Simpliate

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By Electronic Website Submission

29 January 2016

Manager
Financial Innovation and Payments Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/ Madam,

Submission on Crowd-Sourced Equity Funding

We refer to the *Corporations Amendment (Crowd-sourced Funding) Bill 2015* (the **Draft Bill**), the *Corporations Amendment (Crowd-Sourced Funding) Regulation 2015* (the **Draft Regulations**) and the respective explanatory memorandum and explanatory statement thereto.

The Draft Bill will primarily amend the *Corporations Act 2001* (Cth) (the **Corporations Act**) and the Draft Regulations will amend the *Corporations Regulations 2001* (Cth) (the **Corporations Regulations**).

We welcome the opportunity to make the following submission in response to the above draft legislation.

We also act for Eureka Revolution Pty Ltd trading as Joey Crowd – a company which will act in the crowd-sourced funding sector within Australia.

Accordingly, this submission is made in our own capacity and on behalf of our client.

Executive Summary

A full discussion of the following submissions is set out in the Schedule to this submission.

In summary, we commend the Commonwealth Government on taking steps to make it easier and less expensive for small businesses, including start-ups, to raise equity finance (with appropriate protective measures).

However, in our view and experience, we submit that:

1. The $5 million issuer cap only include the current offer and amounts raised under previous offers.
2. The $10,000 retail client investment cap should apply on a per offer basis.
3. The limited governance requirements should apply for 5 years from the date of the earliest CSF offer.

4. The financial statements of companies which make CSF offers should only be required to be audited if consolidated revenues exceed $1 million provided that shareholders with at least 5% of the votes may require an audit.

5. Intermediaries be explicitly authorised to make CSF offers personally.

Should you require any further information or have any questions, please contact the author.

Yours Faithfully,

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Schedule – Detailed Discussion

1. $5 Million Issuer Cap

The proposed new section 738G(2) Corporations Act provides that there will be a $5 million issuer cap. This issuer cap includes the maximum amount of the current offer, the actual amounts raised under any previous offer made within the past 12 months and all actual amounts raised under ss 708(1) and 708(10) Corporations Act.

s 708(1) Corporations Act deals with personal offers and s 708(1) Corporations Act deals with offers made through Australian Financial Services Licensees. Importantly, the exceptions in:

(a) s 708(8) Corporations Act – dealing with subscriptions of more than $500,000 by sophisticated investors; and

(b) s 708(11) Corporations Act – dealing with professional investors; and

(c) s 708(12) Corporations Act – dealing with offers to certain associated persons.

N.B. We have not highlighted the relatively minor exclusions in ss 708(13), 708(15), 708(16), 708(17) and 708(17A) Corporations Act.

There does not appear to be any rationale to include the actual amounts raised under ss 708(1) and 708(1) Corporations Act but to exclude the other exceptions. In our experience, those exceptions are also relatively rarely used.

Such an approach leads to an inconsistency in the law (in that certain offers are included and others are excluded). That inconsistency will ultimately lead to greater compliance costs and a greater likelihood of inadvertent breaches of the law because companies and their directors would not be aware of the distinction between the different types of offers that may be made under the Corporations Act. These factors would be contrary to the intention to make it easier and less expensive to raise equity *without* any specific investor protection arising from the same.

For this reason, it is our respectful submission that the $5 million issuer cap should be limited to the maximum amount of the current offer and the actual amounts raised under any previous offer made within the past 12 months (i.e. retain ss 738G(2)(a) and 738G(2)(b) and delete s 738G(2)(c)).

2. $10,000 Retail Client Investment Cap

The proposed new section 738ZC Corporations Act provides that there will be a $10,000 investment cap for each retail client per intermediary per company in any 12-month period.

We understand that the rationale for the same is to protect retail clients and to limit the amount of exposure that any retail client may have to any particular company. However, this cap also encourages companies to "shop" among intermediaries in order to allow the maximum possible investment from previous investors e.g. if the company previously used Intermediary A within the previous 12-months then that company is encouraged to use Intermediary B for its next offer – this will enable any previous investors to again invest the full $10,000 cap if desired.

Looked at from this light, the investment cap is an unnecessary burden and actively encourages companies to find alternative measures to avoid this cap.

For this reason, it is our respectful submission that the $10,000 investment cap applies on a per offer basis i.e. the maximum amount that can be invested per offer of securities is $10,000.

