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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

CORPORATIONS AMENDMENT (CROWD-SOURCED FUNDING FOR
PROPRIETARY COMPANIES) BILL 2017

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Scott Morrison MP)

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
CSF	Crowd-sourced funding
ASIC	Australian Securities and Investments Commission

General outline and financial impact

Overview

Crowd-sourced funding (CSF) is an emerging form of funding that allows entrepreneurs to raise funds from a large number of investors. Legislation to create a CSF framework for public companies will commence on 29 September 2017. Extending the CSF framework to proprietary companies will allow these companies to access an alternative form of finance with additional obligations that will protect investors.

Date of effect: The amendments in Part 1 of Schedule 1 to extend the CSF regime to proprietary companies will take effect the day after the end of the period of six months after Royal Assent. The changes to the CSF regime for public companies in Part 2 of Schedule 1 take effect from the day after Royal Assent.

Proposal announced: The proposal was announced as part of the 2017-18 Budget. Public consultation on the draft legislation occurred between 9 May and 6 June 2017.

Financial impact: The measure has the following financial impact:

<i>2017-18</i>	<i>2018-19</i>	<i>2019-20</i>	<i>2020-21</i>
-1.3m	0.2m	0.0m	0.0m

Supervisory costs associated with this measure will be recovered from regulated entities, however with a one-year lag.

Human rights implications: This Bill does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 3.

Compliance cost impact: The compliance costs associated with this Bill are \$26.3 million per annum.

Summary of regulation impact statement

Regulation impact on business

Impact: This Bill will extend the CSF regime to proprietary companies, making a new funding source available for small businesses, whilst

maintaining adequate investor protections through additional obligations on companies. These obligations are expected to have compliance costs for proprietary companies that use CSF; however these costs will be lower for CSF proprietary companies than if the company were to transition to public company type under the current regime.

Main points:

- This measure extends upon the *Corporations Amendment (Crowd-sourced Funding) Act 2017* to enable proprietary companies to access CSF without transitioning to public company status.
- Three models are discussed in the regulation impact statement – a model extending CSF to proprietary companies without additional obligations, a model extending CSF to proprietary companies with appropriate additional obligations; and the status quo where proprietary companies may transition to public company model.
- The model in the Bill is the extension to proprietary companies with appropriate additional obligations which balance the structural benefit of the proprietary company structure with certain obligations that increase shareholder protections.
- The regulation impact statement details the stages of consultation undertaken between 2015 and 2017 in considering and refining this model. This included a consultation paper released in August 2015 which canvassed extending CSF to proprietary companies, industry roundtables conducted in late 2016, and public consultation on draft legislation released in May 2017.
- The framework of *Corporations Amendment (Crowd-sourced Funding) Act 2017* will be extended through this Bill and associated regulations. The Government and the Australian Securities and Investments Commission (ASIC) will continue to monitor the regime after its extension to proprietary companies.

Chapter 1

Extending the crowd-sourced funding regime to proprietary companies

Outline of chapter

1.1 This Chapter provides an overview of the Corporations Amendment (Crowd-sourced funding for Proprietary Companies) Bill 2017.

1.2 Unless otherwise stated, all references in this Chapter relate to the *Corporations Act 2001* (the Act).

Context of amendments

Policy background

1.3 Crowd-sourced funding (CSF) is an innovative type of fundraising, typically online, that allows a large number of individuals to make small financial contributions towards a company, in exchange for an equity stake in the company. Legislation will commence on 29 September 2017 to introduce a CSF regulatory framework for public companies, although with some transitional arrangements for proprietary companies who transition to public company status in order to make CSF offers.

1.4 Access to finance is crucial for innovative new businesses, as they can incur costly research and development in the early stages of a business at a time when there may be little or no revenue flowing in. Bank loans with immediate regular payments may not be suitable if they can even be approved. So equity finance such as CSF is often a preferable type of funding for innovative and early stage companies and the investors in those companies.

1.5 Currently proprietary companies are unable to have more than 50 shareholders or make a public offer. Extending CSF to proprietary companies will enable easier access for small and innovative business types to the capital they need to succeed.

1.6 Acknowledging that proprietary companies that access CSF will no longer be closely held, these companies will be subject to obligations

designed to increase shareholder engagement and mitigate the occurrence of fraud. The obligations for proprietary companies that access CSF include: a minimum of two directors; financial reporting in accordance with accounting standards; audit requirements and restrictions on related party transactions.

1.7 These additional company obligations will help to ensure the sustainability of the CSF regime and give investors confidence in the market by ensuring companies meet a minimum standard and that investors have some basic information available to them.

Summary of new law

1.8 The amendments extend the CSF regime to proprietary companies by:

- expanding the eligibility for the CSF regime in section 738H to proprietary companies that meet eligibility requirements;
- providing that proprietary companies with shareholders who acquire shares through a CSF offer are not subject to the takeovers rules;
- adding special investor protection provisions for proprietary companies accessing the CSF regime; and
- removing the temporary corporate governance concessions in the *Corporations Amendment (Crowd-sourced Funding) Act 2017* for proprietary companies that convert to or register as public companies to access the CSF regime.

1.9 The special investor protection provisions that will apply to proprietary companies accessing the CSF regime include requirements to:

- maintain a minimum of two directors;
- prepare annual financial and directors' reports in accordance with accounting standards;
- have their financial reports audited once they raise \$3 million or more from CSF offers; and
- comply with the existing related party transaction rules that apply to public companies.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Proprietary companies that meet the eligibility requirements will be able to access the CSF regime	Only eligible public companies can access the CSF regime
Proprietary companies that have CSF shareholders will have to prepare annual financial and directors' reports in accordance with accounting standards	Small proprietary companies are generally not required to provide annual financial and directors' reports unless directed
Proprietary companies that raise \$3 million or more from CSF offers will have to have their financial statements audited	Small proprietary companies are generally not required to have their financial statements audited unless directed
Proprietary companies that have CSF shareholders will be subject to the related party transaction rules in Chapter 2E	Proprietary companies are not subject to the related party transaction rules in Chapter 2E
Proprietary companies that have CSF shareholders will be exempt from the takeover rules in Chapter 6	Proprietary companies with more than 50 shareholders are subject to the takeovers rules in Chapter 6
Proprietary companies that make a CSF offer will have to include details about the offer and the shareholders as part of their company register	No current law
Eligible public companies that access CSF will not be required to have their financial statements audited until they have raised \$3 million or more from CSF	Eligible public companies that access CSF are not required to have their financial statements audited until they have raised \$1 million or more from CSF

Detailed explanation of new law

1.10 The amendments in Part 1 of Schedule 1 of the Bill extend the CSF regime in Part 6D.3A of the Act to proprietary companies that meet certain eligibility requirements. As proprietary companies that use the CSF regime will be fundraising from the public, they will be required to adhere to additional reporting requirements and governance standards that will foster greater accountability and better decision making.

Extending the CSF regime to proprietary companies

1.11 Paragraph 738H(1)(a) of the Act is amended to extend the CSF regime in Part 6D.3A to proprietary companies. The amendment will

allow a proprietary company to use CSF if it has a minimum of two directors and meets any other requirements that are specified in the regulations. *[Schedule 1, Part 1, item 41, paragraph 738H(1)(a)]*.

1.12 Proprietary companies will be required to have at least two directors before they are able to use the CSF regime as this will provide greater transparency, more robust decision-making and greater certainty around succession planning.

1.13 The regulations may also prescribe other eligibility requirements. It is appropriate to have the power to prescribe other eligibility requirements in the regulations so that the Government can quickly intervene to protect investors if required.

1.14 The existing proprietary company framework in the Act provides for streamlined regulation for closely held companies. As proprietary companies that use CSF will be accessing public funding, these amendments provide for additional reporting and governance regulations to protect investors. Despite these additional requirements, it is possible that the CSF regime for proprietary companies will develop in a manner that creates risks for investors that would not be suitable. If this occurs, it is necessary for the Government to be able to intervene quickly to prescribe additional eligibility requirements that proprietary companies may have to satisfy before accessing the CSF regime, thereby maintaining an effective level of investor protection. It is appropriate for these requirements to be prescribed in the regulations as the Government may need to intervene quickly and as the regulations would be subject to disallowance, there would still be an appropriate level of parliamentary scrutiny.

1.15 Proprietary companies are currently prohibited from engaging in any activity that requires disclosure to investors under Chapter 6D except to existing shareholders and the employees of a company. As CSF is a fundraising activity that requires disclosure to investors, subsection 113(3) of the Act is being amended so that proprietary companies are allowed to make CSF offers (which is defined in section 738B of the Act). *[Schedule 1, Part 1, item 7, subsection 113(3)]*

1.16 To allow proprietary companies to effectively use the CSF regime, the existing shareholder cap which provides that a proprietary company cannot have more than 50 non-employee shareholders is being amended so that it also does not count shareholders:

- who are CSF shareholders (see paragraph 1.188) ; and
- who own shares that were originally issued as part of a CSF offer by the company and the transfer to the shareholder

occurred prior to the company's shares being traded on a financial market in Australia or elsewhere unless the regulations provide otherwise (see paragraph 1.22); and

- all other requirements prescribed in the regulations are met (see paragraphs 1.23 - 1.26).

[Schedule 1, Part 1, item 6, subsection 113(2)]

1.17 Without this change, a proprietary company would only be permitted to have 50 non-employee shareholders, severely limiting its ability to use the CSF regime.

1.18 A CSF shareholder is defined in section 9 as a person (legal or natural) that holds one or more securities in a company that was issued pursuant to a CSF offer by the company. *[Schedule 1, Part 1, item 1, section 9]*

1.19 As such, anyone who is directly issued with a share under a CSF offer will be a CSF shareholder and will not count towards the shareholder cap in subsection 113(1).

Example 1.1

Kim invests \$3,000 to acquire 3,000 shares as part of a CSF offer by Nero Pty Ltd. As Kim's shares were acquired directly as part of a CSF offer she will be a CSF shareholder in the company and will not count towards the shareholder cap under subsection 113(1).

1.20 Similarly, a shareholder who holds shares that were originally issued as part of a CSF offer and the transfer of those shares to the person occurred prior to the company's shares being traded on a financial market in Australia or elsewhere will not count towards the shareholder cap in subsection 113(1).

