



SUBMISSION TO CROWD-SOURCED EQUITY FUNDING

29 January 2016 |

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

Dear Manager

Schedule 1 to the Corporations Amendment (Crowd-sourced Funding) Bill amends the Corporations Act 2001 to develop a regulatory framework to facilitate Crowd-Sourced Funding (CSF) for small, unlisted public companies. This amendment covers the eligibility requirements for CSF, obligations for a CSF intermediary, the process of making CSF offers, rules relating to defective disclosure and investor protection provisions.

Marketlend believes that this is a step in the right direction. However, this is not nearly enough to make CSF viable for the majority of Australian businesses.

To begin with, let us analyse the policy background on this amendment. Firstly, the existing legislative arrangements create a limit of 50 non-employee shareholders for private companies, meaning that companies are not able to utilise the large number of smaller investors that typically develop an equities-based CSF campaign.

Public companies are not subject to this 50 non-employee shareholder prohibition, however they must undergo a strict level of corporate governance and adhere to reporting guidelines that tend to be too expensive for a small business. Where we make reference to private company, we are referring to a body corporate established as a proprietary limited company.

Pre-amendment, the ability for small businesses and start-ups to raise CSF is difficult. For a private company, they cannot utilise the benefits of CSF due to the 50 non-employee shareholder cap; a public company undergoes expensive compliance fees decreasing the incentive and efficiency of CSF.

The changes to CSF eligibility, as aforementioned, are a step in the right direction but are not nearly enough.

Limiting to public companies that are unlisted is insufficient in making any effect and is unlikely to enable strong participation by investors and companies in CSF.

Under the new amendment, an eligible CSF company is one that satisfies the following conditions:

"the company is a public company limited by shares, with its principal place of business and majority of directors in Australia [Schedule 1, Part 1, item 14, paragraphs 738H(1)(a), (b) and (c)]; Corporations Amendment (Crowd-sourced Funding) Bill 2015 14

- *the company satisfies the gross assets and turnover caps [Schedule 1, Part 1, item 14, paragraph 738H(1)(d)];*
- *neither the company, nor any related party, is a listed corporation [Schedule 1, Part 1, item 14, paragraph 738H(1)(e)]; and*
- *neither the company, nor any related party, has a substantial purpose of investing in securities or interests in other entities*

or managed investment schemes [Schedule 1, Part 1, item 14, paragraph 738H(1)(f)]."

This amendment only covers public companies that are limited by shares, unlimited public companies; and unlisted no liability companies. The issue here is that the majority of businesses that use CSF or seek to use CSF are small proprietary companies. The cost of becoming a public company often out-weighs the benefits of being able to use CSF to raise equity.

The amendment seeks to open a very small opportunity for companies to use CSF platforms and fails to offer investors the opportunity to invest in the majority of innovative start-up companies, because often those companies will be proprietary companies.

On a CSF platform, a company can only raise equity if investors believe that their investment will be profitable, either by capital gain, return on capital or both. It is our submission that the market will dictate itself as to what are the most suitable companies to invest in and their structure.

The inclusion of a proprietary company in the legislation is a must, but certain thresholds can be placed up those proprietary companies who want to use CSF. They can include financial reporting or other compliance measures.

Understandably, investors are sufficiently aware of the strength in difference corporate structures and there could be additional disclosure requirements placed on proprietary companies to ensure that investors are well aware of the risks that are unique to that structure.

The government legislature should be aware that the ultimate driver in a CSF will be subscription and share-valuation. This is something that is ubiquitous within any unlisted company, public or proprietary. Internally, this can be solved with the company employing DCF analysis, internal rates of return, or any of the other various methods. However, it is essentially an agreement between the shareholders and the company as to what the valuation is, whether it is on the basis of present and past performance or growth, or what is the value as determined by the seller and accepted by the buyer, being the investor.

