The Senate

Economics Legislation Committee

Corporations Amendment (Crowd-sourced funding) Bill 2015 [Provisions]

February 2016

ISBN 978-1-76010-379-8

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Economics Legislation Committee

Members

Senator Sean Edwards (Chair)	South Australia, LP
Senator Chris Ketter (Deputy Chair)	Queensland, ALP
Senator David Bushby	Tasmania, LP
Senator Sam Dastyari	New South Wales, ALP
Senator Matthew Canavan (to 23 Feb 2016)	Queensland, NATS
Senator Dean Smith (from 23 Feb 2016)	Western Australia, LP
Senator Nick Xenophon	South Australia, IND

Participating Members

Senator Jenny McAllister	New South Wales, ALP

Secretariat

Dr Kathleen Dermody, Secretary

Ms Natasha Rusjakovski, Senior Research Officer

Ms Sarah Batts, Administrative Officer

Ms Hannah Dunn, Administrative Officer

PO Box 6100
Parliament House
Canberra ACT 2600
Tel: 02 6277 3540
Fax: 02 6277 5719
Email: economics.sen@aph.gov.au
Internet: www.aph.gov.au/senate_economics

Table of Contents

Chapter 1
Introduction

Reference

1.1 On 3 December 2015, the Assistant Minister to the Treasurer introduced the Corporations Amendment (Crowd-sourced Funding) Bill 2015 (the bill) into the House of Representatives. On the same day, the provisions of the bill were referred to the Economics Legislation Committee for inquiry and report by 22 February 2016.[1] The committee's reporting date was subsequently extended to 29 February 2016.[2]

1.2 The committee advertised the inquiry on its website and received 22 submissions. A list of submissions received is at Appendix 1.

1.3 A public hearing was held in Canberra on 23 February, 2016. The witness list is at appendix 2.

Terminology

1.4 The committee notes that the bill employs the term 'crowd-sourced funding' (CSF) instead of the more widely used term 'crowd-sourced equity funding' (CSEF). Both terms are used in this report.

Purpose of the bill

1.5 Productivity is one of the core drivers of economic growth. Recognising this, governments have sought to foster innovation as a means of unlocking productivity. The continuing growth of the internet, in particular, offers new opportunities to boost productivity through innovative ways to raise funds. Crowd sourced funding (CSF) is one such method of online fundraising for innovative start-up and other small enterprises that lack access to finance to develop their business at a critical early stage.

1.6 CSF, also known as equity crowdfunding or investment-based crowdfunding, is an evolving concept in corporate capital-raising. Broadly, the term describes a company seeking funds—particularly start-up or early-stage capital—online from 'the crowd'. In exchange for cash, the company offers its equity. Equity offers are published through an online portal, also known as a funding portal; that is, a website.[3]

1.7 CSF allows entrepreneurs to raise funds in small amounts from a large number of investors, instead of relying on large capital outlays from one or more investors.

---

1 *Journals of the Senate*, No. 134—3 December 2015, p. 3624.

2 *Journals of the Senate*, No. 138—22 February 2016, p. 3758.

3 Corporations and Markets Advisory Committee (CAMAC), *Crowd sourced equity funding*, May 2014, p. 1.

1.8 A number of recent reviews have identified CSF as a means of giving emerging, innovative business access to the capital they need to establish and grow. The bill aims to further the objective of encouraging innovation and stimulating economic growth by facilitating funding for emerging businesses.[4]

1.9 The purpose of the bill is to facilitate crowd-sourced equity funding in Australia. The Explanatory Memorandum described crowd-sourced funding as:

> …an emerging form of funding that allows entrepreneurs to raise funds from a large number of investors. It has the potential to provide finance for innovative business ideas and additional investment opportunities for retail investors, while ensuring investors continue to have sufficient information to make informed investment decisions.[5]

1.10 If enacted, the bill would also provide companies that are eligible to crowd fund with temporary relief from otherwise-applicable reporting and corporate governance requirements.

1.11 The bill's explanatory memorandum details why this legislation is necessary, as existing legislative arrangements may be a barrier to small businesses, or start-ups, making securities offers:

- For proprietary companies, a limit of 50 non-employee shareholders and prohibitions on making public offers of securities mean such companies are not able to access the large number of small-scale investors that would typically be targeted under an equity CSF campaign.
- Public companies are not subject to these restrictions, but must comply with substantially higher corporate governance and reporting obligations that may be too expensive to be an option for small business. Public companies making equity or debt offers must generally also use a disclosure document, which can be costly and time consuming to prepare.[6]

1.12 The bill seeks to remove the regulatory barriers to CSF.

Key provisions of the bill

1.13 The bill comprises three schedules setting out amendments to the *Corporations Act 2001* (the Act) and consequential amendments to the *Australian Securities and Investments Commission Act 2001* (the ASIC Act), with the objective

4 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, (Explanatory Memorandum) p. 7.

5 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 3.

6 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 8.

of facilitating crowd-sourced equity funding. It is a key feature of the government's *Growing Jobs and Small Business* package.[7]

1.14 Schedule 1 of the bill would amend the *Corporations Act 2001* (the Act) and establish a regulatory framework to facilitate crowd-sourced funding by small, unlisted public companies. The proposed regime would include:

- eligibility requirements for a company to fundraise via CSF, including disclosure requirements for CSF offers;
- obligations of a CSF intermediary in facilitating CSF offers;
- the process for making CSF offers;
- rules relating to defective disclosure as part of a CSF offer; and
- investor protection provisions.[8]

1.15 Schedule 1 also seeks consequential amendments to the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) to expand the range of financial services covered by the ASIC Act to include a crowd-funding service, as defined by the Corporations Act.

1.16 Schedule 2 of the bill would provide eligible new public companies with temporary relief from reporting and corporate governance requirements. This would reduce potential barriers to adopting the required public company structure.

1.17 Schedule 3 introduces provisions aimed at providing greater flexibility in the Australian Market Licence (AML) and clearing and settlement facility licencing regimes.

Scrutiny of bills

1.18 Under Senate standing order 25(2A), a legislation committee, when examining bills or draft bills, shall take into account any comments on the bills published by the standing committee for the Scrutiny of Bills. The standing committee assesses legislative proposals against a set of accountability standards that focus on the effect of proposed legislation on individual rights, liberties and obligations, and on parliamentary propriety.

1.19 The Standing Committee for the Scrutiny of Bills examined the bill, referring a number of questions to the Assistant Treasurer.[9] That committee was primarily concerned with the delegation of legislative power effected by certain sections of the bill. The committee notes that the standing committee drew attention to these provisions, stating that the provisions may be considered to delegate legislative powers inappropriately. The Standing Committee for the Scrutiny of Bills was also

---

7 See http://www.business.gov.au/small-business/Pages/jobs-and-small-business-package.aspx (accessed 22 February 2016).

8 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 3.

9 Senate Standing Committee for the Scrutiny of Bills, Alert Digest No. 1 of 2016, pp. 9–11.

concerned with provisions reversing the onus of proof. That committee again drew attention to these provisions, noting that they may be considered to trespass unduly on personal rights and liberties.

1.20 In its subsequent report, the standing committee included the Minister's response to the matters raised, which included noting the evolving nature of CSF and the importance of being able to adjust quickly as the market develops and investors become more familiar with the sector.[10] The specific matters raised by the standing committee, outlined in full its report, were not considered as part of this current inquiry. The committee notes, however, that the bill contains provisions designed to ensure that the legislation can be applied flexibly to the rapidly changing CSF environment.

Regulation impact statement

1.21 The bill's Explanatory Memorandum states:

> It is expected that the overall 'per business' compliance costs for issuers that participate in crowd-sourced funding will decline. However, given the likely growth in the number of businesses raising funds through these arrangements, the aggregate compliance burden over the economy is expected to increase.[11]

1.22 The Explanatory Memorandum noted that the CSF model in the bill is likely to have the highest net benefit of the options considered by the government and a 'lower estimated aggregate regulatory cost'.[12]

Human rights

According to the Explanatory Memorandum, the bill is compatible with human rights as 'it seeks to protect retail clients from advertisements that could induce them to make investment decisions without having all the necessary information'.[13] The Parliamentary Joint Committee on Human Rights made no comment on the provisions of the bill.[14]

Acknowledgements

1.23 The committee thanks all those who contributed to the inquiry.

---

10 Senate Standing Committee for the Scrutiny of Bills, Second report of 2016, 24 February 2016, pp. 64–67.

11 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 5.

12 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 9.24.

13 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 10.11.

14 Parliamentary Joint Committee on Human Rights, *Human rights scrutiny report*, Thirty-third report of the 44th Parliament, 2 February 2016, p. 2.

Chapter 2

Background

2.1 CSF is an emerging form of funding and many reviews have been undertaken to ascertain the merit of having a legislative framework designed to facilitate this type of funding. Also a number of countries have introduced a CSF regime, which provides some guidance on the possible forms that Australia could adopt. In this chapter, the committee looks at a number of reviews and public consultation processes that have informed the CSF framework outlined in the bill.

Review of regulations governing crowd-sourced equity funding

2.2 In June 2013, the then government released a 'strategic update', which provided an overview of the initiatives, and outlined a number of new initiatives, that represented the Australian Government's progress to embrace the country's digital future. In this publication, the government indicated that it would conduct a review of regulations governing crowd-sourced equity funding with the view to determine a best practice framework for CSEF.[1] In consultation with stakeholders, the review was to consider:

- whether Australian corporations law appropriately facilitates CSEF;
- whether international models can provide guidance; and
- what would constitute a best practice framework for Australia to balance investor protections and consumer confidence with investment opportunities and access to capital for start-ups, having regard to existing regulations and the Future of Financial Advice (FOFA) reforms.[2]

2.3 The proposed review was intended to provide recommendations by April 2014 for a practical CSEF regime.[3] The Corporations and Markets Advisory Committee (CAMAC)[4] was asked to undertake the review.[5]

---

1 Australian Government, Department of Broadband, Communications and the Digital Economy, *Advancing Australia as a Digital Economy*: *an update to the National Digital Economy Strategy*, 2013, pp. ix, 31 and 33.

2 Australian Government, Department of Broadband, Communications and the Digital Economy, *Advancing Australia as a Digital Economy*: *an update to the National Digital Economy Strategy*, 2013, p. 33.

3 Australian Government, Department of Broadband, Communications and the Digital Economy, *Advancing Australia as a Digital Economy*: *an update to the National Digital Economy Strategy*, 2013, p. 33.

4 CAMAC was established in 1989 and is currently constituted under Part 9 of the ASIC Act 2001. CAMAC provides independent advice to the Minister, when requested or on its own initiative, on the administration of relevant laws or changes to them.

5 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 1.