1.21 Once a company's shares start to be traded on a financial market in Australia or elsewhere (for example if a market for secondary trading of CSF shares develops), the company would begin to resemble a public company. It is therefore appropriate that shareholders who acquire shares after this starts to occur (either on the market or otherwise) count towards the shareholder cap in subsection 113(1).

Example 1.2

Hannah and Geoff invest \$5,000 each to acquire 5,000 shares each as part of a CSF offer by Kavas Pty Ltd.

After a few months, Hannah becomes dissatisfied with the management of Kavas Pty Ltd and transfers all 5,000 shares to Nelson. Nelson will not be a CSF shareholder as he purchased the shares from Hannah rather than through a CSF offer. However, as Nelson's shares were originally purchased as part of a CSF offer and Kavas Pty Ltd's have not been traded on a financial market, Nelson will not count towards the shareholder cap in subsection 113(1).

After Nelson acquires the shares from Hannah, Kavas Pty Ltd's shares start to be traded on a financial market that provides for secondary trading of CSF shares.

Some months later Geoff decides to sell half of his shares (2,500 shares) to Maan. As the transfer to Maan has occurred after Kavas Pty Ltd's shares started to be traded on a financial market, Maan will count towards the 50 non-employee shareholder limit under subsection 113(1). However, Geoff will still not count towards the shareholder cap as his remaining shares were directly acquired as part of the CSF offer.

1.22 There is a regulation making power to provide that some transfers of shares may not count towards the shareholder cap in subsection 113(1) even if a company's shares are being traded on a financial market in Australia or elsewhere. This regulation making power is necessary to provide flexibility in how the shareholder cap will apply if a market for secondary trading of CSF shares does develop. Depending on how a second trading market develops, it may be appropriate that some transfers of shares should not count towards the shareholder cap in some circumstances. For example, it may be appropriate for certain involuntary transfers of shares to be excluded from the shareholder cap even if a company's shares are traded on a secondary market. The regulation making power will therefore provide the Government with an agile approach to refining the operation of the shareholder cap. The regulations will be subject to appropriate parliamentary scrutiny as they would be subject to disallowance.

1.23 Proprietary companies have traditionally been subject to reduced regulation and disclosure on the basis that they are closely held companies. The extension of the CSF regime to proprietary companies and the exclusion of CSF shareholders from the shareholder cap is significant departure from the current regulatory approach. There is therefore also a regulation making power that would allow the Government to prescribe additional conditions to be met before a shareholder (other than a CSF shareholder) is excluded from the shareholder cap.

1.24 The regulation making power would allow the Government to quickly exclude some shareholders from the definition of a CSF

shareholder if it appears that the CSF regime is being used for misconduct or provides avenues for other unintended activities. For example, if the CSF regime is used for illegal activity, the regulation making power could be used to ensure that certain transfers would result in a shareholder counting towards the shareholder cap and thus make the company convert into a public company (once it has sufficient shareholders) and become subject to a more appropriate level of regulation.

1.25 Providing for this in the regulations is appropriate as the Government may need to respond quickly depending on how the CSF market develops. The regulations would be subject to disallowance and thus subject to appropriate parliamentary scrutiny.

1.26 In addition to the changes to the shareholder cap in section 113, proprietary companies will also be able to manage their shareholder base by having clauses in their constitution dealing with transfers of shares.

Proprietary companies with CSF shareholders must have a minimum of two directors

1.27 Once a proprietary company makes a CSF offer, it will be required to maintain at least 2 directors as long as it has CSF shareholders. This is consistent with the requirement for a proprietary company to have at least two directors to make a CSF offer and will provide greater transparency, more robust decision-making and greater certainty around succession planning. In companies where there are only two directors, at least one of the directors must ordinarily reside in Australia. In companies with more than two directors, a majority of the directors will have to ordinarily reside in Australia. *[Schedule 1, Part 1, item 13, subsection 201A(1A)]*

1.28 Where there are only two directors in a company, existing practices apply in determining how a majority is determined. For example, where there is an even split, the chair may have a casting vote.

1.29 The obligation to have at least the two directors exists as long as the company has a CSF shareholder. If all of the shares issued pursuant to a CSF offer are later sold, otherwise transferred or bought back by the company, the company will no longer have any CSF shareholders and will no longer be required to have the second director.

Additional reporting obligations for proprietary companies that have CSF shareholders

1.30 A proprietary company that makes a CSF offer will be required to include additional information as part of its company register. This information must be maintained on the company's register while the company has CSF shareholders. The additional information to be maintained on the register includes the:

- date of each issue of shares as part of a CSF offer;
- number of shares issued as part of each CSF offer;
- shares issued to each member of the company as part of each CSF offer; and
- date on which each person ceases to be a CSF shareholder of the company for a particular share in the company.

[Schedule 1, Part 1, item 10, subsection 169(6)AA]

1.31 Proprietary companies that make CSF offers are being required to maintain this information as part their company registers so that they have an appropriate record of the securities issued pursuant to CSF offers and that they are aware of the number of CSF shareholders in the company at any given point in time. It is essential for these companies to be able identify if they have any CSF shareholders because they will be subject to additional reporting and governance obligations while this is the case (for example, the requirement to have a minimum of two directors outlined above).

1.32 As proprietary companies that make CSF offers are taking funding from the public, it is important for ASIC to be able to identify the companies that have CSF shareholders and provide appropriate supervision. Proprietary companies that make CSF offers will therefore have additional obligation to report to ASIC once they make a CSF offer.

1.33 As such, where a company makes changes to its register because it has issued shares as part of a CSF offer, the company will also be required to notify ASIC of the change to its register. *[Schedule 1, Part 1, item 11, paragraph 178A(1)(b)]*

1.34 As part of the new notification requirements, the company will also have to inform ASIC if it:

- starts to have CSF shareholders; or

- stops having CSF shareholders.

[Schedule 1, Part 1, item 12, subsection 178C(1)]

1.35 These new reporting requirements will help ASIC track the proprietary companies that are subject to additional requirements because they have CSF shareholders.

1.36 In addition, where a proprietary company issues new shares, it will be required to notify ASIC if the issuance of those shares results in the company having a CSF shareholder. *[Schedule 1, Part 1, item 14, subsection 254X(1)]*

1.37 Similarly, where a proprietary company cancels any of its shares, it will have to notify ASIC if the cancellation results in the company ceasing to have CSF shareholders. *[Schedule 1, Part 1, item 15, subsection 254Y(1)]*

Financial reporting obligations for proprietary companies that make CSF offers

1.38 Under section 292, a small proprietary company would normally only have to prepare annual financial and directors' reports if it is directed to by its shareholders (under section 293) or ASIC (under section 294), or in some cases where it is controlled by a foreign company. This is not appropriate where the company makes a CSF offer as the company will be accessing funding from the public and these shareholders should have access to ongoing information on the company's progress. Unlike most investors in proprietary companies, who generally have connections to the company's management and are therefore expected to be able to access information on the company as required, CSF shareholders will generally not have a connection to management and therefore have less ability to obtain the required information on the company.

1.39 As such, to ensure that the individuals who invest their money into proprietary companies through a CSF offer have access to information about their investment in the company, subsection 292(2) is amended to require proprietary companies to prepare annual financial and directors' reports while they have CSF shareholders. *[Schedule 1, Part 1, item 18, paragraph 292(2)(c)]*

1.40 Requiring small proprietary companies that have CSF shareholders to prepare annual financial and directors' reports will build investor confidence in the CSF regime, allowing the market to become established and then grow. It will also allow investors to monitor progress of the companies and make informed decisions on issues they can vote on. The requirement will also establish a minimum standard, ensuring that

only companies that are willing to be transparent with their investors are able to access the regime.

1.41 The financial and directors' reports that are prepared will have to be provided to members in accordance with section 314 and must be provided to ASIC under section 319. There is no requirement for the company to make the reports public but they can elect to do so if they wish.

1.42 The obligation to prepare the financial and directors' reports will apply from the financial year in which the small proprietary company first starts to have a CSF shareholder (which can only occur once the company has completed a CSF offer) and will apply in relation to every future financial year in which the company still has a CSF shareholder. The financial reports prepared must comply with accounting standards.

1.43 Small proprietary companies that have CSF shareholders will only need to provide their annual report via a website and do not have to notify shareholders of alternative ways of receiving the report. An equivalent amendment applies in relation to the provision of concise financial reports to shareholders (where eligible). These provisions replicate the corporate governance concessions for eligible public companies that access CSF in the *Corporations Amendment (Crowd-sourced Funding) Act 2017*. [Schedule 1, Part 1, item 24, subsection 314(1AF) and item 25, subsection 314(2A)]

1.44 As a result of the requirement for these companies to prepare annual financial and directors' reports, there are a number of consequential amendments required in relation to the current reporting exemptions available for small proprietary companies.

