



Australian Government

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Crowd sourced equity funding

Guide through the CAMAC report

This guide is designed to assist in understanding the approach and proposals in the CAMAC report *Crowd sourced equity funding* (May 2014).

1 General considerations

The CAMAC report sets out a detailed regulatory blueprint for the stimulation of the innovative start-up and other small-scale enterprise sector of the Australian economy through internet-based funding.

A legislative initiative to facilitate crowd sourced equity funding (CSEF) has the potential to promote productivity and economic growth in Australia, provide employment opportunities and return financial and other benefits to crowd investors. Equally, lack of a supportive local regulatory environment for CSEF may result in worthwhile Australian entrepreneurs incorporating in other countries, or moving their businesses offshore, to enable their ideas or projects to be funded by the crowd.

CAMAC's proposals are deregulatory in that they seek to overcome current legal impediments to Australian companies (issuers) raising funds through CSEF. However, in the view of CAMAC, for this form of corporate fundraising to operate in the best interests of investors as well as issuers, a regulatory structure specifically designed for CSEF needs to be developed. The elements of this proposed structure are set out in this report.

CSEF is a world-wide phenomenon, given the global reach of the internet and the capacity of issuers to make offers to crowd investors wherever located. In developing its proposals, CAMAC has closely considered recent initiatives in key overseas jurisdictions, including the USA, Canada, the United Kingdom and New Zealand, as well as developments at the European Union level. While each jurisdiction, including Australia, is entitled to forge its own regulatory path, there is a strong benefit in seeking broad cross jurisdictional regulatory guidelines, to which Australia can make a useful contribution.

CAMAC has sought in its proposals to achieve a regulatory balance that takes into account the legitimate perspectives of issuers and crowd investors, as well as the online intermediaries that will host the offers to the crowd. For instance, for innovative start-up and other projects to stand a reasonable chance of success and to

reward their crowd investors, their promoters and controllers should principally focus on using their time, vision and skills to develop the project, not disproportionately on legal compliance. Equally, however, the success of CSEF for issuers rests on the level of take up of equity offers by crowd investors. Sustainable growth, productivity and competitiveness through CSEF are only possible if investors have confidence in investing through that process.

Various proposals in the report involve monetary maximums or caps. For instance, CAMAC proposes limits on how much an issuer may raise, or a crowd investor may expend, through CSEF in any 12 month period. The specified figures have been chosen from the perspective of CSEF being principally designed for, and to be utilised by, the innovative start-up and other small scale enterprise sector of the Australian economy. However, any monetary cap can be arbitrary in some respect, and there is always room for discussion on where caps should be set. Also, caps could be adjusted in light of experience with CSEF, if introduced.

These, and other, general matters affecting CSEF are further discussed in **Chapter 2**.

2 How the proposals would affect issuers

The corporate form

The concept of CSEF is aimed principally at facilitating online fundraising by start-up and other small scale enterprises. Typically, such enterprises would in the past have been incorporated as proprietary, rather than public, companies. Nevertheless, for a start-up or other small scale enterprise to raise funds through CSEF, CAMAC considers that it should be a public company, given that it will be making an offer to the public, in the form of the online crowd, and will have those members of the public who accept the offer as its shareholders. However, to overcome the current disincentives on promoters to form a public company, a new classification of ‘exempt public company’ should be created. An eligible issuer could choose to be a public company or an exempt public company.

Some of the key features of this proposal are:

- ***becoming an exempt public company***: an intending CSEF issuer could be incorporated as an exempt public company, or an existing proprietary or public company could change to an exempt public company in some circumstances
- ***compliance exemptions***: an exempt public company would be relieved from some of the compliance requirements for public companies during the period of exemption
- ***shareholder rights***: every CSEF issuer (whether a public company or an exempt public company) would be subject to specific disclosure requirements concerning the rights that it will attach to the shares offered to the crowd and how those rights compare or contrast with the rights attached to any other shares that the company has issued or can issue

- ***expiration of the exempt status***: the exempt public company status should automatically expire in certain circumstances or at the expiration of a prescribed maximum period (with a limited exception), after which the issuer would become a public company, subject to all the compliance obligations of that type of company.