Corporations and Markets Advisory Committee

2.4 CAMAC considered the following questions:

- in principle, should CSEF be facilitated in Australia?
- (if so) does the existing law facilitate CSEF?
- (if not) what policy option to facilitate CSEF should be adopted?
- what issues arise in implementing the recommended policy option?[6]

2.5 As a starting point, CAMAC recognised that using legislation to facilitate CSEF had the potential to promote productivity and economic growth, provide employment opportunities in Australia and return financial and other benefits to crowd investors. It also noted that:

> …lack of a supportive local regulatory environment for CSEF may result in worthwhile Australian entrepreneurs incorporating in other countries, or moving their businesses offshore, to enable their ideas or projects to be funded by the crowd.[7]

2.6 According to CAMAC, CSEF provided:

> …the potential to bridge the capital gap for some start-ups and other small scale enterprises, and also help them move up the 'funding escalator' as their projects, and future prospects, strengthen. To that extent, crowd investors, collectively, have the potential to play an important, sometimes decisive, role in financing an enterprise at its crucial early stage, which may promote productivity and economic growth and foster employment, while, ideally, returning financial or other benefits to the crowd.[8]

2.7 On the downside, CAMAC recognised some possible negative effects of CSEF such as diverting funding from other worthwhile economic ventures and savings towards start-ups that eventually fail. Importantly it also identified possible financial risk for crowd investors, given that in many instances investors, in effect, were 'being asked to finance innovative projects that do not have the level of maturity that traditional financial market sources require'. CAMAC noted further:

> It may involve retail investors, including those with low financial literacy or capacity, making investments in companies, many of which may fail, leading to the total loss of the funds invested. Even for ongoing projects, any return on an equity investment may be well into the future or never eventuate, and there may be no practical means in the meantime to realise the investment.[9]

---

6 CAMAC, *Crowd sourced equity funding*, May 2014, p. 7.

7 Corporations and Markets Advisory Committee, 'Crowd sourced equity funding', Guide through the CAMAC report.

8 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 6.

9 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 6.

2.8 Respondents to CAMAC's discussion paper strongly supported the facilitation of CSEF in Australia, 'in some form at least'. They made the point, however that:

> …the full extent of this potential to successfully fund and develop innovative start-ups and other enterprises will only become clearer over time as the market develops and responds to new investment opportunities.[10]

2.9 CAMAC acknowledged that, at that stage in what was an evolving concept, arguments both for and against CSEF were speculative.[11] CAMAC also found that the law, as it stood, presented considerable difficulties for proprietary or public companies wishing to use CSEF.

2.10 While recognising that there were arguments both in favour and against facilitating CSEF, CAMAC concluded that CSEF should be facilitated. Such an initiative, CAMAC stated, had the potential 'to encourage the Australian start-up entrepreneurial sector, especially in the crucial early stages of project and product development'. Further:

> …enterprises that are funded through CSEF and prove to be commercially successful may provide meaningful returns to their crowd investors, as well as creating employment and other consequential economic benefits.[12]

2.11 CAMAC proposed a model whereby an eligible issuer (a public company or an 'exempt public company') may seek funds from the crowd by offering its equity through a licensed online intermediary under specified conditions which, among things, included:

- it was offering shares in the company;
- the offer was a primary offer;
- the offer did not exceed the issuer cap;
- the offer disclosure requirements were complied with; and
- the controls on advertising were complied with.[13]

2.12 With regard to the offer, CAMAC proposed that the issue cap not exceed $2 million in any 12 month period.[14]

---

10 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 12.

11 CAMAC, *Crowd sourced equity funding*, May 2014, p. 7. In reaching this conclusion CAMAC conducted its review 'in the context of considerable, and continuing, developments concerning CSEF [crowd-sourced equity funding] in a number of overseas jurisdictions.' CAMAC, *Crowd sourced equity funding*, May 2014, p. 2. Details of approaches to CSEF are set out in appendices to the CAMAC report.

12 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 12.

13 CAMAC, *Crowd sourced equity funding*, May 2014, p. 49.

2.13 According to CAMAC, consideration should be given to excluding companies with substantial capital (for example, more than $10 million) from raising funds through CSEF. It reasoned that they would no longer be start-ups or small scale enterprises, and would tend to 'have the financial capacity to make regulated public offers under Chapter 6D (fundraising) if they wished to raise additional capital'.[15]

2.14 The CAMAC model recognised the central role of intermediaries in bringing together issuers and crowd investors and recommended that each equity offer to the crowd be conducted through one intermediary only, operating online only. The intermediary should be appropriately licensed and comply with the various obligations attached to that licence including:

- conducting limited due diligence checks on issuers;
- providing a generic risk disclosure statement to crowd investors;
- checking compliance with investor caps in some instances;
- providing communication facilities between issuers and investors;
- having, and disclosing information about, dispute resolution procedures and indemnity insurance; and
- disclosing the fees they charge.[16]

2.15 In respect of crowd investors, the CAMAC model contained proposals to protect their interests, such as:

- investment caps for crowd investors ($2,500 per issuer, and $10,000 for all issuers, in any 12 month period);[17]
- requirement for crowd investors to acknowledge the risk disclosure statement before investing;
- cooling-off rights and other withdrawal rights; and
- reporting obligations by issuers to crowd investors.[18]

2.16 These proposals were intended to protect crowd investors in various ways, while drawing to their attention to the inherent risks that remain with this form of investment.[19] For example, CAMAC did not support any sanction being imposed on an investor who breached an investor cap, explaining that:

---

14 Corporations and Markets Advisory Committee, 'Crowd sourced equity funding', Guide through the CAMAC report.

15 CAMAC, *Crowd sourced equity funding*, May 2014, pp. 52–53.

16 CAMAC, *Crowd sourced equity funding*, May 2014, p. 87.

17 Corporations and Markets Advisory Committee, 'Crowd sourced equity funding', Guide through the CAMAC report, May 2014.

18 CAMAC, *Crowd sourced equity funding*, May 2014, p. 135.

19 CAMAC, *Crowd sourced equity funding*, May 2014, p. 135.

> …these caps constitute formal recognition of the financial risks for crowd investors that are inherent in CSEF, given that in many instances they, in effect, are being asked to finance innovative projects that do not have the level of maturity that traditional financial market sources require.

2.17 CAMAC reasoned that the caps could 'act as a brake on excessive investment by most crowd investors, even if the cap is inadvertently or intentionally breached by particular investors in some cases'.[20]

2.18 Importantly, CAMAC noted that if retail investors with low financial literacy and or/capacity were to suffer significant losses the 'confidence of the crowd' could be undermined, placing the overall viability of CSEF as a source of funding at risk.[21]

Consultation process

2.19 The government's Industry Innovation and Competitiveness Agenda, released in October 2014, recognised the potential for CSEF to act as an alternative to traditional bank debt funding for Australian businesses. It announced that, building on CAMAC's report, the Assistant Treasurer would consult on a regulatory framework to facilitate CSEF. This consultation process would seek to ensure that 'any regulatory framework effectively balances the aims of reducing compliance costs, including for small businesses, and maintaining an appropriate level of investor protection'.[22] The government released a discussion paper, 'Crowd-sourced Equity Funding', in December 2014, as part of the consultation process on a potential regulatory framework to facilitate the use of CSEF in Australia. The paper was open for public comment from 8 December 2014 to 6 February 2015, and was supplemented by consultations and round tables.[23] The feedback from this consultation process was to inform the government's consideration of 'a future regulatory framework for CSEF in Australia'.

Financial System Inquiry

2.20 The Murray Inquiry into Australia's financial system (FSI), released by the government in December 2014, also recognised the difficulties SMEs face obtaining access to external financing. In its view, a 'well-developed crowdfunding system' could 'aid broader innovation and competition in the financial system'. It acknowledged that the risks associated with crowdfunding investments would 'require some adjustments to consumer protections', including capping individual's investments and the disclosure of risk. The FSI recommended the government

---

20 CAMAC, *Crowd sourced equity funding,* May 2014, p. 144.

21 CAMAC, *Crowd sourced equity funding,* May 2014, pp. 6 and 12.

22 Australian Government, *Industry Innovation and Competitiveness Agenda, An action plan for a stronger Australia,* p. 81.

23 Australian Government, Discussion paper, 'Crowd-sourced Equity Funding', December 2014, p. iii.

continue the process 'to graduate the fundraising regime to facilitate securities-based crowdfunding'.[24] In more detail, the FSI recommended:

> …facilitating crowdfunding by adjusting fundraising and lending regulation, streamlining issuers' disclosure requirements and allowing retail investors to participate in this new market with protections such as caps on investment.[25]

Government response

2.21 In its response to the FSI, released in October 2015, the government noted that the development of a crowd sourced equity funding market in Australia was 'an urgent priority for the government to support the funding needs of early stage innovators'.[26] The government accepted the FSI's recommendation and stated its commitment to develop a regulatory framework to facilitate crowd-sourced equity funding through the 2015–16 Budget.[27] Further, the government noted that the Minister for Small Business and Assistant Treasurer would consult on draft legislation to implement this framework by the end of 2015. The government would also consult the community on crowd-sourced debt funding in parallel with legislation to implement crowd-sourced equity funding.[28]

Productivity Commission

2.22 In November 2014, before the final FSI report was published, the Treasurer asked the Productivity Commission to undertake an inquiry into barriers to business entries and exits. It was to identify options for reducing these barriers where appropriate, in order to drive efficiency and economic growth in the Australian economy. The Productivity Commission's Business Set-up, Transfer and Closure draft report, released in May 2015, also supported the introduction of a CSEF framework.[29] It recognised the existence of 'significant regulatory barriers to the development of CSEF platforms'.[30]

2.23 In its final report, the Commission recommended that all businesses, public or private, that raise equity under CSEF arrangements should be regulated as 'exempt'

---

24 *Financial System Inquiry, Final Report*, November 2014, p. 179.

25 *Financial System Inquiry, Final Report*, November 2014, p. 145.

26 See Government Response to the Financial System Inquiry, available at: http://treasury.gov.au/fsi (accessed 23 February 2016).

27 Minister for Industry, Innovation and Science, the Hon Christopher Pyne and Assistant Minister for Innovation, the Hon Wyatt Roy, Joint media release, 'Crowd-sourced equity funding vital for innovation', 20 October 2015 http://minister.industry.gov.au/ministers/pyne-roy/media-releases/crowd-sourced-equity-funding-vital-innovation (accessed 23 February 2016).

28 See Government Response to the Financial System Inquiry, p. 16, available at: http://treasury.gov.au/fsi (accessed 23 February 2016).

29 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 7.