- First, small proprietary companies that prepare annual financial and directors' reports in response to a shareholder direction under section 293 or a direction by ASIC under section 294 will have to lodge these reports with ASIC if they have CSF shareholders. [Schedule 1, Part 1, item 26, paragraph 319(2)(a)]
- Second, subsection 298(3) is amended to clarify that the exemption from preparing a directors' report for a small proprietary company will not apply if the company has a CSF shareholder. [Schedule 1, Part 1, item 21, subsection 298(3)]
- Third, subsection 296(1A) is amended to require a small proprietary company that has a CSF shareholder to ensure its financial reports comply with accounting standards even if it is prepared in response to a shareholder direction under

section 293 and the direction provides that the report need not be in accordance with accounting standards. *[Schedule 1, Part 1, item 19, subsection 296(1A)]*

1.45 Small proprietary companies are generally not required to have their financial reports audited. While this is appropriate for closely held companies relying on private funds it is not appropriate for companies that have public investment. As such, small proprietary companies that raise an amount equal to or greater than the CSF audit threshold from CSF offers will be required to have their annual financial reports audited. *[Schedule 1, Part 1, item 22, subsection 301(2)]*

1.46 The CSF audit threshold amount is \$3 million but may be amended in the future through the regulations. The current \$3 million threshold balances the need to keep company costs low with the need for investor protection through external assurance of financial statements. The regulation making power has been included to allow the Government to amend the threshold in future depending on how the CSF market develops. It is appropriate for the power to be in the regulations because if the CSF market develops in a manner that creates unreasonable risks for investors, the Government can quickly intervene and provide greater assurance of financial statements by amending the threshold. It is appropriate for these requirements to be prescribed in the regulations as it gives the Government the ability to intervene quickly and as the regulations would be subject to disallowance, there would still be an appropriate level of parliamentary scrutiny. *[Schedule 1, Part 1, item 1, section 9]*

1.47 As a result of the requirement for small proprietary companies that access CSF to have audited financial statements once they have raised an amount equal to or greater than the CSF audit threshold from CSF offers, the overview of auditing obligations in section 285 is amended to also provide that small proprietary companies that raise an amount equal to greater than the CSF audit threshold from CSF offers must have their financial statements audited. *[Schedule 1, Part 1, items 16 and 17, subsection 285(1) (table item 3, column headed 'comments')]*

1.48 Consequential amendments have been made to the content requirements of the annual directors' report. The amendment provides that a small proprietary company that has CSF shareholders is not required to include a copy of the auditor's declaration in its directors' report until it has raised an amount equal to or greater than the CSF audit threshold from CSF offers. This amendment ensures that only proprietary companies with CSF shareholders that are required to have their financial statements audited are required to include the auditor's declaration in their directors' report. *[Schedule 1, Part 1, item 20, subsection 298(1AC) and item 23, paragraph 314(1)(a)]*

1.49 Once a small proprietary company raises an amount equal to or greater than the CSF audit threshold from CSF offers, its directors will have to ensure there is an auditor appointed from one month after the amount was raised until the company stops having CSF shareholders. If the company later makes another CSF offer, the obligation to have an auditor will again apply from within one month of that offer being made. *[Schedule 1, Part 1, item 30 section 325 and item 31, subsection 325(2)]*

1.50 Directors who are under this obligation are required to do everything reasonable to comply with it. However, where there is a vacancy in the office of the auditor, the obligation to have an auditor appointed will not apply for a one month period from when the vacancy arose. This will allow the directors the time necessary to appoint a replacement auditor. *[Schedule 1, Part 1, item 31, subsections 325(3) and (4)]*

1.51 Directors that do not do everything reasonable to comply with the requirement to have an auditor appointed to a company during the periods it has raised an amount equal to or greater than the CSF audit threshold amount from CSF offers and it ceasing to have CSF shareholders will be liable for 25 penalty units or imprisonment for six months or both. This is appropriate as it is the identical penalty that applies to directors of a public company that breach their equivalent obligations. *[Schedule 1, Part 1, item 46, schedule 3 (table item 1116KM)]*

1.52 Where a small proprietary company has raised an amount equal to or greater than the CSF audit threshold from CSF offers but does not appoint an auditor as required above, the company must notify ASIC no later than seven days after the end of the 30 day period that the company's directors have failed to appoint the auditor. Once the company does this, ASIC is required to appoint an auditor as soon as practicable. This requirement is the equivalent to the existing requirement in relation to public companies that do not appoint an auditor as required. Where ASIC appoints an auditor for a proprietary company that raises an amount equal to or greater than the CSF audit threshold from CSF offers in this way, the auditor will hold office until the company's next general meeting. *[Schedule 1, Part 1, item 32, section 327E (heading) item 33, subsection 327E(1) and item 34, subsection 327E(6)]*

1.53 Similarly, ASIC's power to appoint an auditor to a public company where one is not appointed as required under the Act is extended to apply to proprietary companies with CSF shareholders that have raised an amount equal to or greater than the CSF audit threshold from CSF offers. Where this occurs in relation to a proprietary company, the auditor will hold office until the company's next general meeting. *[Schedule 1, Part 1, item 35, section 327F (heading); item 36, subsection 327F(1), item 37, paragraph 327F(1)(a), item 38, subsection 327F(2) and item 39, section 327G (heading)]*

1.54 Proprietary companies that have raised an amount equal to or greater than the CSF audit threshold from CSF offers and have CSF shareholders will be subject to the existing rules that ensure independence between a company and its auditors. This is to protect against any conflicts of interest arising and is appropriate as it only applies to companies that have raised an amount equal to or greater than the CSF audit threshold from the public through CSF offers. *[Schedule 1, Part 1, item 27, subsection 326CH(1) (table items 1 to 9) and item 28, subsection 324CH(3A)]*

1.55 Similarly, the existing rules that prevent an auditor from becoming a director of an entity they audited for a two year period is extended to also apply in relation to a proprietary company that has raised an amount equal to or greater than the CSF audit threshold amount from CSF offers and has CSF shareholders. *[Schedule 1, Part 1, item 29, paragraphs 324CI(e), 324CJ(e) and 324CK(e)]*

Restrictions on related party transactions

1.56 Since proprietary companies that use CSF are relying on public funding, they will be subject to restrictions on related party transactions to protect investors. Having these additional restrictions will ensure that individual investors have appropriate protection and will also help build confidence in the CSF regime as more investors participate in CSF offers.

1.57 To protect investors against fraud and bias arising as a result of transactions with related parties, proprietary companies that have CSF shareholders will be subject to the existing related party transaction rules and penalties under Chapter 2E. *[Schedule 1, Part 1, item 45, section 738ZK]*

1.58 The application of Chapter 2E to proprietary companies that have CSF shareholders provides shareholders with protections where funds are transferred to any related parties through uncommercial transactions without shareholder approval. This will provide investors with confidence that they have access to the existing related party transaction remedies where funds are transferred to a related party for non-commercial purposes without shareholder approval.

1.59 The restrictions are however not too onerous (in the context of companies that have accessed funding from the public through a reduced disclosure regime) as the transactions are still permissible if they are on commercial terms at arm's length or if the shareholders provide consent.

Takeovers of proprietary companies that have CSF Shareholders

1.60 Proprietary companies that use CSF would generally be subject to the takeover rules in Chapter 6 as they are likely to have more than 50 shareholders. These provisions are complex and would inhibit funding

and other exit opportunities for proprietary companies that use CSF as they apply in relation to the acquisition of control beyond 20 per cent of a company's voting stock.

1.61 This is contrary to the objectives of proprietary companies that use CSF as they may be positioning for a takeover or to become listed in the future. The shareholders of these companies that invest as part of CSF offers also do so in the expectation that, if the company is successful, they will benefit from a payout as part of an exit event.

1.62 As such, a proprietary company that has CSF shareholders will be exempt from the takeover rules in Chapter 6 as long as they meet any of the conditions prescribed in the regulations. *[Schedule 1, Part 1, item 40, section 611]*

1.63 Proprietary companies that have CSF shareholders are being excluded from the takeover rules to reduce compliance costs and avoid unduly restricting companies from adjusting their capital structure. However, as proprietary companies that do use CSF will be accessing public funding through a reduced disclosure regime it is important for the Government to be able to impose conditions if required to protect investors. For example, the Government may need to impose conditions on the takeover exemption if as the CSF market develops it appears that CSF shareholders are not able to benefit from exit events at successful companies. It is appropriate for these requirements to be prescribed in the regulations as the Government may need to intervene quickly and as the regulations would be subject to disallowance, there would still be an appropriate level of parliamentary scrutiny.

Clarifying that companies accessing CSF cannot be listed on overseas exchanges

1.64 The meaning of an eligible CSF company is amended to clarify that the company cannot be listed on a financial market overseas in addition to not being listed on a financial market in Australia. *[Schedule 1, Part 2, item 50, paragraph 738H(1)(e)]*

1.65 This change only applies in relation to CSF offers that are made after Part 2 of Schedule 1 commences. *[Schedule 1, Part 2, item 52, section 1643]*

Reducing the cooling off period for supplementary or replacement CSF offer documents

1.66 The current CSF regime provides that where a supplementary or replacement CSF offer document is published, an intermediary must give written notice to all applicants that previously accepted the offer to advise

them that they have one month (from the date of the notice) to withdraw their acceptance and obtain a refund of application money paid.

1.67 This Bill provides for the cooling-off period to be reduced from one month to 14 days. The reduced period provides greater certainty for the company making the CSF offer and other applicants about the outcome of the CSF offer. The 14 day cooling-off period would still give investors a sufficient amount of time to reconsider their decision to participate in a CSF offer following the provision of a supplementary or replacement CSF offer document. *[Schedule 1, Part 2, item 51, subsections 738X(7) and (9)]*

1.68 This amendment will only apply to CSF offers that are made after Part 2 of Schedule 1 commences. As such, anyone who invests in a CSF offer that is made before this time will have access to the existing one month cooling-off period if a supplementary or replacement CSF offer document is published, even if the supplementary or the replacement CSF offer document is published after Part 2 of Schedule 1 commences. *[Schedule 1, Part 2, item 52, section 1643]*

Increasing the threshold for audited financial statements for eligible public companies using the corporate governance concessions under the Corporations Amendment (Crowd-sourced Funding) Act 2017

1.69 As small proprietary companies with CSF shareholders will only be required to audit their financial statements after they have raised \$3 million or more from CSF offers, public companies eligible for the corporate governance concessions provided for in the *Corporations Amendment (Crowd-sourced Funding) Act 2017* will also only be required to have their financial statements audited and appoint an auditor after raising \$3 million or more from CSF (as opposed to the current \$1 million threshold). *[Schedule 1, Part 2, item 47, paragraph 301(5)9b), item 48, section 328D(heading), item 49, subsection 328D(1)]*

Removal of the corporate governance concessions for new public companies and proprietary companies that convert to access the CSF regime

1.70 The *Corporations Amendment (Crowd-Sourced Funding) Act 2017* provided for a number of corporate governance and reporting concessions for new public companies and proprietary companies that convert to access the CSF regime. These concessions were provided to facilitate new companies registering as public companies or proprietary companies converting to public companies in order to access CSF. As the amendments in this Bill will allow proprietary companies to use CSF without having to convert, the corporate governance concessions are no longer required.