For instance, in regard to shareholder rights, CAMAC considers there may be good reason for not having a one-share one-vote equity structure, but having, say, a separate class of ‘founder’ shares, with voting, dividend and other rights that permit these shareholders to remain in control of the enterprise (on the argument that they are the persons with the ‘vision’ and the skills to make the enterprise successful) and to receive a ‘premium’ return from any profits generated (on the argument that this premium reflects the ‘financial value’ of their ideas, over and above the capital contributed from the crowd). However, issuers should be obliged clearly to set out the comparative rights (or lack of rights) of shares they are offering to the crowd, to avoid potential investors being misled and to assist them to compare the shareholder rights being offered by different issuers, for the purpose of making investment decisions.

These, and other, matters are further discussed in **Chapter 3**, with a guide through the chapter in Section 3.1.

The crowd fundraising process

It is proposed that an eligible issuer may seek funds from the crowd by offering its equity through a licensed online intermediary, provided:

- the offer does not exceed the issuer cap of \$2 million in any 12 month period
- the offer disclosure requirements are complied with
- the controls on advertising are complied with
- the issuer does not lend to crowd investors to acquire its shares
- any material adverse change concerning the issuer is notified.

For instance, in regard to the offer disclosure requirements, CAMAC proposes a standard issuer disclosure template be developed, specifically tailored for this form of corporate fundraising. This approach would:

- provide clear structured guidance to issuers on what they need to disclose to the crowd about themselves and the terms of their offer. This can be particularly helpful to start-ups, given that their controllers may have had little or no experience with fundraising from the public and may have little idea of what is expected of them in this regard
- assist crowd investors to more easily compare offers from different issuers, given that all offers would have to follow the same disclosure format.

In the view of CAMAC, this is an instance where greater (but not undue) disclosure prescription may be in the interests of all involved parties.

These, and other, matters affecting issuers are further discussed in **Chapter 4**, with a guide through the chapter in Section 4.1.

3 How the proposals would affect intermediaries

It is proposed that each equity offer to the crowd be conducted through one licensed intermediary only, operating online only. The issuer would choose the intermediary, subject to the intermediary agreeing to host the issuer on its website.

The CAMAC proposals seek to engender issuer and investor confidence in the CSEF process by requiring intermediaries to take a fully professional approach to their role, including to:

- conduct limited due diligence checks on issuers
- provide a generic risk disclosure statement to crowd investors
- check compliance with investor caps in some instances
- provide communication facilities between issuers and investors
- disclose the fees they charge.

In complying with these requirements, intermediaries would benefit from significant economies of scale as more issuers are hosted on their platforms, thereby reducing their compliance costs.

In addition, intermediaries would be prohibited from:

- engaging in conflict of interest situations, including having an interest in the issuer or being paid in shares of the issuer or according to the amount of funds raised
- providing investment advice to crowd investors
- soliciting crowd investors to accept CSEF offers on their websites
- lending to crowd investors to acquire shares offered on their websites.

For instance, the proposed prohibition on intermediaries providing investment advice or soliciting would include such things as tabs on their websites such as ‘Staff picks’, ‘What’s hot’, or pro-active suggestions, such as ‘You might like this...’, or ‘Your friend liked this; check it out’.

These, and other, matters affecting intermediaries are further discussed in **Chapter 5**, with a guide through the chapter in Section 5.1.

4 How the proposals would affect investors

CAMAC puts forward various proposals to facilitate opportunities for internet users to take up equity, while giving them various protections, including risk warnings.

They include:

- any person of legal capacity can be a crowd investor

- a crowd investor be limited to investing \$2,500 per issuer, and \$10,000 for all issuers, in any 12 month period
- crowd investors must acknowledge the risk disclosure statement before investing
- crowd investors have cooling-off and other withdrawal rights
- share resale restrictions apply only to persons associated with the issuer.

In regard to the investor limits or caps, CAMAC does not support any sanction being imposed on an investor who breaches an investor cap. Rather, these caps constitute formal recognition of the financial risks for crowd investors that are inherent in CSEF, given that in many instances they, in effect, are being asked to finance innovative projects that do not have the level of maturity that traditional financial market sources require. Such caps can act as a brake on excessive investment by most crowd investors, even if the cap is inadvertently or intentionally breached by particular investors in some cases. Investor caps strongly reinforce mandatory risk disclosure statements to crowd investors and their acknowledgement of those risks.

There should be no resale restrictions on shares acquired by crowd investors. Any secondary market in these shares should not be discouraged. However, to counter the possibility of crowd investors being the victims of a share ‘pump and dump’ exercise, there should be a ban on directors or other persons associated with the issuer selling a significant proportion of their equity holding in the issuer within a prescribed period of any CSEF offer by that issuer.

These, and other, matters affecting investors are further discussed in **Chapter 6**, with a guide through the chapter in Section 6.1.