30 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, p. 143.

public companies for a limited period. They would be subject to initial lower reporting and disclosure requirements than public companies raising funds and 'should face a $5 million per year cap in the amount that could be raised from unsophisticated and non-professional investors'.[31] It found that the proposed new regulatory framework for crowd-sourced equity should balance the financing needs of business against the risk preferences of different types of investors.[32]

International developments

2.24 It should be noted that Australia is not alone in its endeavour to introduce a regime designed to facilitate CSEF. In December 2015, the International Organization of Securities Commission (IOSCO) published the results of its fact finding survey, to 'enhance IOSCO's understanding of developments in members' current or proposed investment-based crowdfunding regulatory programs and to highlight emerging trends and issues in this area'. It noted that most regulatory regimes for crowdfunding have only recently been implemented, which showed a variety of approaches to regulate crowdfunding. Based on the responses from 23 IOSCO members, the survey found:

> …despite certain commonalities and divergences in various jurisdictions, and the potential risks and positive rewards, crowdfunding regimes are in their infancy (or have not yet been launched) in most jurisdictions surveyed. Accordingly, this Report does not propose a common international approach to the oversight or supervision of on-going or proposed programs.[33]

2.25 The IOSCO contended, however, that when developing or investing in crowdfunding, it was 'important for regulators and policy makers to balance the need for supporting economic growth and recovery with that of protecting investors.[34]

New Zealand

2.26 Australia's near neighbour, New Zealand, enacted the *Financial Markets Conduct Act 2013* to facilitate CSEF. Following the passage of this legislation, regulatory changes were introduced to authorise financial crowdfunding. Under this regime, companies seeking to raise funds must use a licensed equity-crowdfunding provider. The Financial Markets Authority is responsible for licensing.

2.27 According to Mr James Murray, Department of Business, Christchurch Polytechnic Institute of Technology, the main change that makes financial crowdfunding viable in New Zealand is 'exempting issuers from producing

---

31 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, p. 19.

32 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, p. 2.

33 IOSCO, *Crowdfunding 2015 Survey Responses Report*, December 2015, p. v, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD520.pdf (accessed 5 February 2016).

34 The Board of IOSCO, 'Statement on Addressing Regulation of Crowdfunding, December 2015', http://www.iosco.org/library/pubdocs/pdf/IOSCOPD521.pdf (accessed 5 February 2016).

prospectuses and investment statements when making a regulated offer through an equity crowdfunding platform'. He indicated that the regulations were:

> …not simply a relaxation of financial regulations but reflect a trade-off between different forms of regulation. Reduced disclosure recognises that standard financial disclosures by new and high-growth companies have little value, so they have been replaced by mandatory use of licensed crowdfunding platforms and a $2m limit on the amount that can be raised.[35]

2.28 The New Zealand model places no investor cap other than, as mentioned above, limiting the amount a company can raise through crowd-funding to $2 million in a 12-month period.[36] As at March 2015, there were three active platforms of the four licensed equity-crowdfunding providers.[37] CAMAC described the New Zealand regulatory regime as 'light touch'.[38]

Proposed CSF model

2.29 In August 2015, after taking account of the findings of the various reviews and international developments, the Australian Government released an outline of its proposed framework for CSF. This model reflected:

> …many of the key aspects of New Zealand's approach, such as licensing and other gatekeeper obligations for intermediaries, reduced disclosure for companies raising funds, and a liberal approach to retail investor caps along with investor protections such as risk warnings for investors.[39]

2.30 During a subsequent four-week consultation period, over 50 submissions were received. The government undertook targeted consultation on the draft legislation, making further refinements based on the feedback it received before its introduction into parliament. The government also consulted with state and territory governments which, according to the Assistant Minister, agreed to these amendments to the Corporations Act.

2.31 A number of provisions in the legislation depend on regulations to provide specific detail on requirements. On 22 December 2015, the government released exposure draft regulations that set out the required contents of the CSF offer document, investor's risk acknowledgement, the risk warning and additional detail to

---

35 James Murray, Senior Lecturer, Department of Business, Christchurch Polytechnic Institute of Technology, 'Equity Crowdfunding and Peer-to-Peer Lending in New Zealand: The first year', *JASSA*, The Finsia Journal of Applied Finance, Issue 2, 2015. See http://www.australianbankingfinance.com/new-zealand/crowdfunding-lessons-from-nz/ (accessed 22 February 2016).

36 Craig Foss, Financial Markets Authority, 'NZ financial markets enter new era', media release, 1 April 2014.

37 Consumer, 'Crowdfunding', 4 March 2015, https://www.consumer.org.nz/articles/crowdfunding (accessed 25 February 2016).

38 Corporations and Markets Advisory Committee, *Crowd sourced equity funding Report*, May 2014, p. 16.

39 House of Representatives, *Hansard*, 3 December 2015, p. 14,633.

support intermediaries to carry out their obligations. Submissions closed on 29 January 2016.[40]

Finding the right balance

2.32 The various reviews conducted in Australia found that although there was firm support for a regime, views on the specific model varied. The CSEF regimes introduced in various countries also demonstrate the diversity of approaches taken in designing a crowd fundraising scheme. After a period of wide consultation and refinement of proposals for a CSEF model, the Australian Government introduced its proposal into Parliament in December 2015.

2.33 As the Assistant Minister to the Treasurer noted in his second reading speech, the government consulted extensively on the design of the proposed crowd-sourced equity funding framework. It took into consideration the recommendations of the CAMAC review and international experience including the framework in New Zealand.[41]

2.34 The importance of balancing the needs of business and the interests of investors was a paramount consideration when formulating the framework. The Explanatory Memorandum noted that for CSF to be sustainable:

> …any regulatory framework needs to balance reducing the current barriers to CSF with ensuring that investors continue to have an adequate level of protection from financial and other risks, including fraud, and sufficient information to allow them to make informed decisions.[42]

2.35 There was general agreement that the regulatory framework should minimise reporting and compliance obligations placed on issuers and provide adequate protection to small investors: that it should strike the right balance between promoting crowdfunding and ensuring investor protection and market integrity.[43] For example, during the consultation phase, ASIC's noted that its primary interest in the regulation of this potential source of funding for small businesses and start-ups was to ensure 'an appropriate balance between the effective administration of CSEF and the need for investors to be confident and informed.[44]

2.36 Submitters to this current inquiry made similar observations. They recognised the advantages of having a legislative framework to facilitate the use of CSF regime

---

40 The Treasury website, 'Crowd-sourced equity funding', 22 December 2015, exposure draft.

41 House of Representatives, *Hansard*, 3 December 2015, p. 14,633.

42 Explanatory Memorandum, paragraph 1.10.

43 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, pp. 137 and 144. See also, OICU-IOSCO, Media Release, 'IOSCO publishes 2015 Survey Responses Report on Crowdfunding', IOSCO/52/2015, Madrid, 21 December 2015.

44 ASIC, submission to Treasury's discussion paper on crowd-sourced equity funding, 6 February 2015.

and supported the intention of the bill to introduce such a regime. For example, the Business Council of Co-operatives and Mutuals stated:

> Crowd funding has emerged as a legitimate means for small business and start-ups, especially social enterprises to access modest amounts of funding to commence an enterprise or take their enterprise to the next level. New jobs are created through small business, particularly in rural and regional areas.[45]

2.37 All submissions recognised that the challenge was to find the right balance between creating an attractive capital raising option for small companies and protecting the interests of investors.

2.38 The government was of the view that its model detailed in the bill 'strikes the right balance between supporting investment, reducing compliance costs and maintaining an appropriate level of investor protection'.[46]

2.39 There was, however, a divergence of views on the correct balance, some expressing concerns that the government's proposed model would fall short of expectations and not deliver. Some thought that the eligibility requirements for a company were too restrictive, that the barriers to entry were too high. From their perspective, the proposed regime would in effect deny deserving companies the opportunity to raise funds through CSF. Others looked at the responsibilities and obligations imposed on the intermediaries and contended that they were too onerous and costly and would discourage people from providing this service. While some submitters argued the need to minimise cost and complexity, in their view, the legislation was too complicated to be easily understood.

Conclusion

2.40 In the following chapter, the committee explores the differences of opinions on the government's proposed CSF model. The committee considers, in particular, the provisions governing:

- eligible CSF issuers—the requirement to be a public unlisted company and the asset test;
- eligible offers—the cap placed on the amount that can be raised—$5 million—and the three-month period during which the offer is open;
- offer documents and their required contents—consent requirements, warnings on risk, restrictions on advertising;
- intermediaries—the requirement to hold an AFSL and their gate keeping responsibilities;
- investors and investor protection—the cap on amount that can be invested, cooling-off period and financial literacy; and

45 *Submission 10*, p. 4.

46 House of Representatives, *Hansard*, 3 December 2015, p. 14,633.

- monitoring and reviewing of the legislation.

Chapter 3
Main issues

Introduction

3.1 Submitters largely welcomed the introduction of a legislative framework for crowd-sourced funding as a means of providing an environment conducive to the growth of new businesses and their retention in Australia. Most agreed on the importance of striking the right balance between ensuring an efficient means of raising capital and protecting investors' interests, reflecting consensus among international stakeholders surveyed by the International Organization of Securities Commissions (IOSCO).[1]

3.2 In-principle support for a legislative framework did not, however, translate into support for the Corporations Amendment (Crowd-sourced Funding) Bill 2015 (the bill) in its entirety, with many submitters proposing a range of amendments.

3.3 The views presented to the committee reflected the complexity of the proposed legislation and evolving nature of the funding concept. The differing views aired during the wide-ranging consultation that took place before introducing this bill were evident again during this inquiry. The main concerns raised in submissions centred on eligibility requirements for CSF companies and the associated costs, content of offer documents, the responsibilities of intermediaries and investor protection measures. This chapter considers those concerns.

Eligibility requirements

3.4 The bill sets out the criteria that businesses would have to comply with in order to be considered an eligible crowd-sourced funding (CSF) company.[2] Broadly:

a) the company is a public company limited by shares;

b) the company's principal place of business is in Australia;

c) a majority of the company's directors (not counting alternate directors) ordinarily reside in Australia;

d) the company complies with the assets and turnover test;

e) neither the company, nor any related party of the company, is a listed corporation;

f) neither the company, nor any related party of the company, has a substantial purpose of investing in securities or interests in other entities or schemes.[3]

---

1 Media Release, 'IOSCO publishes 2015 Survey Responses Report on Crowdfunding', IOSCO/52/2015, Madrid, 21 December 2015.

2 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, pp 13–16.

Public company status

3.5 In its 2014 review of CSEF, CAMAC considered that an eligible issuer should be a public company. It reasoned that the issuer would be making an offer to the public, in the form of the online crowd, and would 'have those members of the public who accept the offer as its shareholders'. It argued, however, that to overcome the current disincentives on promoters to form a public company, a new classification of 'exempt public company' should be created. Thus, it recommended that an eligible issuer could choose to be a public company or an exempt public company.[4]

3.6 The government's model, however, does not allow for this category of 'exempt public company'. As noted above, an eligible CSF company must be a public company limited by shares.