1.71 As such, section 738ZI is amended so that the corporate governance concessions are not available to public companies that incorporate, or proprietary companies that convert, after the commencement of these amendments (which will be six months after Royal Assent). Public companies that incorporate or convert prior to these amendments commencing will still be able to access the concessions as long as they are eligible for them. *[Schedule 1, Part 1, item 42, section 738ZI; item 43, paragraph 738ZI(1)(a) and item 44, subsection 738ZI(2)]*

Example 1.3

Winter Walker Ltd (WWL) registers as a new public company one month after this Bill receives Royal Assent. WWL has indicated on its registration that it intends to make a CSF offer and meets all the eligibility requirements to access the corporate governance concessions. WWL will be able to continue accessing the concessions as long it continues to meet the eligibility requirements even after these amendments take effect six months after Royal Assent.

Example 1.4

Snow Dragon Ltd (SDL) registers as a new public company seven months after this Bill receives Royal Assent. As these amendments will have commenced, SDL is not eligible for the corporate governance concessions.

1.72 As public companies (newly incorporated and proprietary companies that convert) will not be able to access the corporate governance concessions after commencement of this Bill, the provisions for companies to indicate their intention to access the corporate governance concessions are being repealed. Companies that have indicated their intention to use CSF on their application (for registration or conversion) prior to this Bill taking effect will be able to continue accessing the corporate governance concessions as long as they meet the eligibility requirements. *[Schedule 1, Part 1, item 8, paragraph 117(2)(mc), item 9, subparagraph 163(2)(d)(iii)]*

Consequential amendments

1.73 The small business guide in Part 1.5 of the Act is being updated to explain that the cap on the number of non-employee shareholders a proprietary company can have will also no longer include shareholders who have shares issued pursuant to a CSF offer as long the company's shares are not traded on a financial market. *[Schedule 1, Part 1, item 3, paragraph 2.1 of the small business guide in part 1.5]*

1.74 Similarly, the small business guide in Part 1.5 of the Act is updated to explain that the prohibition on proprietary companies engaging in fundraising activity does not extend to raising funds under a CSF offer. *[Schedule 1, Part 1, item 4, paragraph 8 of the small business guide in part 1.5]*

1.75 Part 1.5 of the small business guide is also updated to reflect the fact that proprietary companies will have to prepare annual financial and directors' reports if they have CSF shareholders. *[Schedule 1, Part 1, item 5, paragraph 10.3 of the small business guide in part 1.5]*

1.76 The notes under subsection 45A(1) are updated to explain that the cap on the number of shareholders a proprietary company can have does not include shareholders connected with a CSF offer. *[Schedule 1, Part 1, item 2 subsection 45A(1) (note 2) and (note 3)]*

Application and transitional provisions

1.77 The amendments in Part 1 of Schedule 1 to extend the CSF framework to eligible proprietary companies will take effect from the day after the end of the period of 6 months beginning on the day this Act receives Royal Assent.

1.78 The amendments in Part 2 of Schedule 1 relating to eligible public companies that access CSF will take effect from the day after this Bill receives Royal Assent.

Chapter 2

Regulation impact statement

WHAT IS THE PROBLEM THAT NEEDS TO BE ADDRESSED?

2.1 Companies want greater access to equity financing without having to become a public company. Extending crowd-sourced equity funding (CSF) to proprietary companies will facilitate this. Similarly, investors want to be able to invest in start-up and early stage businesses but cannot do so easily under currently regulatory arrangements, which prohibit proprietary companies from raising capital from the general public.

REGULATORY BARRIERS TO CSF FOR PROPRIETARY COMPANIES

2.2 CSF is an innovative type of online fundraising that allows a large number of individuals to make small financial contributions towards a company, in exchange for an equity stake in the company. Development of a CSF market in Australia will provide an additional funding option for entrepreneurs to assist in the growth of their business, and provide additional investment options for people wishing to invest in start-ups and small businesses.

2.3 The use of CSF in Australia is currently limited by a range of regulatory impediments. These include governance and reporting requirements for companies, equity fundraising rules, and requirements for financial intermediaries as set out in the *Corporations Act 2001* ('Corporations Act').

2.4 The Government has already legislated a CSF framework for public companies, including as a part of its response to the Financial System Inquiry and in the National Innovation and Science Agenda. It will commence on 29 September 2017.

2.5 Under this framework, proprietary companies are not eligible to use CSF. This is because proprietary companies are intended to be closely-held, with shareholders who have a close connection to management. The regulatory framework for proprietary companies reflects this intent through reduced reporting and governance obligations compared to public companies, balanced with limitations on their fundraising activities. The regulatory framework for proprietary companies is described in more detail in the Appendix.

2.6 However, most small and early-stage companies operate as proprietary companies. Some of these proprietary companies that may be interested in using CSF may be unwilling or unable to convert to a public company form to access the Government's CSF framework for public companies, due to the higher regulatory obligations imposed on public companies. Some of these companies also wish to remain proprietary companies as this company form is more compatible with their future plans such as exit via acquisition by another company that may have a preference for proprietary companies.

THE NEED TO IMPROVE ACCESS TO FINANCE FOR SMALL AND INNOVATIVE BUSINESSES

2.7 Access to finance is crucial for innovative new businesses, particularly those that are creating a new product or service or significantly improving an existing product or service. Innovative developments often require costly research and development in the early stages of a business at a time when there may be little or no revenue flowing in.

2.8 The Government has implemented a number of policies to address the challenges faced by small businesses, including improving access to affordable finance. A number of these measures were included in the Growing Small Business and Jobs package announced in the 2015-16 Budget.

2.9 Difficulties in accessing debt finance can arise as a result of gaps in information between lenders and borrowers. As the provision of debt finance requires an assessment of a business' ability to service the debt, small businesses and start-ups that do not have adequate evidence of past performance or prospects for success can face particular challenges accessing credit. Lenders may not be willing to bear the cost of obtaining detailed credit-related information to assess the level of risk involved in lending to a smaller business. Some businesses may also struggle to obtain finance from lenders due to insufficient collateral being offered in the event of default.

2.10 However where a bank loan can be obtained, it may not be well suited to the business. Bank loans involve regular repayments starting almost immediately, and failure to meet these payments risks default of the loan. In reality the cash flows of small businesses, particularly start ups, can be volatile, making it difficult to meet such regular repayments.

2.11 Equity finance is therefore a more suitable option than debt for some businesses. Unlike debt finance, equity does not require immediate repayments and equity investors generally accept that returns are

contingent on profits. A CSF framework will improve access to equity financing for eligible companies.

WHY IS GOVERNMENT ACTION NEEDED?

2.12 The main barriers to the use of CSF by proprietary companies are regulatory in nature.

2.13 The Government has already introduced a CSF framework for public companies. Proprietary companies are not eligible to use this framework as they would continue to be prohibited from making equity offers requiring disclosure. Other elements of corporate law, such as the limitation for proprietary companies of 50 non-employee shareholders, also limit the usefulness of CSF for these companies.

2.14 There are currently a small number of operators of online platforms offering investment in Australian start-ups, including proprietary companies. These operators may continue to offer their services to proprietary companies if the CSF framework for public companies is implemented. However, under current legislation offers to invest in proprietary companies, including by online platform operators, can only be made to a limited set of investors, such as wholesale investors or those who fall within the small scale personal offer exemption.

2.15 While this environment may be suitable for some proprietary companies and investors, it does not comprehensively address the barriers to CSF for proprietary companies.

2.16 A consistent theme resulting from the stakeholder consultation process was that many proprietary companies will not access the CSF public company framework because:

- early-stage companies usually do not have the resources to comply with the regulatory burden (both perceived and real) of operating as a public company. Despite the temporary governance and reporting concessions granted under the public company framework, proprietary companies that convert under the framework must:
 - satisfy significantly higher financial reporting requirements (if a small proprietary company);
 - implement higher governance standards such as appointing a minimum three directors and must appoint a secretary;

- hold an AGM, comply with all financial reporting requirements and appoint an auditor (regardless of the amount a company raises) after the concessions lapse.
- conversion may disrupt the normal lifecycle of the proprietary companies, as proprietary companies usually only convert when they intend to undertake an initial public offer. Further, future exit options may be more limited, as proprietary companies are generally a more attractive target for sophisticated bidders in trade sales (for example venture capital) due to the light regulatory nature of proprietary companies and the complexities of converting a public company back to a proprietary company;
- proprietary companies may be more suitable for early-stage high-growth companies where founders do not intend to cede significant control to shareholders (for example there is no statutory right for shareholders of a proprietary company to remove a director while public company shareholders have such a right);
- extensive disclosure obligations may not be appropriate for early-stage companies that have a business model heavily dependent on a technology or intellectual property which needs to be kept confidential.

2.17 More generally, stakeholder feedback suggested that many companies would only access CSF to supplement existing fundraising and financing mechanisms, and CSF would not be the primary method of raising funds. Following this, many proprietary companies may decide against converting on the basis that the benefits of accessing CSF do not outweigh the burden of operating as a public company. This leaves the Government open to the risk that very few companies will use CSF if the only framework available is the public company legislation.

IMPLEMENTATION OPTIONS

2.18 There are three main stakeholder groups with an interest in the extension of the CSF framework to proprietary companies:

- Companies seeking to raise funds stand to benefit from the extension of the CSF framework. This is particularly the case for innovative firms and start-ups, which typically have more difficulty obtaining bank debt finance than established firms,

but existing equity fundraising is prohibitively expensive. These companies would be *issuers* of CSF offerings.

- As noted above, under the current CSF legislation, only public companies with up to \$25 million gross assets and annual turnover will be eligible to raise up to \$5 million of equity per 12-month period via CSF with reduced disclosure requirements.
- Individuals seeking new opportunities to invest stand to benefit from the increased range of financial products that CSF would present, and the inclusion of proprietary companies would expand the number and diversity of investment opportunities. These individuals would be able to diversify the range of products they invest in, and would be *investors* in CSF offerings.
 - Under the CSF legislation, investors have certain protections such as a disclosure document and risk warning, with additional protections for retail investors such as an investment cap of \$10,000 per issuer per 12-month period, a cooling off period of five days and signature of a risk acknowledgement statement.
- A number of organisations are establishing a platform that allows issuers to list their CSF offerings, bringing together issuers and potential investors. These organisations will operate as intermediaries in the CSF market. Expanding eligibility to proprietary companies would increase the number of issuers, and assist platforms with reaching ‘critical mass’.
 - Under the CSF legislation, intermediaries will be licensed and have obligations such as undertaking certain due diligence on CSF issuers and providing a communications facility for investors to communicate with the issuer.

