DALE ADVISERS
Strategy & Funding Solutions

81-83 Campbell Street Surry Hills NSW 2010
contact@dale-advisers.com.au
www.dale-advisers.com.au

Dale Advisers Pty Ltd ACN 104 635 430
Australian Financial Services Licence 298916
ABN 84 831 916 162

Director
Investment Funds Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

29 January 2024

Re: Review of the regulatory framework for managed investment schemes

I am making a late submission to your inquiry because the proposed change to the sophisticated investor rule would have a very bad side-effect on the startup ecosystem.

It is clear that damaging the startup ecosystem is not your intent:

- the name of your inquiry only mentions managed investment schemes, not investment in startups for shares, and
- your consultation paper does not mention anywhere the words: "startup", "ESIC", "early stage investment company", "angel investor", "venture capital". "crowdfunding", etc.

The problem is the sophisticated investor definition ('wealth test'), and the Corporations Act in general, do not differentiate between types of investment, or the knowledge and skill involved in making the investment. There is a world of difference between:

- a semi-retired couple who own their home, with substantial savings in an SMSF and term deposits, reading a managed investment scheme IM and being tempted by the promises of high returns with liquidity; and
- a mid career professional, who may be paying off their home or renting, but has sufficient spare income to risk modest investments ($20 - 50K p.a.) in 1 – 2 startups p.a., for the possibility of very high returns in perhaps 10 years, but with a 50% chance of write-off.

The former relies on what the promoters claim and they need to be advised. The latter knows startups are high risk and the future is unpredictable. They do due diligence and validate what they can before investing. They may also ask experts they know for advice. They may also try to help the startups they invest in, using their technical or business expertise to improve the odds. The role this unpaid army of individual investors play, whether they call themselves angel investors or not, is extremely important to early-stage startups, and also to venture capital fund managers, who often can't invest small deals in the earliest stages, either because they don't have the mandate, or the time and resources to do all work.

Most startups are proprietary limited companies, as such they cannot issue prospectuses to the general public. To raise capital they must rely on personal approaches to individuals and venture

capital funds, which is usually a long and time consuming process. They are limited by the 2/12/20 rule as to how many retail investors they can raise from (wholesale investors don't count towards the limit). They are also limited to a maximum of 50 shareholders, so startups often need individuals to invest via collective investment vehicles like platforms and special purpose unit trusts. While technically managed investment schemes, the purpose of these vehicles is to preserve space on the share registry of startups, and to provide startups and investors with an efficient mechanism for shareholder governance and reporting. When operated as a crowdfunding platform, they also greatly extend a startup's ability to reach more potential investors. Yes there may be fees involved with these "schemes", but no one is promising investment returns or liquidity. Everyone knows investing in startups is high risk and returns, if any, are years away.

Any rule which reduces the number of people who can invest in startups, or makes it more difficult and expensive, is in my view a bad rule. In relation to startups, the wealth test doesn't protect anyone (it is not the semi-retired couple who are likely to invest in startups), and it reduces the benefits to society that a thriving startup ecosystem provides. In contrast, I agree there is a case for limiting access to opaque and technically complex managed investment schemes featuring layers of fees and slick promotion. But we need rules that recognise the difference.

If we must have rules to limit access to investment in startups (by the way, what happened to personal freedom and responsibility, and informed consent?), then they should be based on the knowledge and experience of the investor, not a blunt and unreliable instrument like a wealth test. I suggest that any of the following on their own would be sufficient if a wealth test is not satisfied:

- previous investment in startups, at least one in the last three years;
- active membership of an angel investor group or network that promotes good investment practice and runs programs to educate its members;
- completion of a credentialled startup investment education program or course;
- the existing experienced investor exemption, as assessed by an AFSL, in their professional judgement, based on evidence, at their risk.

All of these are objective criteria, easily supported with evidence, and for the case of investing in startups, much more useful than the wealth test.

Yours sincerely,

Richard Dale
DIRECTOR

Tel: 0415 997 104