3.7 A number of submissions disagreed with the requirement for an issuer to be a public company. For example, VentureCrowd, an equity crowd funding business, argued that the requirement that an CSEF start-up to first become a public company imposes a significant (and unnecessary) regulatory, administrative and compliance burden on those start-ups—tasks and expenses well beyond the capacity and limited resources of a startup. It noted that an ECF start-up would be required to:

- spend thousands of dollars on lawyers and accountants to convert to being a public company;
- sign 50+ new shareholders to subscription agreements, a shareholders agreement and issue share certificates; and
- arrange shareholder resolutions and annual general meetings, maintain an up-to-date shareholder register and keep its many shareholders informed.[5]

3.8 It also noted:

> If there had been proper consultation with the Australian start-up community before the Bill was drafted, it would have been apparent that these fledgling businesses are unlikely to be able to adequately deal with 20 new shareholders, let alone more.[6]

3.9 CrowdfundUp, a crowd funding provider, also expressed the view that the requirement to become a public company in order to raise capital from the crowd

---

3 Subsection 738(H)(1), Corporations Amendment (Crowd-sourced Funding) Bill 2015.

4 Corporations and Markets Advisory Committee, 'Crowd sourced equity funding', Guide through the CAMAC report. The Productivity Commission also recommended that companies that raise equity under CSEF arrangements should be regulated as 'exempt' public companies for a limited period and subject to initial lower reporting and disclosure requirements than public companies raising funds. Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, p. 19.

5 *Submission 5*, paragraph 3(d).

6 *Submission 5*, paragraph 3(i).

would place 'undue compliance costs, administration costs, and regulatory burdens on start ups seeking to raise capital'.[7]

3.10 It recommended that to facilitate crowdfunding in Australia, an expansion of the existing Proprietary Ltd company regime should be introduced.[8] Adopting a similar argument, King and Wood Mallesons suggested that there was no compelling policy basis for restricting eligibility to public unlisted companies and also referred to the administrative costs associated with being a public company, especially at a time in a startup's development when it could 'ill-afford it'.[9] Pitcher Partners also thought it was important to consider the ability for private companies to be introduced as eligible CSF companies. It recommended that 'to ensure that CSF platforms are economically viable, it is important to consider expanding the customer base of the proposed regime to existing and future private companies.[10] Equitise asserted that 'no market has forced a company to change their incorporation to be eligible to raise capital through equity crowdfunding'.[11] It stated:

> Forcing companies to become a Public Company to be eligible to use equity crowdfunding increases the cost and compliance, which will mean many companies will not participate.[12]

3.11 According to BDO Australia, the requirement to become a public company was 'likely to be daunting and costly' for startups and small business and would welcome CSF as an investment option for all types of companies.[13] In its view:

> The requirement to be a public company may act as a significant deterrent to many businesses, and in particular to start-up companies.[14]

3.12 In contrast, other submitters strongly supported the requirement for a CSF company to be a public company. Fat Hen Venture, a retail backed venture capital company, was firmly of the opinion that any company engaging with the general public should be 'under a higher level of duty in relation to having an auditor, holding an AGM and disseminating information on a regular basis as though they were a disclosing entity':

> It does not matter whether a public company raises $250,000 or $25m from the public—they must in our opinion take on the added reporting responsibility and governance around audit, proper systems and shareholder meetings. In today's contemporary business environment, the extra costs are immaterial to the money raised and it would greatly help to reinforce the

---

7 *Submission 15*, paragraphs 1.1–1.2.

8 *Submission 15*, paragraphs 1.1–1.2.

9 *Submission 16*, p. 5.

10 *Submission 12*, p. 4.

11 *Submission 21*, paragraph 18.

12 *Submission 21*, paragraph 18.

13 *Submission 18*, p. 1.

14 *Submission 18*, p. 2.

> duties of directors who have sought to engage with the larger pool of general public for funds and thus have a higher responsibility consistent with running a public company.[15]

3.13 In brief, Fat Hen Venture argued:

> Saving a few dollars should NOT be at the expense of good governance, auditor appointment and keeping shareholders informed. All the investors we speak to want an audit done on the investee company and a continuous style reporting regime in place even if the Issuer only raises up to $1m.[16]

3.14 Fat Hen Ventures called for greater responsibility to be placed on issuers, and, recognising that the cap on individual investment amounts would be relatively low, warned against this leading to complacency:

> There MUST be some rigour around small public companies, many directors of which have never been public company directors before. The costs are not excessive or disproportionate to the funds raised by the company and our fear is that by exempting some companies in such mission critical areas as good accounting, prudent auditing and proper shareholder engagement, companies are more likely to come to grief with loss of shareholders' funds thereby tainting the CSF landscape for the detriment of those companies who do adopt proper financial reporting and shareholder engagement. It is about good practice and the government should not feel obliged to relax such critical pieces of the corporate picture simply because shareholders may be contributing smaller amounts and must be prepared to lose their investment. This should not be the attitude.[17]

3.15 Similarly, the Australian Small Scale Offerings Board (ASSOB) argued strongly in favour of issuer companies having to convert to public companies prior to listing:

> …companies need to learn to be compliant and accountable to investors from the start.[18]

3.16 Although Mr Gavan Ord, CPA, agreed with the view that establishing a public company could be daunting, he argued that there were good public policy reasons for requiring a CSF eligible company to be a public unlisted company. He referred to recent 'harrowing consumer protection stories' justifying the policy settings, which are 'primarily built around decades of corporate failure and addressing those corporate failures'. In his view, the proposed legislation strikes the right balance between investor protection and the funding needs of business and as 'a starting point' the bill should pass as it is.[19] He quoted a colleague:

---

15 *Submission 2*, p. 5.

16 *Submission 2*, p. 5.

17 *Submission 2*, p. 10.

18 *Submission 9*, paragraph 9.2.

19 *Proof Committee Hansard*, 23 February 2016, p. 4.

> …the downside of getting this more conservative approach wrong is less than the downside of getting the alternative approach wrong…I think the public interest is best served by this current approach at this present point in time.[20]

3.17 Mr Trevor Power from Treasury conceded that there would be added costs for companies converting to a public company, from the minor $75 application through ASIC to the costs of drawing up a constitution that could be in the thousands of dollars.[21] Further, that the cost of $15,000 per annum to have an auditor and to audit accounts was a feasible cost that could be applied to an entity of a given size. He noted, however, that there would be many companies below that size where the costs would not be on the higher end.[22] Mr Power explained why the government opted for the approach to use the unlisted public company structure:

> In essence, that structure in Australian corporate law is provided for the marketing of securities to the public, and it has various stepped-up requirements in order to provide disclosure and then ongoing reporting, essentially, to the shareholders of companies. Private companies in Australian law have a much reduced requirement to, and in fact do not in most cases need to, report to their shareholders, because they are closely held and have a limit of 50 shareholders.[23]

3.18 Even so, the proposed legislation recognised the need to ease the compliance burden on small businesses converting to a public company by allowing concessions.[24] According to Mr Power, the proposed legislation has taken on the public company structure so there is 'some transparency of reporting to shareholders' but some of the onerous elements of that have been removed, including 'annual general meetings, the audit of financial statements and also the provision of hard-copy financial statements to shareholders'.[25]

Relief from reporting and corporate governance requirements

3.19 The bill would ensure that eligible companies are entitled to temporary relief from reporting and corporate governance obligations as the Assistant Minister to the Treasurer explained:

> For small business people, time spent on regulatory compliance is time not spent working to ensure the success of their business. While businesses wishing to access crowd-sourced equity funding must be public companies, the government is conscious that the demands involved in transitioning to a public company structure and complying with the corporate governance and

---

20 *Proof Committee Hansard*, 23 February 2016, p. 14.

21 *Proof Committee Hansard*, 23 February 2016, p. 18.

22 *Proof Committee Hansard*, 23 February 2016, p. 20.

23 *Proof Committee Hansard*, 23 February 2016, p. 18.

24 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 3.

25 *Proof Committee Hansard*, 23 February 2016, p. 18.

> reporting obligations, for the amount of funds that an early-stage business would typically seek, can be onerous. As such, the government is providing a holiday of up to five years from these key requirements…[26]

3.20 Companies qualifying for CSF, unlisted public companies with share capital, may be eligible for limited governance requirements for five years. If they have just been created or they have recently been converted to a public company and they plan to raise capital via CSF, they may receive the following concessions:

- no requirement for five years to hold an annual members' general meeting;
- only required to provide online financial reports to shareholders for a period of five years, with no hard copies required to be sent to the members; and
- no need to appoint an auditor until they raise more than $1 million (AUD) from CSF or other offers requiring disclosure.[27]

3.21 According to the Explanatory Memorandum, these concessions 'provide temporary relief to these companies to support the CSF regime by reducing the potential barriers to adopting the required public company structure'.[28] For example, Mr Power drew attention the provisions that would exempt entities who raise less than $1 million from having their financial statements audited. He noted that if they were to raise more than $1 million then they would need to be audited.[29]

3.22 Dr Marina Nehme, however, informed the committee of doubts that these concessions would be enough to encourage a propriety company to convert to a public company to access CSF, stating further:

> Broader concessions may be needed to ensure that the company does not have continuous disclosure obligation imposed on it for a certain period of time.[30]

3.23 According to Dr Nehme, a company developing a new product 'may not start generating profit until at least three years after it had become an exempt public company'. Given that the product development cycle may vary from one case to the next, Dr Nehme recommended that ASIC be given 'the power to allow exempt public companies to apply for an extension of the five year exemption period if needed'.[31]

3.24 Pitcher Partners was also concerned that the compliance concessions to AGM, audit and reporting were 'very small' and for a very short time (5 years). In commenting on these limited compliance savings, it drew attention in particular to the audit exemption, which 'only applies if the eligible CSF has raised less than $1 million from a platform at any time (on a cumulative basis)'. Pitcher Partners explained:

---

26 House of Representatives *Hansard*, 3 December 2015, pp. 14634–5.

27 Dr Marina Nehme, *Submission 7*, pp. [3–4].

28 Explanatory Memorandum, p. 3.

29 *Proof Committee Hansard*, 23 February 2016, p. 20.

30 *Submission 7*, p. [4].

31 *Submission 7*, p. [5].

> The costs of an external audit are significant and (in addition) would also require the company to incur significant costs on hiring specialist staff to deal with the audit.[32]

3.25 BDO Australia noted that all public company reporting requirements would be applicable to CSF companies after five years, including to prepare audited financial reports that are sent to shareholders and to hold an AGM. In its view:

> Depending on the industry in which the company operates it would not be unreasonable for a business to take many years before it is profitable and able to meet the public company reporting burdens. To impose such a deadline is likely to be daunting for potential CSF Companies and restrictive for many.[33]

3.26 On the other hand, the ASSOB did not consider that the exemptions to public company compliance proposed by the legislation were necessary, or as an alternative, it would support a shorter exemption time (ie perhaps two years rather than five).[34]

3.27 It should be noted that the regulation impact statement estimated that the costs per issuer were 'expected to fall in net terms by $9,950 per year, driven primarily by temporary exemptions from audit, annual general meeting and disclosure requirements'.[35]

Committee view

3.28 Clearly, the intention of the bill is to ensure that private companies seeking to become eligible to CSF would need to adhere to stricter corporate governance and reporting obligations but that these new requirements would not be unnecessarily burdensome. The framework is designed to enable small businesses to issue equity through CSF with reduced disclosure compared to the requirements under a full public equity raising. It attempts to achieve the right balance between encouraging and supporting investment, reducing compliance costs and maintaining an appropriate level of investor protection.