OPTION 1: NO CHANGE

2.19 Under Option 1, there would be no change to the current requirements under the Corporations Act for proprietary companies, nor any change to the legislated CSF framework for public companies. CSF

2.20 Proprietary companies would only be able to access CSF if they transition to public companies. Companies that transition will be given certain exemptions from the more costly and time consuming governance and reporting requirements, including:

- relief from the requirement to hold an annual general meeting;
- the option to provide financial reports to members in an online format only; and
- no requirement to appoint an auditor unless the company has raised more than \$1 million.

OPTION 2: EXTEND CSF TO PROPRIETARY COMPANIES WITHOUT ADDITIONAL INVESTOR PROTECTIONS

2.21 Option 2 would allow proprietary companies to access CSF without converting to a public company or complying with any additional governance and reporting requirements.

2.22 Consistent with the public company framework, proprietary companies with less than \$25 million in assets and annual turnover would be able to raise up to \$5 million in any 12 month period through crowdfunding platforms. Retail investors would be able to invest up to \$10,000 per company per 12 month period.

2.23 Small proprietary companies accessing CSF would continue to experience light regulation and would not be required to hold annual general meetings, prepare annual financial reports, appoint auditors or have their financial statements audited. The main corporate governance and reporting standards small proprietary companies are subject to include:

- ***constitution:*** no requirement to have a constitution (or lodge a constitution where a company adopts one). In the absence of a constitution a company is subject to the replaceable rules in the Corporations Act;
- ***financial reporting:*** must keep financial records but there is no requirement to produce financial reports unless 5% of the company's members request the company to produce such reports or ASIC directs it;
- ***related party transactions:*** not subject to the Chapter 2E restrictions and processes on related party transactions (note that there are indirect restrictions on related party transactions for proprietary companies including the application of director's duties);
- ***directors:*** a proprietary company needs only one director (and that director must ordinarily reside in Australia); and

- **annual general meeting:** there is no requirement for a proprietary company to hold an AGM.

2.24 There would be no requirement for these companies to convert to public companies at any stage. Please see section 3.4 for a table summarising the characteristics of proprietary companies.

2.25 To ensure that proprietary companies can use the regime, two amendments to the existing requirements of proprietary companies would be necessary:

- **shareholder limit:** the current proprietary shareholder limit of 50 non-employee shareholders would be amended (via section 113 of the Corporations Act) so that proprietary companies are restricted from having more than 50 non-employee or non-CSF shareholders (rather than simply 50 non-employee shareholders). This will ensure that the crowd can access CSF in proprietary companies; and
- **takeover provisions:** the takeover provisions in Chapter 6 of the Corporations Act will not apply to CSF proprietary companies.

OPTION 3: EXTEND CSF TO PROPRIETARY COMPANIES WITH APPROPRIATE PROTECTIONS

2.26 Option 3 would permit both public and proprietary companies to access CSF subject to meeting base level governance and reporting requirements. Proprietary companies that elect to access CSF would need to comply with higher governance and reporting obligations (compared to what they are currently subject to), while public companies would already meet these standards due to existing Corporations Act obligations.

2.27 Under Option 3, amendments would be needed to the CSF public company framework to ensure that the reporting and governance concessions extended to proprietary companies that converted to public companies for the purpose of accessing CSF are removed (although grandfathered for those companies who have already converted prior to the commencement of the extension to proprietary companies). These concessions were initially granted on the assumption that proprietary companies would not have the opportunity to access CSF under their current structure.

2.28 The preferred design characteristics of Option 3 are set out below, and fall within the following categories:

- rules around the CSF offer and intermediaries;

- structural issues;
- corporate governance obligations; and
- financial reporting obligations.

A: Rules around the CSF offer and intermediaries

2.29 To ensure consistency between the public company legislation and any proposed proprietary company framework, the rules around the CSF offer and intermediaries will be the same for both types of companies. The design of these policy features will largely mirror the content of the CSF public company Bill, including:

- **eligibility:** to be eligible to access CSF a company must have less than \$25 million in gross assets and annual turnover, not be listed on a stock exchange and the company's principal place of business must be in Australia;
- **fundraising & investor caps:** a retail investor may invest a maximum \$10,000 in a company over a 12 month period and a company accessing CSF may raise a maximum \$5 million over a 12 month period through a CSF raise;
- **initial disclosure:** the regulations prescribe certain information that a prospective CSF issuer will need to disclose in the disclosure document. Companies may need to include some additional generic disclosures around company type, capital structure and any other rights or conditions associated with shares (such as tag and drag rights). CSF
- **role of the intermediary:** the intermediary will have the same gatekeeper obligations with respect to both proprietary and public companies that access CSF. These include conducting certain checks on the issuer and management as well as ensuring disclosure documents are completed and clear.

B: Structural issues in relation to proprietary companies

2.30 To extend CSF to proprietary companies, various mechanical arrangements were considered to ensure that proprietary companies could functionally access the framework:

- **'tagging' system:** a proprietary company will be subject to the additional governance and reporting obligations once it is tagged as a CSF company. The CSF tag will be triggered as soon as the company has a CSF investor on its register and will continue until no CSF investors remain. This

information will be kept by ASIC, and will be accessible by the public through ASIC's company records system. The tagging system will ensure that proprietary companies that do not elect to use CSF will not be subject to additional reporting and governance obligations;

- **shareholder limit:** the current proprietary shareholder limit of 50 non-employee shareholders will be amended (via section 113 of the Corporations Act) so that proprietary companies are restricted from having more than 50 non-employee or non-CSF shareholders (rather than simply 50 non-employee shareholders). Unless shares of the company have been traded on a secondary market, off-market transfers from CSF shareholders to new shareholders will not count towards the cap. This will ensure that the crowd can access CSF in proprietary companies and ensure that the cap does not unduly constrain liquidity;
- **no requirement to convert to a public company:** there will be no requirement for a proprietary company to convert to a public company after it accesses CSF (unless an existing trigger in the Corporations Act requires that proprietary company to convert e.g. more than 50 non-employee or non-CSF shareholders); and
- **takeover provisions:** the takeover provisions in Chapter 6 of the Corporations Act will not apply to CSF proprietary companies. CSF

C: Corporate governance obligations

2.31 It is appropriate that a proprietary company which elects to access CSF complies with additional governance obligations to that of a normal proprietary company. However, by the same measure it is important that proprietary companies are not burdened by unnecessary governance obligations. In terms of the corporate governance issues that were considered:

- **annual general meetings:** proprietary companies will not be required to hold an annual general meeting;
- **number of directors:** proprietary companies will be required to have a minimum of two directors (rather than a minimum of one director); and

- **related party transactions:** proprietary companies will be subject to the related party transaction regime in Chapter 2E of the Corporations Act.

D: Financial reporting obligations

2.32 Similar to the approach adopted for corporate governance standards, proprietary companies would be required to disclose greater financial information than they currently do. Currently, a proprietary company is only required to prepare financial statements and have them audited where more than 5% of its members request it do so or ASIC directs it.

2.33 It is proposed under Option 3 that:

- **ongoing financial reporting:** companies that issue equity via CSF will be required to provide financial statements to CSF investors in accordance with accounting standards; and
- **audit:** a CSF proprietary company would be required to undertake an audit where it raises more than \$3 million from a CSF raise or any other raise which did not require disclosure. This threshold will also be carried through to the transitional governance concessions that apply to newly converted public companies.

E: Consequential amendments to public company legislation

2.34 If CSF is extended to proprietary companies, it is advisable to remove the governance and reporting concessions granted to proprietary companies in order to lower the cost of conversion to public companies under the public company CSF framework. These concessions will be redundant if proprietary companies are able to retain their current structure to access CSF. The concessions will be grandfathered, that is, companies that converted prior to the date of commencement of the proprietary company extension will retain eligibility for the concessions.

2.35 All public companies that access CSF will be required to meet the standard obligations of public companies, including to:

- hold an annual general meeting;
- appoint an auditor (and have financial statements audited); and
- provide financial statements to shareholders in the usual manner.

2.36 Public companies that meet the eligibility threshold will all be able to access CSF because they automatically satisfy the minimum standards required to access the regime.

TABLE 1: REQUIREMENTS FOR CSF COMPANIES UNDER OPTIONS 1-3

	Option 1: No extension to CSF public company framework to allow access by proprietary companies	Option 2: Extend CSF to proprietary companies without additional investor protections	Option 3: Extend CSF to proprietary companies with appropriate protections
<i>Requirements for:</i>	<i>CSF public companies</i>	<i>CSF proprietary companies</i>	<i>CSF proprietary companies</i>
Shareholder limits	No limit	Max. 50 non-employee/non-CSF shareholders	Max. 50 non-employee/non-CSF shareholders
Offers to the public	Yes	Yes, through CSF only	Yes, through CSF only
Company eligibility to crowdfund	Yes, if unlisted Satisfy annual turnover (below \$25 million) and gross assets (below \$25 million) test	Yes Satisfy annual turnover (below \$25 million) and gross assets (below \$25 million) test	Yes Satisfy annual turnover (below \$25 million) and gross assets (below \$25 million) test
Fundraising amount	Companies can raise up to \$5 million in a 12-month period	Companies can raise up to \$5 million in a 12-month period	Companies can raise up to \$5 million in a 12-month period
Investor cap	Retail investors can invest up to \$10,000 in a company per 12-month period	Retail investors can invest up to \$10,000 in a company per 12-month period	Retail investors can invest up to \$10,000 in a company per 12-month period
Disclosure for public offers	Low-level disclosure document plus communication facility	Low-level disclosure document plus communication facility	Low-level disclosure document plus communication facility
Conversion to public company	Convert prior to making CSF offer	Access to CSF does not require conversion	Access to CSF does not require conversion

	Option 1: No extension to CSF public company framework to allow access by proprietary companies	Option 2: Extend CSF to proprietary companies without additional investor protections	Option 3: Extend CSF to proprietary companies with appropriate protections
<i>Requirements for:</i>	<i>CSF public companies</i>	<i>CSF proprietary companies</i>	<i>CSF proprietary companies</i>
Financial reporting obligations (in accordance with accounting standards)	Annual financial report Directors' report Auditors' report, if raising above \$1 million from public	Not required	<ul style="list-style-type: none"> Annual financial report Directors' report Auditors' report, if raising above \$3 million from public
AGM	Not required – up to 5 years	Not required	Not required
Number of directors	At least three (two residing in Australia)	At least one (residing in Australia)	At least two (at least one residing in Australia)
Application of Ch 2E rules about related party transactions	Yes	No	Yes
Application of Ch 6 takeover provisions	Yes	No	No

WHAT IS THE LIKELY NET BENEFIT OF EACH OPTION?

