Government equity co-investment through the introduction of new programs to attract greater public-private investment into high growth Australian companies would have a positive impact on productivity, jobs and economic growth.

Recommendation 10
Provide startups and SMEs with support through partnerships, grants and procurement

Further accelerate the growth in the number of **CVC** arms and innovation labs by incentivising more corporates to play a role as investors and customers. Encourage government entities to engage with startups and **SMEs** via targeted grants or other incentives such as partnerships or procurement agreements.

Regional Innovation Fund

There is currently a lack of capability and investment capacity to support new ventures and innovative businesses located in regional and rural areas of Australia, despite the fact that regional Australia contributes one third of our national output and is home to 8.8 million people. With the establishment of the Biomedical Translation Fund and overseas schemes such as the Opportunity Zones program in the US, the government has a blueprint for launching programs which couple government funding and private capital and direct it towards specific areas of need.

As an example, the need for investment in new technologies to make farming more viable and sustainable, can be seen in the growing number of AgTech start-ups that are progressing through incubator and accelerator programs with help from seed and early stage capital.

In the next few years, these new businesses will need further funding support, particularly from **VC** investment, to get to their next stages of growth. These businesses' innovative products and services have the potential to revolutionise Australia's AgTech sector which is predicted to be Australia's next $100 billion industry by 2030.

There is a tremendous opportunity to catalyse growth in regional and rural areas through the establishment of a regional innovation fund to capitalise on Australia's strengths in areas such as AgTech.

Similar to the **BTF**, professional fund managers would be eligible to manage the fund and invest it in the most promising companies and technologies. These areas should be given the same opportunities and resources to benefit and be a part of technology-driven changes within the economic landscape.

Recommendation 11
Launch a Regional Innovation Fund
A Regional Innovation Fund be introduced to stimulate and support the establishment and growth of startups, news businesses and industry sectors to catalyse economic growth of fintech and regtech in regional and rural areas of Australia.