Assets and turnover test—$5 million

3.29 The Explanatory Memorandum noted that, given the CSF regime is intended to assist small-scale businesses, there were restrictions on the size of company that could access the regime.[36] The legislation makes clear that the value of the consolidated gross assets of the issuer and any related parties must be less than $5 million at the time the company is determining its eligibility to crowd fund. The Explanatory Memorandum explained that the gross asset cap is based on:

---

32 *Submission 12*, paragraph 1.24.

33 *Submission 18*, p. 2.

34 *Submission 9*, paragraph 9.2.

35 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 9.20.

36 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 2.20.

> ...the value of consolidated gross assets of an issuer and any related parties for integrity reasons to ensure that the cap applies appropriately to related parties of the same group.[37]

3.30 As well as satisfy the asset test, the company and related parties must also have consolidated annual revenue of less than $5 million.[38] Subsection 738(H)(2) of the bill defines the assets and turnover test which forms eligibility criterion.

> (2) The company complies with the assets and turnover test at the test time if:
>
> a) the value of the consolidated gross assets of the company, and of all its related parties is less than:
>
> i. $5 million; or
>
> ii. if the regulations prescribe a different amount—the prescribed amount; and
>
> b) the consolidated annual revenue of the company, and of all its related parties, is less than:
>
> i. $5 million; or
>
> ii. if the regulations prescribe a different amount—the prescribed amount.[39]

3.31 The rationale behind the assets and turnover test met with some disagreement. Fat Hen Ventures Ltd wanted to see eligibility criteria eased and expanded to allow more established companies access to CSF:

> Our strong view has always been that the CSF framework should cover companies at least to $20m gross assets/revenue and ideally $50m. There is a crisis in Australia in small unlisted companies (i.e. to $50m assets/revenue) being able to access capital in the $lm to $5m range. It is NOT only about start ups and limited record, low revenue, low assets, high risk companies.
>
> To further stimulate the economic powerhouse and employment drivers—i.e. the SME's of this country it would be best for the CSF regime to cater for companies with revenues to $50m and/or assets to $50m.
>
> …
>
> It is the unlisted companies with revenue/assets to $50m that cannot access equity capital for growth of up to $5m. This is a drag on the ability of the Australian economy to stimulate growth and employment.[40]

---

37 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 2.22.

38 Explanatory Memorandum , Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 2.24.

39 Subsection 738(H)(2), Corporations Amendment (Crowd-sourced Funding) Bill 2015.

40 Fat Hen Ventures Ltd, *Submission 2*, p. 3. See also Equitise, *Submission 21*, p. 4.

3.32 Equitise argued that imposing a cap of less than $5 million in assets and turnover would 'concentrate risk and encourage retail investors to place their money in the highest risk early stage start-ups, losing all the benefits of diversification'. It stated:

> For companies looking to raise capital, this misses out on many of those that are most in need and, indeed, most suitable to attract the capital. Our early capital markets are broken and many businesses are forced to list on the ASX or seek funds offshore as their only way to access capital.[41]

3.33 CrowdfundUP suggested an increase in the amount of capital that issuers would be allowed to raise, proposing that the figure be lifted from $5 to $20 million.[42] The Australian Private Equity and Venture Capital Association Limited (AVCAL) likewise questioned the $5 million cap:

> It should also be noted that other countries such as New Zealand, for example, do not impose a similar cap on the size of the company that can access CSF. Prescribing thresholds on issuer size may inadvertently disqualify some genuine startups from crowdfunding. In any case, the caps on the amount of CSF capital that can be raised will likely result in smaller companies self-selecting to use the CSF regime anyway.[43]

3.34 AVCAL also raised concerns about the consolidated gross assets tests and consolidated annual turnover prescribed by the bill, describing it as "problematic":

> ...if other related parties such as existing directors and investors (e.g. angel or early stage VC [venture capital] groups, or corporates) are caught up in this definition…promising startups have existing seed investors but may yet still seek CSF investment for various reasons.[44]

3.35 Overall, many submitters were of the view that the proposed eligibility criteria was counterproductive and should be relaxed so as to include a broader cross-section of the business community. The Business Council of Co-operatives and Mutuals argued that the bill does 'not serve the capital needs of small or start-up enterprises, particularly cooperative or social enterprise models'.[45]

Committee view

3.36 The committee notes that the proposed regulatory framework is specifically intended to assist small-scale businesses, which is why restrictions on the size of the companies that can access the regime are proposed. Speculation on the future direction of what is, even internationally, an emerging and evolving funding model may be premature—the committee therefore suggests that eligibility requirements could be reviewed once the regime is in place and has had an opportunity to be judged on its effectiveness.

---

41 Mr Jonathon Wilkinson, *Proof Committee Hansard,* 23 February 2016, p. 3.

42 CrowdfundUP, *Submission 15,* p. [3].

43 *Submission 3,* p. 3.

44 *Submission 3,* p. 3.

45 *Submission 10,* p. 3.

Making an offer and offer documents

3.37 The proposed legislation provides the following requirements for making a CSF offer:

- the offer must be for the issue of securities of the company making the offer;
- the company making the offer must be an 'eligible CSF company' at the time of the offer;
- the securities must satisfy the eligibility conditions specified in the regulations;
- the offer must comply with the 'issuer cap'; and
- the company must not intend the funds sought under the offer to be used by the company or a related party of the company to any extent to invest in securities or interests in other entities or managed investment schemes.[46]

3.38 The bill also provides regulation-making power to prescribe other eligibility requirements for a CSF offer.[47]

3.39 Details of the proposed requirements are set out in the explanatory memorandum. These requirements demonstrate that policymakers considered the CAMAC 2014 report and recommendations carefully when drafting the proposed legislation.[48]

3.40 A number of submissions raised concerns about provisions relating to the offer and to offer documents.

Audits

3.41 Fat Hen Ventures Ltd suggested that the requirement for offer documents to contain the company's most recent statement of financial position was inadequate. Instead, Fat Hen proposed that CSF offers should be required to contain statements of financial performance, which arguably provide a better picture of a company's standing than (potentially) outdated financial positions statements.[49]

3.42 In its submission, Chartered Accountants Australia and NZ suggested that the $1m audit threshold be removed and instead CSF companies have the option to have an annual review (rather than an audit) while they are eligible for limited governance requirements.[50] BDO agreed. It suggested that rather than imposing an audit once $1 million has been raised, it may be 'more appropriate for some level of independent

---

46 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 11. The memorandum sets the listed requirements out in detail.

47 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 11.

48 Corporations and Markets Advisory Committee (CAMAC), *Crowd sourced equity funding*, May 2014, p. 49.

49 Fat Hen Ventures Ltd, *Submission 2*, p. 5.

50 *Submission 14*, p. 4.

financial procedures to be performed in relation to CSF Offer Documents and ongoing financial reporting'.[51]

3.43 Mr Ord, CPA, thought that BDO's suggestion was quite valid and would support its approach. It did stress, however:

> As long as there is some sort of independent verification of the financial information—and I am talking from a consumer point of view; that they are confident the business is a going concern, that it will exist and that it will actually make an investment—we do not mind either way how that is achieved.[52]

3.44 Pitcher Partners, similarly suggested that an eligible CSF company be subject to the requirements of a 'review' rather than an audit, which would provide 'a middle ground for reducing compliance costs' for such entities seeking finance through a CSF model.[53]

Class of offer

3.45 A number of submissions noted that the requirement to have only one class of share, being an ordinary share, would significantly limit a business's ability to raise capital on fair terms now and in the future. According to CrowdfundUp, the strategy of only offering ordinary shares, and not affording preference shares or unit trusts, would 'stifle innovation in this sector, which has already been stifled for over three years'. It indicated:

> Preference shares and unit trusts would afford the ability of debt crowdfunding in the Australian marketplace and allow for a quasi-bond market—something that is desperately in need in the Australian marketplace.[54]

3.46 Equitise was also concerned about the inflexibility of having ordinary shares as the only class of shares that could be issued, which, from the perspective of many companies and even investors, 'might not work'.[55] Equitise noted that other jurisdictions, such as the United Kingdom and New Zealand, do not place restrictions on the class of offer which can be made:

> In the UK and New Zealand there is no restriction on one class of share being offered and these two countries have markets that are well performing and provide the necessary balance to investors and companies. By forcing this requirement we will have a less innovative, poorer functioning market where both companies and investors are worse off.[56]

---

51 *Submission 18*, p. 1.

52 *Proof Committee Hansard*, 23 February 2016, p. 15.

53 *Submission 12*, paragraphs 1.27 and 1.29.

54 Mr Jack Quigley, *Proof Committee Hansard*, 23 February 2016, p. 1.

55 Mr Jonathon Wilkinson, *Proof Committee Hansard*, 23 February 2016, p. 5.

56 Equitise, *Submission 21*, p. 5.

3.47 The same submission went on to describe much of the proposed legislation relating to the content of offer documents—including provisions around the publication of offer documents—as 'emblematic of the lack of understanding in the drafting of the Bill.'[57]

Issuer cap of $5 million

3.48 The issuer cap is set at $5 million in any 12-month period with a regulation-making power to adjust the cap in the future in light of the experience with CSF.[58] Dr Nehme argued that:

> While this cap is supported and promoted by ASSOB, no justification has been put forward to explain the need to raise the cap to this amount. The cap supported by the CAMAC and NZ models seems more justifiable then the one put forward by the Bill model. In fact, only Italy has adopted a higher cap than the one proposed by the Bill. Most countries have adopted a cap that varies between $1–2 million.[59]

3.49 Accordingly, Dr Nehme recommended a return to the $2 million cap.[60]

3.50 Conversely, Mr Jeffrey Broun, Fat Hen, suggested that a lot of private companies would benefit from having that cap increased to close to $20 million. He explained that it was quite a difficult roadway for companies looking to raise up to $5 million to $10 million:

> It is too small for institutional investors, so they need to rely on opening it up to more of a broader investment base through the retail side of things, which we could do.[61]

3.51 In his view, the restriction would 'just defeat the whole purpose of why we would like to engage in the crowdsourced funding regime'.[62]

Three-months offer period

3.52 Some submitters contended that the maximum period of three months for an offer to be open was insufficient, particularly in relation to the duration of other offer periods specified for fundraising activities under the Act. The Law Council of Australia (Corporations Committee of the Business Law section) was of the view that the maximum period of 3 months for an offer to be open was too short when compared to the offer period for other fundraising activities under the Act. It recommended extending the period to a maximum of 12 months 'to avoid the costs of

---

57 Equitise, *Submission 21*, Appendix 3.

58 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 2.34.