OPTION 1: NO CHANGE

2.37 The benefits to implementing the CSF public company framework and not extending CSF to proprietary companies include:

- ***Maintaining public / proprietary distinction:*** By only extending CSF to public companies, the current legal distinctions between public and proprietary companies will be maintained. The legal framework for public companies is designed to support investment by the general public, whereas the regulatory framework for proprietary companies assumes the company is closely held. This option would preserve the notion that only public companies are able to

raise from the public while lowering the cost of transitioning to a public company for a period of time.

- **Lower risk:** This option will ensure that public investors are afforded greater protection compared to any investment in a proprietary company. Companies that access CSF will be required to produce more comprehensive financial information and comply with higher governance standards. This may reduce the risk of fraud and increase investor, which may be critical to the ongoing sustainability of any CSF market.
- **Secondary market:** As public companies maintain a more consistent flow of information to the public, it is more likely that a secondary market in shares of public CSF companies could be developed in time. Information about proprietary companies is closely held and it would be difficult for public investors at arms' length to value the shares in a secondary market.

2.38 The disadvantages and risks of this option include:

- **Regulatory burden:** Approximately 98% of Australian-registered companies are proprietary companies, and start-ups in particular usually adopt this company structure. The regulatory burden of operating as a public company, in particular for companies that do not have adequate resources (for example time and money used to meet higher reporting and governance obligations), may deter proprietary companies from converting to access CSF, limiting the effectiveness of the policy in increasing access to finance.
- **Disruption to the normal lifecycle of a company:** Many of the types of companies the CSF framework is targeting would not usually consider converting to a public company at the point in time they intended to access CSF. There may be unintended negative consequences for companies that convert earlier than other similar companies. For example, companies that intend to exit via a trade sale may find it more challenging to find bidders as a public company because investors (especially venture capital) generally consider public companies a less attractive target due to the complexities and shareholder consent associated with takeover laws.
- **Loss of growth and investor opportunity:** If few companies decide to convert to public companies to access CSF due to

the above reasons, both retail investors and companies alike will miss out. Firstly, retail investors are not currently able to invest in the majority of Australian SMEs because proprietary companies cannot offer securities to the public. Secondly, stakeholder consultation indicates that there is a funding gap for niche companies, such as companies building themselves based upon investment in intellectual property and for companies that have a proven product and want to scale up. In particular, feedback indicates a “funding gap” for achieving scale between \$5 million to \$25 million in annual turnover or assets. These companies may continue to miss out on important funding if there is limited take-up of the framework due to barriers to entry.

Net benefit

2.39 Out of the three options, Option 1 is the most conservative approach towards developing a CSF framework. By requiring all CSF companies to comply with the standards set for public companies, this option will provide investors with the greatest protection and do the most to promote consumer confidence in CSF investments. Consumer confidence will be crucial to the long-term sustainability of the sector. However, these benefits are likely to be offset by the regulatory burden imposed on companies due to the requirement to convert to a public company. This is likely to lead to limited take-up of the CSF framework, limiting the effectiveness of the policy in increasing access to funding for businesses and potentially limiting the ongoing viability of the CSF sector.

OPTION 2: EXTEND CSF TO PROPRIETARY COMPANIES WITHOUT ADDITIONAL INVESTOR PROTECTIONS

2.40 A range of stakeholders have expressed a clear appetite for CSF to be extended to proprietary companies given that most companies (particularly start-ups and early-stage companies) in Australia operate as proprietary companies. Under Option 2, small proprietary companies would be able to access CSF and continue to experience light regulation.

2.41 The key benefits of Option 2 include:

- ***Opening up new funding sources:*** Option 2 will allow innovative proprietary companies to access a new funding source, allowing them to pursue an agenda of growth. Proprietary companies would be able to choose the optimal mechanism for fundraising based on the company’s needs and objectives.

- **Removing regulatory burden:** This option would remove a key disincentive for these companies to use CSF. As discussed in section 4.1, proprietary companies interested in using CSF may be unwilling or unable to convert to a public company due to the higher regulatory obligations imposed on public companies or because it might limit their ability to find investors or buyers in the future.
- **More effective use of resources:** Secondary to the above point, early-stage high-growth companies will be able to focus on developing their businesses (and subsequently returns for investors) if they do not have to allocate resources to increased compliance obligations.
- **Commercially sustainable:** Intermediaries will play a critical role in any CSF framework, and will be regarded as the ‘gatekeepers’ to CSF issuers. It is important that any CSF framework enables platforms to be commercially viable and offer a good level of service to companies and investors. Extending CSF to proprietary companies will increase the amount of companies accessing CSF, which will strengthen the commercial viability of the industry.
- **Increased diversity:** Extending CSF to proprietary companies will encourage a greater number of entrants to the market. This may result in a wider range of business models to meet issuer and investor needs and potentially greater competition.
- **Minimum legislative changes:** This option would require the fewest legislative amendments to the Corporations Act.

2.42 The disadvantages and risks of Option 2 include:

- **Increased investor risk:** The regulatory regime for proprietary companies was designed on the assumption that the company would be closely held and would not have a broad retail shareholder base. This would no longer be the case if the ‘crowd’ is able to invest in proprietary companies. CSF investors in these companies will have few rights and less knowledge of the company’s operations relative to retail investors in public companies because they will lack important shareholder protection measures such as ongoing financial reporting and restrictions on related party transactions. As a result, they may be exposed to a higher risk of fraud. If consumers lack confidence in the framework, then it could also jeopardise investor interest in CSF and limit the commercial viability of the CSF market.

- **No change to company habits:** Requiring companies to comply with higher corporate governance and reporting standards encourages companies to adopt better practices. There are associated benefits with imposing higher standards and creating an expectation of better practices, including greater engagement with shareholders, transparency, better decision making and more comprehensive and accurate financial records (which feed into the company's strategic planning).
- **Tax incentives:** Retail investors may be incentivised to invest in CSF companies to obtain tax offsets for early-stage innovation companies, of which a proportion of eligible investments will be in proprietary companies. Consumers may not assess the risk weight of the company relative to immediate tax considerations.

Costing

2.43 Removing existing restrictions on proprietary companies accessing CSF without mandating additional investor protections is expected to result in a small increase in regulatory costs for individual proprietary companies, intermediaries and investors. However, the expected growth in proprietary companies using CSF is likely to result in the aggregate compliance burden across the economy increasing.

2.44 The removal of the public company exemptions in the CSF legislation for public companies, given proprietary companies will not need an exemption period to ease the transition to public company form, is expected to slightly increase costs for public companies on average. However, expected growth in the number of public companies using CSF is expected to be far lower than under option 1, with most CSF users expected to remain proprietary companies.

2.45 Under this option:

- Costs per issuer are expected to increase by \$750 per year for proprietary companies using CSF driven primarily by costs associated with monitoring compliance with the CSF framework. Costs per issuer are expected to increase by \$1,090 for public companies using CSF as they will not have the costs associated with monitoring compliance with the CSF framework offset by the temporarily reduced costs associated with exemptions from annual general meetings and audit requirements contemplated in the legislation for public companies.

- Fixed costs for intermediaries are expected to be the same as under the public company framework. Intermediary costs that vary with the number of issuers raising funds are also expected to be the same as under the public company framework, with overall costs increasing in line with the expected increase in businesses raising funds via CSF.
- Costs per investor are expected to be the same as under the public company framework.

2.46 Using the regulatory burden measurement framework, it has been estimated that the indicative model would increase compliance costs by \$7.4 million per year. This is due primarily to the assumption that a greater number of companies will use the CSF framework if they can remain proprietary companies rather than switching to public companies, as required under the status quo. For all reporting periods, the Treasury portfolio has reported net compliance cost reductions and there is no reason why the portfolio will not continue to deliver on its red tape reduction targets this year, in line with the Government's regulatory reform agenda.

Table 1: Regulatory burden estimate (RBE) table

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	\$7.0 million	\$0	\$0.4 million	\$7.4 million

Assumptions underlying this estimate are in the Appendix.

Net benefit

2.47 Out of the three options, Option 2 is the most significant departure from the current operation of the Corporations law. This option is likely to have the greatest take-up by potential CSF companies as companies would not incur many additional costs by accessing CSF under this option. However, the risk exposure of retail investors is the greatest under this framework. There is a higher chance of fraudulent activity which may diminish investor confidence and undermine the credibility of the CSF sector. On balance, the lack of a minimum standard for companies in terms of their transparency and responsibility toward investors is a significant departure from the existing mechanisms that support a stable market and confident investors in Australia.

OPTION 3: EXTEND CSF TO PROPRIETARY COMPANIES WITH APPROPRIATE PROTECTIONS

2.48 Shareholders have acknowledged that companies that fundraise from the public should be subject to higher governance and reporting standards than ordinary proprietary companies. Option 3 balances the need to extend CSF to proprietary companies with the importance of providing retail investors with adequate protection by mitigating the risk of fraudulent activity.