In the case of CSF, the legislation needs to allow the company to enable this to be something that is determined by market forces, and not by a prescriptive format within the legalisation. Start-up companies, the main users of CSF platforms globally, are constantly in a bind as to what is the valuation, but the final determination comes down to what the market is willing to accept.

Amendments to S738H

An eligible CSF company should include a proprietary company, with at least two company directors residing in Australia.

To require the majority of company directors to ordinarily reside in Australia could be difficult to interpret and also in small start-up companies may not be possible.

Amendments to Section 611

We submit that the changes to this section do not assist in the interpretation of the document or improve the provision for CSF offer documents. It could actually place further confusion as to the meaning of what is an IPO.

Amendments to Section 738C

It is our submission that if a financial services licensee regulatory environment has made provision for authorised representatives of the financial services licensee, then that should be included in the legislation. Also that if a financial services licensee has a licence to:

- a) arrange for a person to deal in a financial product,
- b) issue apply for, acquire, vary or dispose a financial product, on behalf of another or itself,

further authorisation is not necessary.

By adding the present amendments, the risk is that further authorisation is needed. Consequently it may be that a well-established regulatory environment for obtaining Australian Financial Services licences will need to be amended to deal with it.

By considering this amendment, a quick solution for CSF platforms is available, as established licensees would be able to immediately operate CSF platforms.

CSF Intermediary roles

The amendment also introduces new regulations regarding the roles and obligations of a CSF intermediary. Firstly, it requires the CSF intermediary to hold an AFSL. It requires CSF intermediaries to also have gatekeeper obligations with regards to publishing the offer document of an issuer company on its platform; the obligation to provide a communication facility within the platform; the obligation to display the risk warning and to appropriately disclose fees regarding the issuer company. As a company that fills all of these requirements of a crowd-sourced lending platform, Marketlend believes that these gatekeeper obligations are extremely important for the future of CSF. Without proper regulation on CSF intermediaries, the possibility for market failure or mismanagement exists and can threaten the many benefits of CSF.

S738G - Eligibility requirements for a CSF offer need to be increased

In summation, an eligible offer is one that complies with the issuer cap, is originating from an eligible CSF company, and does not intend for the funds sought by the company to be used to invest in securities or interested in other entities or investment schemes.

The most interesting aspect of this eligibility requirement is the "issuer cap". The issuer cap is \$5 million in any 12-month period, with the ability to increase the cap depending on the success of CSF. This is relatively reasonable in the current landscape of CSF funding, however in the future, this may be insufficient, especially for larger businesses and start-ups. We acknowledge that this \$5million-dollar cap exempts offers from sophisticated investors; those with net assets of \$2.5 million or a gross income of \$250,000. This means that companies can employ CSF and private investment, which is highly beneficial for start-ups that are looking to access funding from wholesale investors. Realistically, and to prevent the advent of further amendments, an issuer cap of \$15million may be more likely to meet recent market needs.

Another important feature of this amendment is the introduction of a retail investor cap per Issuer Company of \$10,000. Realistically, this is too small and could be a significant deterrent to the majority of issuers. We recognise that there is a concern that a retail investor could put a significant investment into one company that would significantly expose them to financial ruin. As a suggested solution, a means test could be applied so that a retail investor is not able to invest any more than a certain percentage of his net worth to one investment, in order to mitigate risk.

S738M Consents needed for publication of CSF offer document should not include proposed directors consents

We don't think it is appropriate or realistic to set the requirement similar to that of a public company for the consents. To require that the proposed directors of a company consent to the CSF offer document places an additional hurdle and compliance costs that are unnecessary and unlikely to protect the investor.

We are talking about companies that are not worth more than \$5million in assets. A lot of these companies will have only a handful of directors with little direction on proposed directors.

Furthermore, this could cause a blockage in the process where proposed directors, who can typically be investors, may delay or restrict the company from its operations by refusing consent.

If you want to discuss or need more information relating to this submission please contact Marketlend on 02 80064649 or administrator@marketlend.com.au

Kind regards,

Marketlend