59 *Submission 7*, p. [3].

60 *Submission 7*, pp. [1–2].

61 *Proof Committee Hansard*, 23 February 2016, p. 5.

62 *Proof Committee Hansard*, 23 February 2016, p. 6.

re-issuing a CSF offer every three months, if needed.[63] ASSOB labelled the three month limit as 'absurd':

> Raising within the start-up and earlier stage market requires a considerable amount of work to explain to investors the new concept/product/service that is to be commercialized. Often it takes a concerted education campaign to potential investors to explain the offer—a campaign that takes well above the suggested 3 month time limit.[64]

3.53 ASSOB recommended that offers ought to be able to be open for 12 months at least.[65]

Responsibilities of intermediaries

3.54 Operators of crowd-funding platforms are referred to as intermediaries.[66] The legislation recognises that the CSF intermediary occupies a pivotal role in the CSF regime.[67] In recognition of the importance of intermediaries to the successful operation of an equity crowdfunding market, intermediaries must hold an Australian Financial Services License (ASFL) that expressly authorises the provision of a crowd-funding service:

> Requiring intermediaries to be licensed provides issuers and investors alike with confidence in the integrity of the intermediary and their capacity to carry out the obligations of operating a crowd-sourced equity funding platform.[68]

3.55 The Explanatory Memorandum noted, however, that depending on the nature of the activities carried out by the intermediary, they could 'also be considered to be operating a financial market and therefore be required to hold an Australian Market Licence (AML)'.[69] Elaborating on this provision, the Explanatory Memorandum noted:

> The policy intent is that the provision of the crowd funding service should be subject to the obligations and protections, particularly as they apply to retail clients, of the AFSL regime…Therefore, a person that holds an AML would not satisfy the definition of CSF intermediary unless they also held

63 *Submission 8*, p. 5.

64 *Submission 9*, paragraph 1.4(e)

65 *Submission 9*, p. 2.

66 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 25.

67 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 3.3.

68 The Hon Alex Hawke MP, Assistant Minister to the Treasurer, *House of Representatives Hansard*, 3 December 2015.

69 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 3.8.

> an AFSL that expressly authorised the provision of the crowd-funding service.[70]

3.56 The bill provides greater flexibility in the Australian Market Licence (AML) and clearing and settlement facility licencing regimes. As noted in the Explanatory Memorandum:

> Under the changes, the Minister would be able to provide that certain financial market and clearing and settlement facility operators are exempt from some of the requirements in Chapter 7 of the Act. Providing for this flexibility is necessary to enable secondary trading markets for CSF securities to be licensed once the CSF regime is established. The flexibility would also facilitate the development of other emerging or specialised markets as they would be subjected to a regulatory regime tailored to best address their activities.[71]

Committee view

3.57 As evident with the eligibility requirements for a CSF company, there was also a range of views on the provisions governing the making of an offer and the offer documents. Some submitters wanted changes to the requirements relating to financial statements so they would not be so onerous for small companies. A number of submitters thought that restricting the class of offer to ordinary shares was unnecessary and would 'stifle innovation'. With regard to the issuer cap of $5 million, some wanted it lowered; others wanted it lifted. Finally, a few submitters deemed the maximum period of three months for an offer far too short.

AFSL and AML licence

3.58 Many submitters supported the requirement for an intermediary to have an AFSL.[72] Dr Nehme noted that this requirement for an intermediary to hold an AFSL would provide investors with a range of protections such as 'the establishment of compensation arrangements and internal and external dispute resolutions processes'. It would also allow ASIC 'to monitor each online platform and ensure that the conditions of its licence are met'.[73]

3.59 CrowdfundUP agreed with the requirement for intermediaries to have an AFSL but that the crowdfunding licence should carve out the requirement to obtain a AML.[74] In its view:

---

70 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 3.9.

71 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 4.

72 See, for example, Fat Hen Ventures, *Submission 2*, p. 7 and CrowdVenture, *Submission 5*, paragraph 2(c).

73 *Submission 7*, p. [7].

74 *Submission 15*, paragraph 4.4.

> To put an extra level of licensing on top of the already rigorous AFSL regime would be punitive in nature of the intermediaries.[75]

3.60 ASSOB was not troubled by the requirement to have an AFSL but considered the requirement for intermediaries to obtain an AML as too onerous and could make their businesses commercially unviable. It would like:

> …some assurance that the ministerial right to waive such an obligation would be the rule rather than being exercised on a discretionary basis for each licence applicant.[76]

3.61 ASSOB was concerned about intermediaries finding appropriate insurance cover for this new licensed activity (AML) because insurers were 'unlikely to be able to assess the risks involved in the newly regulated environment'.[77]

3.62 Taking an even lighter touch to licensing, King and Wood Mallesons suggested that the proposed regime provide 'a clear exemption' from the AML and other AFSL requirements 'where a platform meets certain criteria or operates within certain limits'. It considered a Crowdfunding Licence would 'be sufficient for CSF platforms in most instances to cover the services and functions that most platform providers offer'.[78] A submission from the Business Council of Co-operatives and Mutuals called for the AFSL requirement to be scrapped.[79]

Committee view

3.63 The committee fully supports the requirement for intermediaries to hold an AFSL as a necessary investor safeguard.

Obligations of CSF intermediaries

3.64 The proposed CSF regime would place the following obligations on intermediaries:

- 'gatekeeper' obligations (which set out when the intermediary must not publish or continue to publish an issuer's offer document);
- the obligation to provide a communication facility;
- the obligation to prominently display on the platform the CSF risk warning, information on cooling-off rights, and fees charged to and interests in an issuer company;
- the obligation to ensure retail clients receive the benefit of the relevant investor protections (cooling-off rights, the investor cap, the risk acknowledgement) and that the obligation to comply with the prohibition on providing financial assistance is adhered to; and

---

75 *Submission 15*, paragraph 4.5.

76 *Submission 9*, paragraphs 1.4 and 5.1–5.3.

77 *Submission 9*, paragraph 1.4 (c).

78 *Submission 16*, p. 3.

79 Business Council of Co-operatives and Mutuals, *Submission 10*, p. 3.

- the obligations to close or suspend the offer as required, and handle application monies appropriately.[80]

3.65 Among the gatekeeper obligations, a CSF intermediary would be required to conduct checks before publishing a CSF offer document. For example, a CSF intermediary must not publish a CSF offer document (or a document that purports to be a CSF offer document) on its platform unless the intermediary has, before starting to publish the document, conducted the checks prescribed by regulations to a reasonable standard. Failure to comply with this subsection is an offence of strict liability.[81]

3.66 Also, a CSF intermediary must not publish a CSF offer document (or a document that purports to be a CSF offer document) on its platform, or continue to publish such a document while the offer is open, if, among other things:

- the intermediary is not satisfied as to the identity of the company making the offer, or of any of the directors or other officers of the company; or
- the intermediary has reason to believe that any of the directors or other officers of the company are not of good fame or character; or
- the intermediary has reason to believe that the company, or a director or other officer of the company, has, in relation to the offer, knowingly engaged in conduct that is misleading or deceptive or likely to mislead or deceive; or
- the intermediary has reason to believe that the offer to which the document relates is not eligible to be made.[82]

3.67 VentureCrowd, an equity crowd funding business, supported the bill's approach to the regulation of intermediaries and was of the view that an intermediary 'must be appropriately licensed and should demonstrate a strong commitment to education for investors of the risks involved in investing in startups including the benefits that flow from investing in a diversified portfolio to spread the risks'.[83] It contended that the intermediary was:

> …the most sophisticated of the 3 parties involved in an ECF and is therefore the party best able to bear the majority of the regulatory burden. The relatively unsophisticated retail investors and the start-ups seeking early stage funding should bear [the] regulatory burden only to the extent that it is essential to maintain ECF system integrity.[84]

3.68 In contrast, the Law Council of Australia stated that it was 'neither necessary nor desirable' that intermediaries are made 'gatekeepers' under the proposed

---

80 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, pp. 25–26.

81 Section 738Q, *Corporations Act 2001*.

82 Section 738Q, *Corporations Act 2001*.

83 *Submission 5*, paragraph 2(c).

84 *Submission 5*, paragraph 5(e).

legislation. In its view, ASIC should be the 'only "gatekeeper" for CSF'.[85] It contended:

> Prospective intermediaries are being warned that the burden of the obligations under the proposed legislation may practically make it difficult for them to obtain common business insurances necessary to mitigate the risks of conducting a crowd sourced equity facility.[86]

3.69 ASSOB was also concerned about the level of responsibility and costs that the proposed legislation would impose on intermediaries.[87] It indicated that the level of costs related to compliance and associated risk to intermediaries may become 'too high for raises below $500,000.[88] Likewise, Mills Oakley Lawyers were of the view that most of the compliance costs would be borne by intermediaries, not issuers or investors:

> In addition to the costs of managing the conflicts of interest, there will be considerable costs in conducting due diligence on each issuer, both up front and ongoing due diligence to manage a CSF intermediary's liability for any misleading or deceptive conduct or a defective CSF offer document. Inevitably, being subject a strict liability offence for a failure to conduct tests against the standard of reasonableness, prudent risk management may lead to costs that are underestimated by the Regulatory Impact Statement.[89]

3.70 Although Dr Nehme conceded that the obligations on intermediaries may be costly, in her view, they were 'essential to ensure the protection of investors and enhance the corporate governance of the intermediary'.[90] According to Dr Nehme, the due diligence requirement will help reduce the risk of fraud, while the generic risk warning requirement will highlight to investors the risks their investment may involve.[91] It should also be noted that it is in the best interests of the intermediary to ensure that the businesses they are working with are reputable and appear commercially viable. In this regard, Dr Nehme observed:

> Intermediaries are motivated to make sure that the businesses that are coming to them succeed because it will look good for them. No-one wants to invest in a platform that promotes bad businesses.[92]

3.71 The regulation impact statement indicated that the intermediary requirements were expected to increase by $1,550 per fundraising campaign.[93]

---

85 *Submission 8*, paragraph 7.

86 *Submission 8*, paragraph 7.

87 *Submission 9*, paragraph 1.2.

88 *Submission 9*, paragraph 1.2

89 *Submission 20*, p. 2.

90 *Submission 7*, pp. [7–8].

91 *Submission 7*, p. [7].

92 *Proof Committee Hansard*, 23 February 2016, p. 26.

3.72 It should be noted that ASIC will have responsibility for issuing licences and monitoring the operation of the framework. To support its work in this area, ASIC was provided with $7.8 million in funding through the 2015-16 Budget.[94]

Investor protection

3.73 The proposed legislation seeks to balance investor protection and the fundraising needs of businesses. Safeguards designed to protect investors centre on regulating businesses, intermediaries and investors alike.