2.49 Many of the benefits discussed in section 4.2 apply to this option to varying degrees including ‘Commercially Sustainable’, ‘Increased Diversity’, ‘Effective Allocation of Resources’ and ‘Opening up New Sources of Funding’. However, these benefits are achieved in Option 3 without the risk exposure of retail investors being irresponsibly heightened. The benefits of Option 3 include:

- **Reduced regulatory burden:** As discussed in section 4.2, permitting proprietary companies to access CSF will eliminate the regulatory burden of changing company types. The regulatory burden of converting to a public company includes costs associated with the additional reporting and governance obligations required of public companies (such as the cost of additional directors, preparing full financial records and eventually holding AGMs after the concessions lapse). Although there is relief under the public company CSF framework for some of these costs for up to five years for proprietary companies that convert, the costs will be incurred fully after five years. Option 3 will ensure that the CSF framework does not interfere with the normal lifecycle of a company. Importantly, proprietary companies that access CSF would be able to smoothly transition back to normal proprietary company status if no CSF investors remain on the register. Clear transition paths between company types are crucial to ensuring that companies can use CSF to support their development.
- **Responsible practices:** Requiring companies to comply with higher governance and reporting standards is likely to promote investor confidence and facilitate a successful CSF market. Proprietary companies which access the ‘crowd’ will no longer be closely held, and external investors will expect disclosure of certain financial and non-financial information as well as higher governance practices. These higher standards will support meaningful shareholder engagement, better decision-making, greater transparency and more comprehensive and accurate record keeping habits.

- ***Simplicity in public company structure:*** By removing the concessions granted to proprietary companies which convert to a public company, all public companies that access CSF after the commencement of the proprietary extension will be subject to the same set of rules.
- ***Stakeholder support:*** On balance, this option is the most compatible with the views of stakeholders which were expressed during the consultation. This option strikes the responsible middle ground by opening up CSF to a greater range of companies, creating a manageable framework for intermediaries while also acknowledging concerns about a lowering of investor protections.

2.50 The disadvantages and risks include:

- ***Increased costs:*** Proprietary companies will be required to comply with additional obligations. This will mean increased compliance costs, particularly in relation to: appointing an additional director; preparing an annual financial report; and having financial statements audited once the proprietary company exceeds the audit threshold. However, these obligations (and costs) are in aggregate lower than those placed on public companies.
- ***No secondary market:*** Due to the reduced ongoing reporting obligations it is less likely that a secondary market will emerge under this option. The public will have no information to value shares or understand the business plans of these companies.
- ***Increased investor risk:*** As discussed in section 4.2, the regulatory regime for proprietary companies was designed with the intent that such companies would not have a wide retail shareholder base. Shareholders in these companies consequently have fewer rights and protections. While the additional obligations for proprietary companies undertaking CSF proposed under this option will increase the rights and protections for shareholders, risks to investors will still be higher than under option 1 where retail investors would generally only be able to invest in public companies.

2.51 In particular, shareholders in CSF proprietary companies will not have access to audited financial statements until the company has raised more than \$3 million from CSF or other offers requiring disclosure. This may be the case for an extended period of time, compared to the \$1 million threshold and five year limit on the concession for public

companies under option 1. Audit provides external assurance about the reliability of financial statements; consequently, shareholders may be able to place a lower level of reliance on the accuracy of the financial statements for a longer period than under the status quo. Shareholders will also not have access to the protections provided by the takeovers provisions. This means that shareholders will not have statutory rights in relation to the process of a takeover bid and receipt of information to enable them to assess the merits of the bid. However, shareholders may have access to rights to participate in exit events that are contained in individual companies' constituent documents (e.g. a constitution or shareholders' agreement). Proprietary companies will be required to disclose the existence or otherwise of 'tag' rights (which provide a right to a minority shareholder to choose to sell their shareholding to a buyer that acquires a certain percentage of the company's shares) as part of their CSF offer document. CSFCSF

Costing

2.52 Removing existing restrictions on proprietary companies accessing CSF is deregulatory in nature. However, the additional obligations placed on CSF proprietary company issuers to protect crowd investors increase their regulatory burden compared to non-CSF proprietary companies. The expected growth in proprietary companies using CSF is likely also to result in the aggregate compliance burden across the economy increasing.

2.53 The removal of the public company exemptions in the CSF legislation for public companies, given proprietary companies will not need an exemption period to ease the transition to public company form, is expected to slightly increase costs for public companies on average. However, expected growth in the number of public companies using CSF is expected to be far lower than under option 1, with most CSF users expected to remain proprietary companies.

2.54 Under this option:

- Costs per issuer are expected to increase by \$13,700 per year for proprietary companies using CSF driven primarily by costs associated with additional reporting requirements associated with having a wider range of investors and to a lesser extent governance and monitoring requirements. Costs per issuer are expected to increase by \$1,090 for public companies using CSF as they will not have the costs associated with monitoring compliance with the CSF framework offset by the temporarily reduced costs associated with exemptions from annual general meetings and audit requirements in the legislation for public companies.

- Fixed costs for intermediaries are expected to be the same as under the public company framework. Intermediary costs that vary with the number of issuers raising funds are also expected to be the same as under the public company framework, with overall costs increasing in line with the expected increase in businesses raising funds via CSF.
- Costs per investor are expected to be the same as under the public company framework.

2.55 Using the regulatory burden measurement framework, it has been estimated that the indicative model would increase compliance costs by \$26.8 million per year. This is due primarily to the assumption that a greater number of companies will use the CSF framework if they can remain proprietary companies rather than switching to public companies, as required under the status quo. For all reporting periods, the Treasury portfolio has reported net compliance cost reductions and there is no reason why the portfolio will not continue to deliver on its red tape reduction targets this year, in line with the Government's regulatory reform agenda.

Table 1: Regulatory burden estimate (RBE) table

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	\$26.3 million	\$0	\$0.4 million	\$26.8 million

Assumptions underlying this estimate are in the Appendix.

Net benefit

2.56 Out of the three options, Option 3 represents a balanced approach to opening up investment and fundraising opportunities while recognising the needs of investors to have some transparency of their investments. This will improve the sustainability of the CSF regime over the long-term by increasing investor confidence in the sector, compared to Option 2. Under this option, the scope of the companies that will be able to access CSF will broaden considerably. Proprietary companies accessing CSF will continue to enjoy many of the structural benefits of the proprietary company structure such as reduced reporting requirements, lower governance obligations and greater flexibility in exit events. However, acknowledging that CSF proprietary companies will not be closely held, these companies will be subject to certain obligations

designed to increase shareholder engagement and mitigate the occurrence of fraud.

CONSULTATION

CONSULTATION PAPER

2.57 In August 2015, the Government released a consultation paper – ‘Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses’ – that sought feedback on the proposed public company CSF framework and whether it should be extended to proprietary companies. 53 submissions were received for this consultation (including nine confidential submissions) from a broad range of stakeholders including businesses, crowdfunding and trading platforms, industry bodies, advisory and legal firms, public organisations, individuals and universities.

2.58 Most stakeholders agreed that crowdfunding should be extended to proprietary companies. However, some stakeholders suggested to either first assess the operation of the CSF public company framework before considering any extension, or to not extend the framework at all.

2.59 Other feedback included:

- Stakeholders generally agreed that additional reporting obligations should apply to proprietary companies undertaking CSF, but views diverged on the level and detail of these obligations.
- Stakeholders held diverse views on the fundraising cap that should apply if proprietary companies use CSF.
- Stakeholders who supported extending crowdfunding to proprietary companies generally agreed the current non-employee shareholder limit is too low to facilitate crowdfunding. Stakeholders suggested a range of potential limits.

INDUSTRY ROUNDTABLES

2.60 Given the diversity of stakeholder views received in response to the August 2015 consultation, Treasury hosted two industry roundtables over October and November 2016 with respondents to the public consultation to seek more detailed views on a potential model for

extending CSF to proprietary companies.¹ Treasury also undertook bilateral discussions to understand issues raised at the roundtables.

2.61 Treasury consulted with approximately 30 stakeholders including: ASIC, AASB, AuASB, law firms and the Law Council, CSF platform operators, accounting firms and industry representatives, academics specialising in corporate law, venture capital investors, investment advisory firms and industry bodies representing companies and shareholder representatives.

2.62 Feedback from these roundtables, as well as follow-up bilateral discussions on specific issues, has informed the development of detailed options for the Government's consideration.

EXPOSURE DRAFT LEGISLATION

2.63 Exposure draft legislation was published for public consultation on the Treasury website.² 22 submissions were received from a broad range of stakeholders, whom were generally supportive of the CSF extension to proprietary companies.

2.64 Feedback included:

- Several stakeholders raised the concern that CSF shareholders on selling their shares could lead a proprietary company to breach the 50 shareholder limit, requiring it to convert to a public company.
- Stakeholders had diverse views on the audit requirement, with some supporting audit where a proprietary company raises more than \$1 million through CSF, with others arguing the audit should start at a lower or higher threshold.
- While stakeholders agreed that it would be inappropriate to apply the general takeover provisions, they were concerned about the complexity and restrictions on shareholding management associated with having a conditional exemption to the general takeover provisions.

¹ See <http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Crowd-sourced%20equity%20funding/Key%20Documents/PDF/Crowd-sourced-equity-funding.ashx>.

² See <https://treasury.gov.au/ConsultationsandReviews/Consultations/2017/Extending-CSF-to-proprietary-companies>

2.65 Treasury further refined the legislation through targeted consultation, including with members of the Treasurer's Fintech Advisory Group.

GOVERNMENT POLICY

OPTION 3: EXTEND CSF WITH APPROPRIATE PROTECTIONS IS THE PREFERRED OPTION

2.66 Following consideration of the three options, the Government has elected to implement Option 3: extend CSF with appropriate investor protections. This model balances the need to improve access to finance for small and innovative businesses while maintaining investor protections, and incorporates suggestions from stakeholder feedback. This option builds on the legislated CSF framework for public companies, maintaining one model of CSF offer for public and proprietary companies.

2.67 For issuers, the option to extend CSF proprietary will offer access to the CSF regime without needing to convert to the more onerous public company type. Further, the additional company obligations will require companies to meet a minimum standard that will help to ensure the sustainability of the CSF regime.

2.68 For intermediaries, this option extends the legislated CSF framework, maintaining the same intermediary rules and offer document that will enable them to seamlessly extend their service from public companies to be available to proprietary companies.

2.69 For investors, this option increases the access retail investors have to small proprietary companies. Further the investor protections will raise the standard of investment by requiring: a minimum of two directors; financial reporting in accordance with accounting standards and restrictions on related party transactions.

