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Senate Standing Committees on Economics  
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CANBERRA ACT 2600  
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Dear Senators

**Submission - Corporations Amendment (Crowd-sourced Funding) Bill 2015**

Please find enclosed our submissions on the Bill.

In light of the Treasury consultation process on the Crowd-sourced Funding (CSF) Regulation – we have taken account of the interaction with the proposed Regulation, but are conscious that it is still in the consultation phase.

Our firm has a group of market leading specialists in licensing, financial regulation, disclosure regulation, structured products, capital markets and technology whose expertise is highly relevant to start-ups, disruptors, fintech and finreg. This team has been consulting and collaborating with crowdfunding platforms, startup hubs, fintech innovators, tech-sector investors and major corporates who are interested in this space, and working actively with regulators and clients on new disclosure and regulatory models.

We would welcome an opportunity to discuss our submissions with you.

Yours sincerely

Shannon Finch  
Partner

## 1 Overall assessment

### 1.1 Thoughtful proposal – but should be regarded as a first step

The CSF Bill introduces a package of reforms that clearly reflect key regulatory concerns with retail crowdfunding, and are a thoughtful response.

It was essential to move quickly and make a start on reforms in this space, and it is pleasing to see Government making this issue a priority for reform.

The greatest risk of the CSF Bill is that few startups or platforms will use it, and it will not support the development of Australian start-up businesses.

If the CSF Bill is the only solution put forward – this market will not develop and Australian innovations will be commercialised elsewhere.

### 1.2 The Bill focusses on unsophisticated retail, and misses other stakeholders

Anecdotal feedback suggests that retail investors are keen to be get access to, and support, start-up investment opportunities – yet many are not well-placed to be investing in companies with a high risk of failure and uncertain prospects of returns.

The new disclosure and liability regime appears focussed on this class of inexperienced investors, and responds well to their needs and concerns.

However, the new regime does not address the needs of the start-up community. Most of Australia's start-ups will not be eligible to use it. For those that are – use of the regime will leave them with an expensive cost structure and an unmanageable investor base, for what is a very small scale business.

For crowdfunding platforms – the rationale for the regime makes a lot of sense, but its rigidity and prescriptive nature is likely to deter them from using it. The regime does not appear to take account of the concerns that the platform stakeholders raised during consultation.

## 2 Recommendations

### 2.1 Accessibility & coherence of the legislation

- Send the legislation for further consultation to see if it can be simplified. It is surprisingly complex and there are some difficulties ascertaining how it connects with other parts of the Corporations Act, and the Criminal Code.
- Simplify the proposed regulations, which effectively recreate prospectus-level disclosure, rendering the benefit of using the CSF regime illusory.

## 2.2 Improve the utility of the regime for startups

- Raise the limit for each investment under the CSF regime to \$20,000 to avoid creating large registers of small shareholders that are cumbersome and expensive to administer.
- Raise the limit on existing assets and revenue to \$10 million, so inexperienced retail investors are not always drawn into the most risky part of the startup market, and opportunities are available to retail investors for more established startups.
- Remove the “different treatment” of the broker-certified experienced investor category (under section 708(10)) – that is not an avoidance path for unsophisticated investors, it is the pathway used for smaller investments by significant high net worth investors, and it seems strange that it would erode the level of funds that can be raised through CSF.

## 2.3 Clarify the licensing arrangements

- Provide for a clear exemption from the Market Licence and other AFSL requirements where a platform meets certain criteria or operates within certain limits. This area of uncertainty is urgently in need of clarification.
- It would be preferable for a Crowdfunding Licence to be sufficient for CSF platforms in most instances, to cover the services and functions that most platform providers offer. There should not be uncertainty as to whether a separate AFSL or Market Licence is also required.
- Reconsider the “gatekeeper” obligations on the platform provider – this needs further industry consultation, and is an impediment to use of the regime.

## 2.4 Areas for broader consultation – expansion of the regime so that it better meets the needs of startups

- Test the restriction for use by listed companies – the rationale suggested in the explanatory materials (ie they can use streamlined disclosure to raise funds from their existing shareholders) does not justify it – and listing offers communication benefits and critical liquidity for small investors.
- Particularly if listed companies are then permitted to use the regime, include an exemption from section 707 for on-sale of these securities. The prescribed disclosure is effectively the same as a prospectus for an early stage company, so there is no reason for the prospectus-avoidance provisions of section 707 to apply.
- Re-prioritise the broader assessment of reforms to the proprietary company structure, reporting requirements and limitations - query why two forms of company are needed when this is now out of line with key international markets.
- Open up a consultation process for a simplified form of collective investment structure and licensing to better meet the needs of this market and manage retail exposure and to be more competitive internationally and more in line with other jurisdictions.
- Open up a consultation process on more effective ways to connect startups with high quality funding sources that can support and guide growth, and to connect startups with customers. The CSF Bill is not the solution.

