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Australian Securities & Investments Commission

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Manager
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By email: csef@treasury.gov.au

Dear Sir/Madam

Treasury's discussion paper on crowd-sourced equity funding

I am writing on behalf the Australian Securities and Investments Commission (ASIC) to provide comments in response to Treasury's discussion paper on crowd-sourced equity funding **(CSEF)**.

ASIC has taken a keen interest in the growth and development of crowd funding for investment purposes and makes these comments in light of our experience as the regulator responsible for financial services licensing, equity investments and markets matters.

Our primary interest in the regulation of this potential source of funding for small businesses and start-ups is to ensure an appropriate balance between the effective administration of CSEF and the need for investors to be confident and informed.

Confident and well-informed investors are more likely to continue to participate in CSEF, which is important in ensuring that CSEF becomes a sustainable funding option for businesses in the long term.

The key issue from ASIC's perspective is to limit CSEF to small business fundraising by imposing a cap on the maximum amount to be raised, and to limit the exposure of investors by imposing an annual cap on investments (both total investments and per issuer). This is because of the risks of CSEF we set out below.

Risks associated with crowd-sourced equity funding

CSEF by small businesses and start-ups is considered to be a very high-risk form of investment. The risks involved with small businesses and start-ups are the main reason they have difficulty obtaining funding from banks or sophisticated investors.

CSEF also lacks the transparency and liquidity associated with the more traditional forms of investment that retail investors are accustomed to such as, for example, investments in large well-established companies that have a track record of profit-making, public reporting on financial results, and meeting their obligations to shareholders and creditors.

Issuers

CSEF has been considered as a potential new source of funding for small businesses and start-ups. This is generally the reason why many CSEF regulatory regimes overseas have placed a cap on the amount that can be raised through CSEF by issuers. Placing a cap of $2-5 million would seem appropriate for any Australian based regime. Not only is this amount generally sufficient for small businesses and start-ups, it also ensures that any regulatory reform to facilitate CSEF by these types of businesses does not become an attractive fund raising mechanism for larger more established business that have access to traditional forms of fund raising and for whom CSEF is less appropriate.

Investor protection

The regulatory safeguards used for CSEF need to take into account the potential risks posed by CSEF and the types of investor who want to participate.

Limits on the amounts each year that can be invested through CSEF in total or per issuer are a common feature of many overseas CSEF regulations, to guard against the risk of some investors being overly exposed to CSEF generally or in a particular company. We consider a cap on amounts that investors can invest in CSEF investments would be an appropriate feature of any CSEF regime in Australia. Administering a cap need not require complex regulation. It could be as simple as requiring an investor to certify they have not exceeded any relevant thresholds and Intermediaries' IT systems not allowing investors to breach the caps.

ASIC would also encourage careful consideration of investor protection mechanisms such as the inclusion of a prominent warning indicating that investors in a CSEF arrangement may lose all of the funds they invest, a requirement for investors to acknowledge this risk via the CSEF platform before investing, and a requirement that investors be presented with an optional knowledge test.

In the event that a regulatory framework for crowd-sourced debt funding is implemented, ASIC considers that significantly enhanced investor safeguards will be necessary to reflect the different types of investors that might be interested and address their expectations, for example, of being repaid the principal and interest.

Intermediaries

Given their pivotal role in CSEF, it is important that the intermediaries operating the online platforms through which investors and issuers participate are adequately resourced and subject to appropriate regulation.

Generally, ASIC considers the AFS licensing regime to be appropriate for this purpose. However, CSEF arrangements are not always uniform. Therefore, if adopted in Australia, other forms of regulation may be more suitable for some types of CSEF arrangements. For example, it may be more suitable in some circumstances to require an issuer to hold an Australian market license and/or comply with regulations that apply to registered managed investment schemes.

As an AFS licensee, in addition to the obligations to ensure that its services are provided efficiently, honestly and fairly, an intermediary would need to have in place arrangements for managing conflicts of interest, and adequate risk management and dispute resolution systems. ASIC also has the power, in some circumstances, to impose conditions on, suspend or cancel an AFS license.

ASIC supports requiring intermediaries to provide investors with information that will assist them to make an informed decision, e.g. providing general information about CSEF and the CSEF platform they operate. ASIC also supports requiring intermediaries to perform certain clearly defined due diligence checks on issuers before giving them access to the platform.

Our role as regulator of crowd-sourced equity funding

In the event that ASIC had responsibility for the regulation of CSEF, we anticipate further resources would be required in order to change ASIC's systems and procedures to suit any new regime and to provide guidance to businesses and investors.

Given that CSEF will involve a large number of smaller value offers, regulatory oversight will very likely need to be on a risk-targeted basis.

In the interests of transparency, it should also be made clear that ASIC does not regulate all crowd-sourced funding activities, only crowd-sourced funding activities associated with financial products such as securities.

Further consultation

ASIC is available for further consultation on this topic as needed.

Yours faithfully

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