2.70 The Government considered the application of the takeover provisions for proprietary companies with CSF shareholders (either the general provisions or a modified version). It was decided that a full exemption is the most consistent with a 'light touch' regulatory regime and was also preferred as it would not impede reasonable fine-tuning of major shareholdings.

2.71 These protections represent a balance between encouraging broad take up of CSF by ensuring that the costs associated with raising funds are not excessive, while recognising that the extension of the framework to proprietary companies will have additional risks for retail

investors (although they will benefit from a wider range of investment opportunities).

2.72 The option to extend CSF with investor protection is likely to have the highest net benefit of the options considered, despite having higher estimated aggregate regulatory costs than either the no change or extend CSF to proprietary companies without additional investor protections options.

IMPLEMENTATION AND EVALUATION

2.73 The preferred model will be implemented through legislative amendments and regulations to the Corporations Act, and regulatory guidance published by ASIC. It is proposed that the Bill will be introduced into the Parliament in the Spring 2017 parliamentary sitting period. The regulations will be considered by the Federal Executive Council following the Bill's passage through the Parliament. The new laws will commence six months after the Bill receives Royal Assent.

2.74 During the transition period ASIC will produce regulatory guidance to help industry transition to the new laws. In the 2017-18 Budget, ASIC received \$4.5 million over four years to implement, monitor and enforce the extension of the CSF framework to proprietary companies. This will build on ASIC's implementation of the CSF framework for public companies, which includes regulatory guidance for intermediaries and companies, and the introduction of a new CSF authorisation category within the AFSL.

2.75 The Government and ASIC will closely monitor the CSF market to ensure that the changes to the law are operating as intended. By making it easier and less costly for small companies to raise equity financing through CSF, the Government would expect that the number of businesses who crowdfund will increase. Further the Government would expect the investor protections to contribute to the sustainability of the CSF sector. ASIC will use its information gathering powers to monitor key metrics, including amounts raised and the types of companies using CSF (including if they are relying on concessions available to companies with a crowd-funding offer); information about unsuccessful offers; and the number of retail clients participating and any complaints made. This will help inform the monitoring by the Government and ASIC.

2.76 The regulation impact assessment has taken into account ASIC's initial regulatory guidance and information gathering initiatives to implement the model.

2.77 The legislation provides a number of regulation making powers to fine tune the framework as the crowd funding market evolves over

time. This includes an ability to adjust key eligibility thresholds and an ability to intervene to modify concessions should examples of poor behaviour to the detriment of investors occur. These would be subject to the usual scrutiny and oversight arrangements.

APPENDIX

Current regulatory arrangements for companies

2.78 Governance and reporting requirements for the various types of companies are set out in the Corporations Act.

2.79 These requirements have over time been implemented to address the inherent conflicts of interest in corporations in which the owners of the company, that is the shareholders ('principal') and managers of the company ('agent') are separate. As the agent typically has better information than the principal about the company, the principal cannot easily be assured of the performance of the agent ('agency costs').

2.80 The law provides a number of mechanisms to minimise these agency costs such that companies are directed and controlled in a manner that protects and promotes the interests of participants. These mechanisms differ between the two broad categories of companies provided for in the Corporations Act: public companies and proprietary companies.

2.81 **Public companies** are able to make public equity offers and are not subject to restrictions on the number of shareholders they may have. Public companies are subject to a range of reporting and corporate governance obligations to protect shareholders and address agency costs, including:

- Auditors who assist in the monitoring of managers by attesting to the accuracy of companies' financial statements.
- A board of directors, each of whom has fiduciary duties to act with reasonable care and diligence, in the interests of the company, and for a proper purpose.
- Disclosure of information by companies allows shareholders to properly monitor managers and directors. Obligations such as annual financial reports, prospectus (or offer information statements in some cases) and continuous disclosure obligations seek to address the asymmetry in access to information regarding the operation and prospects of a company that exists between the managers and the owners.

This information is used to determine whether a person wishes to become, remain or exit from being a shareholder of a company.

- Annual general meetings, which provide a forum for shareholders to be informed about financial and other matters, ask questions of management and make decisions relating to matters that need to be considered.
- Members' rights to call a meeting, undertake litigation against the company, and vote when resolutions are put forward by the company.
- Restrictions on related party transactions including processes where a company intends to enter into a related party transaction that falls within a permitted exemption.

2.82 There are also a range of requirements in relation to the contents of disclosure documents, the process for making equity offers, liability of directors for misleading statements in offer documents and restrictions on advertising to ensure the disclosure is clear, effective and reliable.

2.83 **Proprietary companies** are intended to be closely-held companies where the shareholders have access to the management and consequently information asymmetries and agency costs are likely to be lower than in more widely-held public companies. Proprietary companies are subject to lower compliance and transparency obligations than public companies. Proprietary companies are defined as either small proprietary companies or large proprietary companies, with small proprietary companies having lower compliance obligations than large proprietary companies.

2.84 For example, proprietary companies are not required to hold annual general meetings, and small proprietary companies are not generally required to prepare annual financial reports, appoint auditors or have their financial statements audited.

2.85 To ensure they reflect this closely-held nature, proprietary companies are prohibited from making public offers of equity and are limited to having no more than 50 non-employee shareholders.

2.86 For both public and proprietary companies, there are certain exemptions from the requirement to use a disclosure document in primary capital raisings. These exemptions include wholesale (professional, sophisticated and experienced) investors (who are less likely to suffer from information asymmetries) and 'small scale personal offers' (where a personal offer is made and no more than \$2 million is raised in any 12

month period from no more than 20 Australian investors, to facilitate small capital raisings that may not occur if a disclosure document were required).

REGULATORY BURDEN ESTIMATE ASSUMPTIONS

Compliance cost	Details	Estimate
General assumptions		
Labour costs	Labour costs of staff members undertaking activities where otherwise not noted	\$68.79 ³
Leisure time	Lost leisure time costs for investors undertaking compliance activities	\$31 ⁴
Number of issuers	Number of new issuers using ASIC Class Order CO/273 in absence of CSF being extended to proprietary companies Number of new issuers entering the market where CSF extended to proprietary companies	25 in first year; 5 per cent growth rate per year 100 in first year; growth rate starting at 80 per cent in year 2, declining to 5 per cent per year long term ⁵
Costs for issuers		
Preparation and lodgement of annual report	Cost of preparing annual report for a start-up or small business	\$4,000
Appointment of additional director	Cost of appointing an additional director	\$5,000

³ Based on ABS labour rates in the RIS guidelines, including employer costs.

⁴ Based on leisure time rates in the RIS guidelines.

⁵ While growth rates in other comparable CSF markets have been taken into account, the growth rate of companies using CSF remains inherently speculative.

Compliance cost	Details	Estimate
Audit	Cost of having the financial statements of a start-up or small business audited on an annual basis Number of years expected, on average, to fall below the CSF audit threshold	\$10,000 6 years ⁶
Assessing eligibility to issue under CSF	Staff hours spent assessing eligibility Hours of legal advice Hourly rate of legal advice	5 hours 20 hours \$107.68 ⁷
Monitoring compliance with issuer cap	Staff hours spent on monitoring Cost of establishing systems and processes to monitor funds raised under various disclosure exemptions	4 hours \$10,000
Cost of preparing disclosure document	Total cost of preparing information statement for issuers using current online equity fundraising platforms Total cost of preparing a template disclosure document under CSEF regime	\$7,500 \$5,000
Costs for intermediaries		
AFSL	Applying for, obtaining and complying with AFSL	N/A – in place for public company framework

⁶ An average of 6 years has been estimated on the basis that the assumption under the CSF public company model (option 1, and previously estimated in a RIS dated December 2016) was 4 years. However, proprietary companies undertaking CSF are expected, on average, to be smaller and raise less funds than public companies would have under the status quo as the removal of the requirement to convert to a public company will provide less of a barrier to companies entering the CSF market. This 6 year estimate remains speculative as it is difficult to forecast how the CSF market will develop over time.

⁷ In the absence of reliable data on charge-out rates for small legal firms, estimate obtained from Hays data on salaries for legal staff, assuming a senior associate at a small private practice with a \$120,000 annual salary corresponding to an hourly rate of \$61.53. A 1.75x multiplier is applied to approximate charge-out costs, based on the approach for labour rates in the RIS guidelines.

Compliance cost	Details	Estimate
Due diligence on issuers and management	Average time to complete per issuer	5 hours
	Number of associates of issuer on whom due diligence would need to be completed	4 people
Provision of application form and disclosure statements	Average time to complete per issuer	0.5 hours
Monitoring of investor caps	Average time to complete per issuer	4 hours
	Costs of establishing systems and processes	N/A – in place for public company framework
Provision of communications facility	Average time to monitor communications facility per issuer	4 hours
	Cost of establishing communications facility and monitoring process	N/A – in place for public company framework
Costs for investors		
Monitoring compliance with investor caps	Average time to complete prior to each investment	0.5 hours
Consideration and signature of risk acknowledgement statement	Average time to complete prior to each investment	0.15 hours

Chapter 3

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017

3.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

3.2 This Bill amends the *Corporations Act 2001* to extend the crowd-sourced funding (CSF) regime to proprietary companies by:

- expanding the eligibility for the CSF regime in section 738H to proprietary companies that meet eligibility requirements;
- providing that proprietary companies with shareholders who acquire shares through a CSF offer are not subject to the takeovers rules;
- adding special investor protection provisions for proprietary companies accessing the CSF regime; and
- removing the temporary corporate governance concessions provided for in the *Corporations Amendments (Crowd-sourced Funding) Act 2017* for public companies that access the CSF regime.

3.3 The special investor protection provisions that will apply to proprietary companies accessing the CSF regime include requirements to:

- maintain a minimum of two directors;
- prepare annual financial and directors' reports in accordance with accounting standards;

- have their financial reports audited once they raise \$3 million or more from CSF offers; and
- comply with the existing related party transaction rules that apply to public companies.

Human rights implications

3.4 This Bill does not engage any of the applicable rights or freedoms.

Conclusion

3.5 This Bill is compatible with human rights as it does not raise any human rights issues.