There has been some resistance from the legal market to opening up some of these concepts, but given that there is an increasing need to be competitive in international markets, and for our regulatory structures to keep pace with international developments – we believe it is time to revisit some of these historical concepts to test whether they meet the needs of the participants in our market.

Our more general comments on the Bill follow.

### **3 Certain parts of the Bill provide a useful skeleton for a crowdfunding model**

#### **3.1 Useful elements**

The key elements or underlying principles of the framework for the new regime are useful, in particular:

- support for use of qualified intermediaries (although there has to be some benefit to them for taking on that role – the gatekeeper provisions look out of proportion to duties that other licensed intermediaries bear).
- streamlining of liability (although the resulting model is a little muddled, and probably leads to the same outcomes as the prospectus regime).
- streamlining disclosure (although the regulations may have defeated that objective – the resulting disclosure will be very similar to a prospectus for an early stage business).
- clarifying licensing requirements and responsibilities (although they should not be so onerous as to deter reputable platforms from offering services to this market).
- setting some investment limits for truly unsophisticated investors.

#### **3.2 Implementation of the elements is too complex**

In our view, those elements are the right issues to be addressing. However, the way they have been addressed has produced a complex, confusing outcome that needs to be refined and simplified for it to be accessible and effective.

It's using a hammer to crack a nut.

### **4 There are some real shortcomings, that may deter anyone from using this regime**

#### **4.1 Over-regulation will stifle the market**

It is easy to see the regulatory concerns that drove the inclusion of the various elements of the new regime, and they are valid concerns.

However, if those concerns produce overly prescriptive regulation, then it will have the result of stifling the market that the regime is seeking to support.

We have seen that already in the area of financial product advice, which led to so many major financial institutions closing down retail services altogether, leaving retail investors with poorer outcomes.

#### **4.2 Addressing the needs of the startup market**

The Bill also needs to address the needs of *all* stakeholders in the relevant market, to be effective.

While it addresses the regulatory need to limit the exposure of inexperienced investors to risky investment, it does not “fit” the startup community and does not address their needs.

Some particular aspects of this are highlighted below.

##### ***Public company regime is not suitable***

- The public company requirement is consistent with traditional Australian proprietary company restrictions, but there is no compelling policy basis for those restrictions. A more flexible, graduated regulatory framework would make more sense.
- Most startups that have less than \$5 million in existing assets and revenue and that are unlisted, are very early stage businesses.
- They are not suited to a public company reporting, and the costs of public company administration will increase ongoing costs at a time in their development when they can ill-afford it.
- Many successful tech businesses will only convert to a public company just before IPO.
- We would encourage reconsideration of this restriction, even if a broader consultation on other implications must be conducted.

##### ***Listed company restriction is misconceived***

- The CSF regime will not be accessible by listed companies, and the Explanatory Materials indicate that listed companies have access to other forms of streamlined disclosure, to raise funds.
- However, those forms of streamlined disclosure only enable them to raise funds from existing shareholders – to conduct a crowdfunding campaign, small listed companies would still need to issue a transaction specific prospectus.
- The policy reason for this limitation is also not clear – the listed status of a small company can improve liquidity for investors, transparency via the disclosure platform, and existing structures for managing an investor base.
- We would encourage reconsideration of this restriction.

##### ***A regime is needed that facilitates support from more than just unsophisticated retail***

- While it is good to respond to retail demand for some access to crowdfunding campaigns, it is more beneficial for startups to have a register with good representation from more

sophisticated investors, and investors who are likely to be a good source of ongoing funding.

- It would be preferable for any offering regime to be suited to conducting one offer that all can participate in (even if unsophisticated investors will have some limits), rather than having to run separate processes.

#### **4.3 Encouraging high quality platform providers**

In our view, encouraging CSF campaigns to be conducted via qualified platform providers is an important investor protection.

However, there has been a growing need to clarify the licensing requirements and obligations for CSF platform providers.

The CSF Bill provides a reasonable starting point, but there are some key aspects that need to be clarified, and there should be some reconsideration of the “gatekeeper” responsibilities.

Importantly – the requirements and obligations should not be more onerous than an AFSL, or the arrangements for simply providing a business introduction service (which has the benefit of class order relief). That would put CSF platform providers at a disadvantage to brokers and other investment intermediaries, including those that connect retail investors to other investment opportunities (which may be far more substantial). The compliance costs will be borne by the startups or the investors.

The risk of “overkill” in these requirements is that reputable platform providers simply will not use the CSF regime, and those that do may not take their obligations seriously.

## **5 Further consultation is needed**

This is an important initiative to get right. There are numerous points of detail to be addressed in the draft Bill, and there are a number of aspects that would benefit from industry consultation before being finalised.

We would welcome an opportunity to participate in consultation and to provide further detail around the points raised in this submission.

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