3.74 With regard to retail investors, in order to mitigate the size of their financial exposure, they would only be permitted to invest up to $10,000 per issuer per 12-month period. They would also be entitled to a five-day cooling off period after making their investment.

3.75 The proposed protections received a mixed response from submitters, with some of the view that the protections were inadequate or inappropriate. These views are set out below.

Cooling-off period

3.76 The bill stipulates that investors would have access to a five-day cooling off period.[95] As with many of the proposed measures, the cooling-off period measure drew a variety of responses and differing views, with some arguing against its introduction altogether, and others suggesting that it be extended.

3.77 Representatives of those who did not support the introduction of a cooling off period indicated that the five-day period could produce unintended, adverse consequences. For example, Equitise, an established equity crowdfunding (ECF) platform operating in New Zealand, was concerned that the cooling off period would allow and encourage market manipulation. It stated:

> Cooling Off or the ability to rescind an investment will create opportunities for manipulation and will result in the unwinding of successful transactions or even the success of those which would have otherwise failed…None of the established and functioning equity crowdfunding markets utilise Cooling-Off periods and the pragmatic approach would be to allow platforms to apply their own discretion for the cancelling of trades in situations where it is appropriate.[96]

3.78 Equitise explained that manipulation could occur in two main ways:

> The first is similar to the stock manipulation practice of ramping. This would entail the CEO of the company making an offer, getting five or 10 of his friends to each contribute $10,000 for the capital raising at the

93 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, paragraph 9.20.

94 House of Representatives, *Hansard*, 3 December 2016, p. 14,635.

95 Subsection 738(ZD)(1), Corporations Amendment (Crowd-sourced Funding) Bill 2015.

96 *Submission 21*, p. 4.

> beginning of the offer. This would give the appearance of demand and strong backing, creating momentum for the deal. As we have learnt operating in New Zealand and witnessing crowdfunding globally, momentum is often the key to a successful deal. Once the pump had been primed and more money had flowed into the offer, with other investors following on, the friendlies could quickly pull their investment with the deal being a success and other investors having been duped into investing. It is similar to ramping on the stock market.
>
> Conversely, a competitor of the business could put the last money in to close an offer, then pull it out, potentially unwinding the entire transaction. Given the highly public nature, let alone the time and expense, needed to run an equity crowdfunding campaign, this could have a catastrophic impact on the business and even be its death knell.[97]

3.79 CrowdfundUp agreed that the cooling-off period posed a risk: that it was inappropriate and had the potential to allow for the facilitation of market manipulation.[98] It explained that these amendments could:

> …allow cornerstone investors to commit substantial amounts of capital to a funding goal to gain momentum to fall the capital raise. If larger investors arrive to initially commit funds to give momentum to a project funding, then later withdraw the funding during the cooling off period, retail investors are given a false sense of security that a project is gaining momentum when in fact it is only being manipulated by investors who potentially have a conflict of interest.[99]

3.80 This view on the risks associated with a cooling-off period was by no means unanimous, with other submitters proposing that the cooling off should be extended. Fat Hen Venture suggested that the cooling-off period may need to be longer for example, 10 days:[100]

> Our thoughts re cooling off are that it may need to be a longer period e.g. 10 days etc and thus the issue could not close until all cooling off periods expired. What about Supplemental Information, continuing disclosure releases that may impact on an applicant's decision? Ten days would seem more appropriate.[101]

3.81 On the other hand, ASSOB would prefer a cooling-off period of only two days: that 5 business days was 'unnecessarily long'.[102]

3.82 It should be noted that, according to Mr Power from Treasury, New Zealand does not have a cooling-off period so 'once you are in, you are in'. Italy has seven days

---

97 Mr Jonathon Wilkinson, *Proof Committee Hansard*, 23 February 2016, p. 3.

98 *Submission 15*, paragraph 2.1.

99 *Submission 15*, paragraph 2.2.

100 *Submission 2*, p. 7.

101 Fat Hen Ventures, *Submission 2*, p. 7.

102 *Submission 9*, paragraphs 1.4(h) and 8.1(b).

while Korea has a withdrawal right up until the end of the offer period. Canada has a cooling-off period of 48 hours that commences when the investor commits to invest. In the US, however, an investor can cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. This range of cooling-off periods demonstrates 'the different approaches in terms of how jurisdictions balance investor protections'.[103]

Individual investment caps

3.83 The bill proposes an investment cap of $10,000 per investor per 12-month period as a means of limiting investors' exposure to a single company.[104] Dr Marina Nehme provided the following view on the rationale behind this approach:

> The imposition of investment caps stems from the nudge theory. This theory seeks to enhance the understanding and management of heuristic influences on human behaviour which affects the decision-making of individuals. With this understanding, it aims to reshape existing choices of individuals through choice architecture. The investment caps recommended by the CAMAC model are designed to change behaviour by limiting the number of businesses individuals can invest in. The fact that there is a limitation is intended to stop a person from rushing into any particular investment and instead make them reflect on whether such an investment is possible or whether they should save their funds and invest it in other, more promising businesses. Curtailing investment choices through caps is a paternalistic approach to CSF and may go beyond the liberal paternalism promoted by the nudge.[105]

3.84 As with other measures outlined by the bill, the proposed investment attracted a range of responses. The Law Council of Australia supported the restriction as proposed, provided it did not limit an investor from investing additional amounts using any of the exemptions found in section 708 of the *Corporations Act 2001*. The Law Council's submission also noted that investors would not be restricted from making multiple investments in a range of CSF offers.[106]

3.85 In contrast, the ASSOB preferred an investment cap of $20,000 per issuer via a particular intermediary within in 12-month period.[107] Likewise, King and Wood Mallesons suggested that the limit for each investment under the CSF regime be increased to $20,000 'to avoid creating large registers of small shareholders that are

---

103 The Treasury, correspondence correcting transcript of *Proof Committee Hansard*, 23 February 2016, p. 17.

104 See subsection 738(ZC)(1), Corporations Amendment (Crowd-sourced Funding) Bill 2015.

105 Dr Marina Nehme, *Submission 7*, pp. 9–10.

106 Law Council of Australia, *Submission 8*, p. 5.

107 *Submission 9*, paragraphs 1.4(h) and 8.1(a).

cumbersome and expensive to administer'.[108] BDO Australia also sought an increase in the $10,000 investment cap, 'if not for all then at least for most investors'.[109]

3.86 As pointed out by CAMAC, however, 'any monetary cap can be arbitrary in some respect.'[110] The committee notes and agrees with CAMAC's position: caps, once introduced, can always be adjusted in light of experience with CSEF.[111]

3.87 The committee is of the view that placing a relatively low cap on individual investments is a prudent mitigation of risk strategy, as investors would be protected from excessive potential losses. The committee also notes that the level of the cap will be able to be adjusted by regulations.[112]

Other matters

3.88 The bill attracted comments on many of its provisions and the committee has considered the major, but not all, concerns raised in submissions. There were also a few matters that the committee notes in particular which are discussed below.

Understanding the bill

3.89 The Law Council of Australia (Corporations Committee of the Business Law section) was concerned about the complexity of the bill, noting that its experienced corporate lawyers found the 'interaction between the bill and existing provisions of the Act difficult to interpret, particularly in relation to licensing and disclosure for an offer of securities'. In its view, the proposed legislation risked excluding the participation of those very people for whose benefit it was designed. It suggested, at the very least, that a simple guide to the legislation be included at the beginning of the legislation, similar to the small business guide in the Act.[113]

3.90 The committee is of the view that this suggestion is sensible and worthy of consideration.

Penalties

3.91 In her submission, Dr Nehme noted that any breach by an intermediary of its obligations regarding the CSF offer may result in criminal action, noting further the proposed penalties are a maximum 60 penalty units and/or one year imprisonment. In her view:

> While this may send a message that the obligations imposed on intermediaries are very important, the amount of the fine imposed is low

108 *Submission 16*, p. 3.

109 BDO Australia, *Submission 18*, p. 3.

110 CAMAC, 'Crowd sourced equity funding', Guide through the CAMAC report, p. 2.

111 CAMAC, 'Crowd sourced equity funding', Guide through the CAMAC report, p. 2.

112 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2015, p. 29.

113 *Submission 8*, p. 2.

> and should be raised. Further, the chances of such action being taken are minimal.[114]

3.92 Dr Nehme recommended that a civil penalty regime should be introduced in the context of these specific obligations, which would ensure that 'the regulator has a range of enforcement tools at its disposal to deal with the breach'.[115]

Review of legislation

3.93 In chapter 2, the committee outlined the long and comprehensive consultation process that preceded the drafting of this legislation. Mr Power noted that the process started with the CAMAC report, the Productivity Commission report and the government's consultation process, two round tables run by the Hon Bruce Billson, former Minister for Small Business, and Treasury's own bilateral meeting. He informed the committee that when he reflected on this process, it suggested that there has been a lot of consultation throughout the development of this legislation:

> That is not to say that everybody gets what they want out of the consultation process…I think there is a difference between having views considered and having them adopted, and I think they have been considered and not all of them have been adopted by the government, because the government has taken an approach that balances, from its point of view, the different competing considerations.[116]

3.94 The Explanatory Memorandum noted that the government and ASIC would continue to monitor the regime to ensure that changes to the law were operating as intended.[117] CrowdfundUP contended that this legislation, although not in the best form at the moment, could be passed in its current form. It should, however, be revisited within 12 months, 'with strong engagement from industry representatives to make sure that any kinks are ironed out in the implementation'.[118]

3.95 VentureCrowd suggested that after 2–3 years the legislature should re-visit these limitations as the regime becomes better understood.[119] Likewise, Chartered Accountants suggested that the CSF framework be reviewed after 2 years 'to identify any changes that might be needed to ensure an appropriate balance between protecting investors and enabling issuers to raise funds is maintained'.[120]

3.96 CPA was of the view that, given the potentially high-risk nature of investing through crowdfunding, the bill 'by and large strikes an appropriate balance between

---

114 *Submission 7*, p. [8].

115 *Submission 7*, p. [8].

116 *Proof Committee Hansard*, 23 February 2016, p. 23.

117 Explanatory Memorandum, p. 5.

118 Mr Jack Quigley, *Proof Committee Hansard*, 23 February 2016, p. 2. In its submission, CrowdfundUP strongly suggested that, after 12–24 months of the legislation being enacted, it be revisited and revised. *Submission 15*, conclusion.

119 *Submission 5*, paragraph 2(d).

120 *Submission 14*, p. 2.

the funding needs of business and appropriate investor protections'. Mr Ord, CPA, stated further that should, for some reason the law not work well, CPA 'would be very supportive of the government of the day revisiting the proprietary public company test and looking at whether the investor protections are adequate as well'. He noted, 'It's better to be on the train when it's pulling out of the station than trying to catch up when it's got a full head of steam.'[121] CPA's position was that the bill should pass as is.