3. Limited Governance Requirements

The proposed new section 738ZI(c) provides that a company is eligible for limited governance requirements if (among other things) the end of the current financial year ends less than 5 years after that company's registration.

This poses 2 potential problems:

(a) There will be a technical benefit for companies incorporated earlier in the financial year (e.g. 1 July) because they will be they only companies able to fully utilise the limited governance requirements.

For example, Company A is incorporated on 30 June 2015 whereas Company B is incorporated on 1 July 2015 (a 1 day difference). Assume that those companies satisfy the other limbs in s 738ZI Corporations Act.

It is now the financial year ended 30 June 2020. Company A was not eligible for the limited governance requirements in that financial year; whereas Company B is so eligible – this is despite the 1 day difference in their incorporation dates.

(b) This method discourages existing small businesses from using crowd-sourced funding as opposed to start-ups.

We note that according to the Australian Bureau of Statistics existing small businesses comprise 97.38% of all businesses in Australia.

The purpose of crowd-sourced funding is to make it easier and less expensive for small businesses (not just start-ups) to raise equity finance.

However, because the limited governance requirements apply from the date of incorporation (rather than the date that the earliest crowd-sourced funding offer is made) existing small businesses (especially those that have existed for over 5 years) are discouraged from accessing such funding.

For example, Company A is designs and manufactures components for a "smart connected" home. Company A has traded for the previous 5 years. Company A wishes to expand its range so that it can now offer an internet connected home. In order to do this Company A wishes to access crowd-sourced funding. Compared to a start-up, Company A is at a disadvantage because the limited governance requirements will not apply to Company A.

Accordingly, it is our respectful submission that the limited governance requirements should apply until the end of the financial year which falls on the 5th anniversary of the earliest crowd-sourced funding offer. N.B. This also coincidentally corrects timing issues for companies who do not adopt a standard financial year.

4. Auditing

The proposed new section 301(5) Corporations Act provides that a company does not need to audit its financial reports if the company is entitled to the limited governance requirements and it has raised less than $1 million from all crowd-sourced funding offers and other offers of securities that need disclosure to investors.

We note that this $1 million cap is unique to crowd-sourced funding and does not apply to any other form of company.

This can be compared to:

(a) Small proprietary companies (which many existing small businesses are) which do not have to prepare financial reports (and accordingly, do not have to audit them). For this purpose, small proprietary companies are those with:

(i) consolidated revenues of more than $25 million; or

(ii) consolidated gross assets of more than $12.5 million; or

(iii) more than 50 full-time equivalent employees.

(b) Small companies limited by guarantee which do not have to prepare financial reports (and accordingly, do not have to audit them). For this purpose, small companies limited by guarantee are those with revenues of less than $250,000.

(c) Other companies limited by guarantee which do not have to audit their financial statements unless their consolidated revenues exceed $1 million.

The addition of s 301(5) Corporations Act seemingly adds a further complication when deciding whether or not a company must audit its financial statements.

As discussed above, many companies which will use the crowd-sourced funding mechanism are likely to be small proprietary companies. In this context, the owners of those companies typically do not prepare financial statements that comply with Australian Accounting Standards (let alone audit them).

Accordingly, it will be a significant change for those companies to comply with the strict requirements of the Australian Accounting Standards. We note that those financial statements would also require that the relevant accountant sign a compliance statement in respect of the same. Accordingly, in that context, they would be completely unaware and not familiar with nature or obligations of an audit.

Accordingly, we suggest that in order to rationalise the law and make it consistent, crowd-sourced funding companies should be excused from auditing their financial statements unless their consolidated revenues exceed $1 million provided that shareholders with at least 5% of the votes may require an audit.

5. Crowd-sourced Funding Intermediary Also Being Offerer

Although not explicitly provided for in the Draft Bill, it is relatively clear from the structure of the Draft Bill and the explicit naming of the intermediary and the eligible CSF company being one and the same company.

As you are no doubt aware, crowd-sourced equity funding is a relatively novel form of equity funding worldwide (and completely unknown with Australia) – Australia is one of the first 15 countries to implement crowd-sourced funding worldwide and is within the top handful in terms of capital that may be raised from retail investors.

Accordingly, as a technology demo and in order to allow intermediaries to acquaint the Australian public with crowd-sourced funding, we respectfully submit that intermediaries should explicitly be permitted to make CSF offers personally.