23 January 2024

By email: misreview@treasury.gov.au

Dear Sir/Madam

Flying Fox submission to the review of the regulatory framework for managed investment schemes: Consultation Paper (August 2023)

Introduction

Flying Fox Ventures Pty Ltd ACN 633 845 217 (**Flying Fox**) manages an investment syndicate for wholesale investors interested in high growth, early stage technology companies. Two other entities in our group have recently been granted Australian Financial Service Licences (Flying Fox Nominees Pty Ltd and Flying Fox Licensee Pty Ltd). Flying Fox has been operating since 2019, has more than 60 companies in its portfolio and has had over 400 wholesale investors invest through it.

While Flying Fox very clearly has a vested interest in the wholesale investor threshold tests, we would nevertheless like to make submissions in relation to Chapter 1 of the Consultation Paper, given the depth of our experience in the small but important niche of startup investment which is likely to be deeply impacted by the proposed changes.

Introductory comments

Flying Fox was formed to address the significant "seed funding gap" that has and continues to exist here in Australia. Australian per capita investment in early stage technology businesses is far below its OECD counterparts. Over the last 5 years, many businesses and platforms similar to Flying Fox have grown to offer these investment opportunities to wholesale investors, which in turn, has served the dual purpose of building a more robust and thriving ecosystem of young, high growth technology companies. In addition, leading universities have invested significantly in education programs to increase the number of informed technology investors in our ecosystem - Melbourne University's Wade Institute (where Flying Fox partner Rachael Neumann is the Lead instructor) and the University of New South Wales Angel Investor Program (where Flying Fox partner Kylie Frazer is a core contributor) are leading the charge here. These innovations have resulted in:

- Record numbers of Australian angel investors - many of whom have had university accredited education
- Businesses like Flying Fox being able to offer access to companies at a low minimum investment amount - while our average cheque size per investor is just under $10,000 per company, we have taken as little as $1,000 from investors.
- Total startup ecosystem value for Sydney and Melbourne seeing 5-year growth of 50% and 43% respectively

As all early stage startup investments are by definition high risk and highly illiquid, having a diversified portfolio is key to success. Being able to 'fractionalise' startup investments - making smaller, more frequent investments - has been an important development in the Australian innovation ecosystem to provide both access to the asset class, and increase the statistical probability of achieving outsized returns.

Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?

We accept that there may be valid policy considerations to increase the thresholds to protect retirement savings and remain in line with inflation. However, wealth is a blunt measure of financial sophistication. While many of our peers have submitted guidance on whether thresholds should be increased, we offer three considerations outside of the income/asset means test that warrant additional consideration in the totality of this important decision.

Pathways for Non-Means tested Accreditation

It is not controversial to state that wealth is a blunt measure of financial sophistication. The USA has recognised this and passed legislation to enable the SEC Accredited Investor exam. A knowledge pathway to wholesale investor status seems to make sense for Australia.

An exam for across-the-board wholesale certification is certainly an option. Australian regulators however, can avail themselves of the already-existing excellent education offering available to investors in the startup investment space. We suggest that the easiest way to do this is to provide greater guidance on the relevant considerations to the section 761GA sophisticated investor test (which should in turn also be applied to Chapter 6 and other parts of the Corporations Act where the wholesale/retail distribution is relevant).

Flying Fox has never relied on section 761GA to accredit an investor as 'sophisticated'. We simply did not know what reasonable grounds for certification would be and have been unwilling to take on the risk. Guidance from the regulator as to what considerations are relevant for this test would be hugely beneficial. For example the guidelines could:

- Suggest annual financial thresholds for investing through a singular platform (say, $100,000 per given time period, with no more than $10,000 on a single deal)
- Refer to university education programs as evidence of experience
- Recognise sector experience (both as an investor, but also working at a venture-backed startup) as a relevant consideration
- Recognise that investments that are clearly marketed as high risk and highly illiquid do not pose the same threat to retirement savings as investments that are marketed with redemption periods

If the thresholds are materially increased, a likely consequence will be that businesses like Flying Fox will be unable to keep their minimum cheque sizes low. Access will become more expensive and risk will increase and concentrate.

Expanding the timeframe for Means-Tested Eligibility

The existing thresholds already frequently penalise and exclude women significantly more than men. We have had dozens of women investors who cease to satisfy the income test as they take parenting leave. This continues to act as a barrier to correcting the problematic under-representation of women investors that plagues the asset class. We would suggest that any income test be applied over a number of years, for example, that a person must satisfy the income test for 2 of the last 5 years. As per the section above, accreditation on the grounds of experience and/or education will provide an additional pathway for women to access these investment opportunities with equal measure to their male counterparts. Any changes to the policy must take into consideration the potential - and likely unintended negative impact - it will have on women, while the industry is simultaneously seeking to close the gender gap in the investment space. The benefits of closing this gap extends beyond the financial benefit of the individual female investor and unlocks broader societal benefits including financial empowerment and independence, as well as seeing more female founders access capital to support their growing businesses.

Grandfathering

Other submissions have referenced the need to grandfather existing investors. Any grandfathering arrangements need to take into account the longer time frame applicable to start up investments (sometimes over 10 years to realisation).

If the thresholds are increased, many of our investors will be ineligible to make further investments into the companies they already have interests in, as well as continuing to diversify their startup portfolio. This will impact the strategy many of our investors have set out. Many investors prefer to invest a small amount in a company's first funding round, securing the ability to invest in a later round when the company has more revenue and is somewhat derisked. Ideally any grandfathering would preserve the ability of investors to access these pro rata rights, and continue to execute the portfolio strategy they devised when starting their investor journey.

We thank you in advance for your consideration of this submission, and remain available for any further discussion as desired.

Yours faithfully

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