

5 February 2016

**Mills Oakley**  
ABN: 51 493 069 734

All correspondence to:  
PO Box 453  
Collins Street West  
MELBOURNE VIC 8007

Dr Kathleen Dermody  
Committee Secretary  
Senate Standing Committees on Economics  
PO Box 6100  
Parliament House  
Canberra ACT 2600

**Partner**  
Mark Bland +61 3 9605 0832  
Email: mbland@millsOakley.com.au

**Email:** economics.sen@aph.gov.au

Dear Dr Dermody

### **Corporations Amendment (Crowd-sourced Funding) Bill 2015 (CSF Bill)**

Mills Oakley values the opportunity to make a submission on the CSF Bill. Our comments focus on the aspects of the bill relating to CSF intermediary and the Australian financial services licensing regime.

#### **1. Risks of conflicts arising from the dual nature of “Crowd-funding service”**

Under the CSF Bill, the CSF intermediary would be providing the financial service of “crowd-funding service” to both parties to a transaction: the issuer of securities and the investor, potentially both as retail clients.

We are concerned that the CSF Bill would put a CSF intermediary in such a position of actual and potential conflict of interest and duty that it would undermine the object of the CSF Bill.

It is noted that the CSF Bill intends to split out each financial service to two different events in timing. The service is provided to the issuer when the issuer enters into the contractual arrangement with the CSF intermediary; the financial services provider to the investor at the time the person first uses the application of facility to apply for an offer. However it also states that a crowd-funding service is also taken to include performing all aspects of the role of CSF intermediary as required under the CSF regime (s766F(2)). Accordingly, it appears that a CSF intermediary will be simultaneously be providing financial services to each party of the transaction.

ASIC’s Regulatory Guide 181 *Licensing Managing conflicts of interest* notes that in addition to the statutory obligation to have adequate arrangements for the management of conflicts of interest that arise in relation to the provision of financial services by the licensee (s912A(1)(aa)), a licensee would also have obligations under the common law. One such obligation includes fiduciary obligations as a trustee (RG181.19). As the CSF licensee will need to hold application monies on trust for applicants, it will be in a fiduciary relationship with the investor.

The underlying principles of RG 181 are that conflicts of interest, if not properly managed, can harm the client, reduce the quality of the service and diminish confidence in the licensee or market.

#### **NOTICE**

The information contained in this email/facsimile is confidential and intended only for the use of the addressee and it may also be privileged. If you are not the intended recipient, any use, disclosure or copying is prohibited. If you have received this email/facsimile in error, please telephone the sender and return it by mail to the sender.

We recommend an amendment to the CSF Bill to provide that “crowd-funding service” is defined such that it only applies to the services provided by the CSF intermediary to the investor and not the services provided to the issuer.

This amendment would require a consequential amendment to item 26 of Schedule 1 of the CSF Bill to preserve the exemption from the financial service of dealing.

## **2. Onerous obligations on a CSF intermediary**

In the Regulation Impact Statement in chapter 9 of the Explanatory Memorandum, it is stated that the regulatory compliance cost of option 4 (the option implemented by the CSF Bill) is \$54.6 million. One might think that most of this will apply to the CSF intermediary which is effectively put in a position of de facto regulator of the CSF regime.

In addition to the costs of managing the conflicts of interest, there will be considerable costs in conducting due diligence on each issuer, both up front and ongoing due diligence to manage a CSF intermediary’s liability for any misleading or deceptive conduct or a defective CSF offer document. Inevitably, being subject a strict liability offence for a failure to conduct tests against the standard of reasonableness, prudent risk management may lead to costs that are underestimated by the Regulatory Impact Statement.

There a number of things the CSF Bill does not deal with which will likely cause greater compliance costs. For example:

- (a) The financial requirements of a licensee are typically set by ASIC through licence conditions. We expect that ASIC will impose a net tangible asset requirement of somewhere from \$150,000 to \$5m to a CSF intermediary. This would be a significant barrier to entry for CSF intermediaries.
- (b) It is not clear how the advertising regime, in particular the advertising restrictions and risk disclosure requirements, intersects with financial product advice laws, in particular general advice, which is often given in the course of advertising.
- (c) Any general advice provided a CSF intermediary may trigger the prohibition against conflicted remuneration. This will impact on the flexibility of fee arrangements proposed to be accommodated by the CSF regime.
- (d) The competency and qualification requirements that ASIC may require of a CSF intermediary are not known.

While a number of the matters listed above are properly excluded from the CSF Bill, because they are matters generally determined by ASIC, they are key factors to the achievement of the object of the CSF Bill. They present potentially significant barriers to entry for CSF intermediaries, without which there will be no crowd-sourced equity funding.

## **3. “Related party” and the collaborative economy**

The definition “related party” includes an “associate” as defined in sections 10 to 17 of the Corporations Act. Under these clauses, two parties acting “in concert” will be associates. We are concerned that this will present structural challenges and additional costs because it will restrict the collaborative approach that is a defining feature of crowd funding culture.

If you have any questions or require further information please do not hesitate to contact Mark Bland on +61 3 9605 0832 or [mbland@millsoakley.com.au](mailto:mbland@millsoakley.com.au)

Yours sincerely

**MARK BLAND**  
**PARTNER**  
**FINANCIAL SERVICES**