> If at some point in time the public company test is not working, we are quite happy to revisit that and consider expanding it to proprietary companies, but first of all we should start off by testing the water with the public companies.[122]

Recommendation 1

3.97 The committee recommends that the government monitor carefully the implementation of the legislation and undertake a review of the legislation two years after its enactment with special attention to the matters detailed in this report.

Conclusion

3.98 Although CSEF is still in its infancy, stakeholders were unanimous in the view that crowd-sourced equity funding was 'very much needed to help encourage a more innovative and entrepreneurial business culture in Australia'. Further that such funding needed to be legislatively supported domestically in order to ensure Australia remains an attractive place for new businesses.

3.99 Evidence received during this inquiry indicates that a healthy diversity of views on the bill exists. Some submitters, who were generally supportive of the bill suggested that the proposed legislation needed tweaking[123], others indicated that, although not ideal, the bill could pass in its current form,[124] some were comfortable with certain aspects of the legislation but concerned about specific provisions.[125] King & Wood Mallesons recommended that the bill be sent for further consultation to see if it could 'be simplified'.[126] On the other hand, the CPA supported the passage of the bill, indicating that:

> We understand it is a bit of policy experimentation but, by and large, we think it is heading in the right direction.[127]

---

121 *Proof Committee Hansard*, 23 February 2016, p. 13.

122 *Proof Committee Hansard*, 23 February 2016, p. 14.

123 Mr Jeffrey Broun, *Proof Committee Hansard*, 23 February 2016, p. 1; Law Council of Australia, *Submission 8*, p. 1; ASSOB, *Submission 9*, paragraphs 1.1–1.3.

124 Mr Jack Quigley, *Proof Committee Hansard*, 23 February 2016, p. 2.

125 Mr Timothy Heasley, *Proof Committee Hansard*, 23 February 2016, p. 2.

126 *Submission 16*, paragraph 2.1.

127 Mr Gavan Ord, *Proof Committee Hansard*, 23 February 2016, p., 13.

3.100 The committee cannot fault the government's consultation process and, although the proposed legislation came under heavy criticism for being either too restrictive or too liberal, the committee is of the view that the cautious approach taken at this early stage is prudent. In this context, CAMAC observed that if retail investors with low financial literacy and or/capacity were to suffer significant losses the 'confidence of the crowd' could be undermined, placing the overall viability of CSEF as a source of funding at risk. Similarly, as noted earlier:

> …the downside of getting this more conservative approach wrong is less than the downside of getting the alternative approach wrong…I think the public interest is best served by this current approach at this present point in time.[128]

3.101 The crux of the question about this bill, however, is whether it would provide a good starting place to build the necessary legislative framework. The committee believes that the benefits presented by this bill—namely, the introduction of a functioning CSEF framework—far outweigh any risks that may exist. This is largely because sufficient safeguards are in place to ensure that investors are protected.

3.102 Australia is one of a number of countries seeking to be competitive in this arena, and policymakers are charged with devising a framework that will be optimal for the domestic landscape. It may well be true that, if enacted, the legislative framework will benefit from subsequent fine-tuning—this is to be expected. Overwhelmingly the committee is of the view that the government has, after extensive consultation, taken a prudent course of action by introducing a low-risk regulatory framework which strikes the right balance between supporting small businesses and protecting investors. The committee therefore supports the passage of this bill.

Recommendation 2

3.103 The committee recommends that the Senate pass the bill.

Senator Sean Edwards

Chair

128 Mr Gavan Ord, *Proof Committee Hansard*, 23 February 2016, p. 14.

Dissenting Report by Labor Senators

1.1 Labor has long recognised the importance of early stage innovation to drive economic growth in Australia.

1.2 Australia's start-ups have already proven their potential here and abroad and we need to encourage the growth of successful start-ups—especially considering that the majority of jobs to be created over the next decade and beyond will be in companies that do not exist today.

1.3 That is why it is important to have policies in place that help grow as many more of these companies as possible—policies that help remove some of the barriers to growth, particularly a lack of capital.

1.4 While traditional sources of funding for early stage innovation and start-ups have come from venture capital and angel investors, equity crowdfunding has emerged as an alternative way of raising capital.

1.5 This Bill amends the Corporations Act 2001 and the *Australian Securities and Investments Commission Act 2001* to facilitate crowd-sourced equity funding in Australia. A series of proposed regulations to help enact the Bill were also released on 22 December 2015.

1.6 Labor has had a strong interest in the value of equity crowdfunding as a way of supporting the capital needs of early stage businesses.

1.7 The origins of this Bill sit within a decision taken in 2013 by the previous Labor Government: where the Corporations and Markets Advisory Committee (CAMAC) was tasked to advise on the appropriate framework to allow equity crowdfunding to operate in Australia.

1.8 Since then, Labor has consulted with the start-up community and heard their views on what will make for a productive regulatory framework. These consultations and the work of CAMAC have influenced Labor's approach to this policy area.

1.9 While we understand that equity crowdfunding will not be used by all start-ups and small businesses, we recognise that the overall legal framework for equity crowdfunding should trigger confidence in the value of this fundraising mechanism for these small firms.

1.10 Having reviewed the submissions and taking note of the views expressed at the Committee's public hearing, it is very clear that the Government's proposals have drawn a mixed reaction.

1.11 While industry stakeholders have welcomed progress in bringing equity crowdfunding laws closer to reality, many have expressed disappointment in the Government approach, some arguing that it has completely ignored concerns about aspects of the framework that will potentially add regulatory and financial impost on start-ups and crowdfunding platforms.

1.12 Many stakeholders argued the Bill adopts a heavy regulatory approach that will be costly and act as a disincentive, preventing many small businesses from

accessing the new system. We note claims made in the submissions and list some of the concerns below. For example, one crowdfunding platform—CrowdfundUP—details a repeated criticism of this Bill:

> In its present form, the…Bill would not be attractive to start-up companies due to the onerous requirement for a company to become a public company.[1]

1.13 The Faculty of Law at the University of New South Wales stated:

> Currently the Bill excludes over 99.7% of companies from accessing CSF.[2]

1.14 Additionally the Law Council argued that it:

> ...is concerned that the CSEF Bill is too complicated to be easily understood by start-ups and early stage companies seeking to take advantage of CSEF and may give rise to too high a regulatory burden for intermediaries to readily embrace the establishment of CSEF platforms.[3]

1.15 The Business Council of Co-operatives and Mutuals does not support the key aspects of the Bill because they:

A. do not serve the capital needs of small or start up enterprises, particularly co-operative or social enterprise models and

B. impose unwarranted regulatory imposts on the disclosure regime for the offer of securities by co-operatives governed by state and territory laws.[4]

1.16 Notably, legal firm Pitcher Partners recommended changes to the Bill because:

> …to ensure that (equity crowdfunding) platforms are economically viable, it is important to consider expanding the customer base of the proposed regime to existing and future private companies.[5]

1.17 Again, the overall submissions—along with the public hearing into the Bill—focussed on key shortcomings of the Government's proposed equity crowdfunding framework. Specifically, there appeared to be considerable concern around the demand for small firms to convert into unlisted public companies in order to access crowdfunding. The concerns centre on the cost and complexity.

1.18 During the public hearing, Treasury did acknowledge the concerns surrounding cost, recognising that start-ups and small businesses would be required to absorb costs in the 'thousands' to take the necessary steps to convert into a public company.

---

1 *Submission 15,* p. 5.

2 *Submission 7,* p. 2.

3 *Submission 8,* p. 2.

4 *Submission 10,* p. 3.

5 *Submission 12,* p. 4.

1.19 While we do accept the Bill provides limited regulatory relief from some of the burdensome consequences of being a public company, some of the submissions argue that this is hardly enough to overcome the cost.

1.20 The Government should embrace a lighter regulatory touch. It is for this reason the Opposition submits a dissenting report, as the substantive report failed to address the very real concerns raised with the Committee.

1.21 The Opposition believes it is important to usher in a new equity crowdfunding framework in Australia. We do not intend to block the Bill. However we do need to remove a major barrier to small firms accessing the equity crowdfunding system.

1.22 Section 738H (1)(a) should be amended to remove the restriction that limits crowdfunding to unlisted public companies. In its place, the Bill should merely allow small firms to access the Bill's Corporations Law exemptions from the point at which they enter into a legally enforceable agreement with an intermediary (crowdfunding platform) to hold an equity crowdfunding campaign.

1.23 The second change that should be made to increase the number of firms that can access equity crowdfunding would focus on lifting the assets and turnover caps, taking them from $5m to $10m.

1.24 As the Committee heard, the current $5m cap on assets and turnovers concentrates risk and encourages retail investors to place their money in the highest risk early stage start-ups, losing all the benefits of diversification.

1.25 Labor agrees with the report recommendation to submit the equity crowdfunding laws to a review two years after the Bill receives Royal Assent.

Senator Chris Ketter

Deputy Chair

Appendix 1

Submissions and additional information received by the committee

Submissions received

1 Employee Ownership Australia Ltd

Supplementary to submission

2 Fat Hen Ventures Ltd

3 Australian Private Equity & Venture Capital Association Limited (AVCAL)

4 Confidential

5 VentureCrowd

6 Financial Ombudsman Service Australia

7 Dr Marina Nehme

8 Law Council of Australia (Corporations Committee, Business Law Section)

9 Australian Small Scale Offerings Board (ASSOB)

10 Business Council of Co-operatives and Mutuals (BCCM)

Attachment 1

11 ASX Ltd

12 Pitcher Partners Advisors Proprietary Limited

13 Solutions4Strategy

14 Chartered Accountants Australia and New Zealand

15 CrowdfundUP

16 King & Wood Mallesons

17 Macpherson Greenleaf

18 BDO Australia

19 CrowdReady

20 Mills Oakley Lawyers

21 Equitise

22 Mr Paul Niederer

Answers to questions on notice received by the committee

1. Answers to questions on notice from a public hearing held in Canberra on 23 February 2016, received from The Treasury on 29 February 2016.

Appendix 2
Public Hearings

Canberra ACT, 23 February 2016

Members in attendance: Senators Edwards, Ketter, McAllister.

Witnesses

BROUN, Mr Jeffrey Cameron, Managing Director, Fat Hen Ventures Ltd

HEASLEY, Mr Timothy Ian, Director, VentureCrowd

HOGAN, Ms Lauren, Analyst, Financial System Division, The Treasury

NEHME, Dr Marina, Private capacity

ORD, Mr Gavan Russell, Manager, Business and Investment Policy, CPA Australia

POWER, Mr Trevor, Principal Adviser, Financial System Division, The Treasury

QUIGLEY, Mr Jack, Managing Director, CrowdfundUP Pty Ltd

WILKINSON, Mr Jonathon (Jonny), Managing Director, Equitise Pty Ltd