

The Senate

Economics
Legislation Committee

Corporations Amendment (Crowd-sourced
Funding) Bill 2016 [Provisions]

February 2017

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Senate Economics Legislation Committee

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TABLE OF CONTENTS

Membership of Committee	iii
Chapter 1: Introduction and overview of the bill	1
Referral and conduct of the inquiry	1
Terminology	1
Previous committee inquiry	1
Overview of the bill	2
Scrutiny of bills	5
Regulation impact statement	5
Human rights	6
Acknowledgements	6
Chapter 2: Main issues	7
Introduction	7
Eligibility requirements	7
Investor protection and the cooling off period.	10
Access to crowd-sourced equity funding for proprietary companies.....	12
Review of legislation	17
Dissenting Report by Labor Senators	19
Background and overview	19
Key contributions from the written submission process	19
Specific Measures.....	21
Conclusion	21
Appendix 1: Submissions received	23

Chapter 1

Introduction and overview of the bill

Referral and conduct of the inquiry

1.1 On 24 November 2016, the Treasurer introduced the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (the bill) into the House of Representatives. On 1 December 2016, the provisions of the bill were referred to the Economics Legislation Committee for inquiry and report by 13 February 2017.¹

1.2 The committee advertised the inquiry on its website and received 20 submissions. A list of submissions received is at Appendix 1. The committee did not hold any public hearings for this inquiry.

Terminology

1.3 Crowd-sourced funding (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.²

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.

Previous committee inquiry

1.5 The bill is similar to the Corporations Amendment (Crowd-sourced Funding) Bill 2015 (the 2015 bill) which was introduced in the previous Parliament. The 2015 bill was referred to the Economics Legislation Committee and the inquiry report was tabled on 1 March 2016.³ The 2015 bill lapsed at the dissolution of the Senate and the House of Representatives on 9 May 2016 for a general election on 2 July 2016.⁴

1.6 In its report, the committee examined the extensive reviews and public consultation processes that had informed the proposed CSF framework outlined in the 2015 bill. The committee also considered the following matters which were raised in submissions:

1 *Journals of the Senate*, No. 23—1 December 2016, p. 752.

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

3 Senate Economics Legislation Committee, *Corporations Amendment (Crowd-sourced funding) Bill 2015 [Provisions]*, 1 March 2016.

4 Corporations Amendment (Crowd-sourced Funding) Bill 2015 http://www.aph.gov.au/Parliamentary_Business/Bills_LEGislation/Bills_Search_Results/Result?bId=r5588 (accessed 2 February 2017).

- 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 Australian financial services license (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
- monitoring and reviewing of the legislation.⁵

1.7 The committee recommended that the bill be passed, with the government to monitor carefully the implementation of the legislation and undertake a review of the legislation two years after its enactment.

Overview of the bill

1.8 As the committee noted in its previous report, 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.

1.9 A number of recent reviews have identified CSF as a means of giving emerging, innovative businesses access to the capital they need to establish and grow.⁶ The purpose of the bill is to facilitate crowd-sourced equity funding in Australia. The Explanatory Memorandum (EM) 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.⁷

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.⁸

5 Senate Economics Legislation Committee, *Corporations Amendment (Crowd-sourced funding) Bill 2015 [Provisions]*, 1 March 2016.

6 Explanatory Memorandum, Corporations Amendment (Crowd-sourced Funding) Bill 2016 (hereafter 'Explanatory Memorandum'), p. 7.

7 Explanatory Memorandum, p. 3.

8 Explanatory Memorandum, p. 10.

1.11 The bill's EM 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.⁹

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 of facilitating crowd-sourced equity funding. It is a key feature of the government's *Growing Jobs and Small Business* package.¹⁰

1.14 Schedule 1 of the bill would amend the Act and establish a regulatory framework to facilitate CSF 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.¹¹

1.15 Schedule 1 also seeks consequential amendments to the ASIC Act to expand the range of financial services covered 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.

9 Explanatory Memorandum, p. 8.

10 See <http://www.business.gov.au/small-business/Pages/jobs-and-small-business-package.aspx> (accessed 2 February 2017).

11 Explanatory Memorandum, p. 3.

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

Amendments to the proposed CSEF framework

1.18 Following the introduction of the 2015 bill into Parliament in December 2015, this committee's inquiry into the 2015 bill and broad government consultations, including with its FinTech Advisory Group, the government decided to adjust the CSEF framework.¹²

1.19 In March 2016, the government indicated that it was considering two potential amendments to the CSEF framework: increasing the eligibility cap from \$5 million to \$25 million and reducing the cooling-off period from five working days to 48 hours.¹³ Following further consultation, the government decided to proceed with these amendments.¹⁴

Commencement

1.20 The amendments in schedules 1 and 2 to this bill will commence on a day to be fixed by Proclamation. If the amendments do not commence within six months from the date of Royal Assent, they will commence on the day after the end of the period of six months after Royal Assent. The amendments in schedule 3 will commence on the day after Royal Assent.¹⁵

Main Stakeholder Groups

1.21 The EM notes that there are three main stakeholder groups with an interest in the development of a framework that removes the regulatory impediments to CSEF:

- Companies seeking to raise funds stand to benefit from the establishment of a CSEF framework. This is particularly the case for innovative firms and start-ups, which typically have more difficulty obtaining bank debt finance than established firms, but for whom existing equity fundraising is prohibitively expensive. These companies would be issuers of CSEF offerings.
- Individuals seeking new opportunities to invest stand to benefit from the increased range of financial products that CSEF would present. These individuals would be able to diversify the range of products they invest in, and would be investors in CSEF offerings.
- A number of organisations are seeking to establish and operate a platform that allows issuers to list their CSEF offerings, bringing

12 Explanatory Memorandum, paragraph 9.65.

13 See <http://fintech.treasury.gov.au/files/2016/03/Fintech-March-2016-v3.pdf> (accessed 7 February 2017).

14 Explanatory Memorandum, paragraph 9.139.

15 Explanatory Memorandum, p. 4.

together issuers and potential investors. These organisations would operate as intermediaries in the CSEF market.¹⁶

Scrutiny of bills

1.22 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.

1.23 The Standing Committee for the Scrutiny of Bills (the standing committee) examined the Bill, referring a question to the Treasurer. That the committee was primarily concerned with the delegation of legislative power effected by the proposed new paragraph 738G(1)(f), which allows the regulations to prescribe other requirements in relation to the securities or the CSF offer. The committee notes that the standing committee drew attention to this provision, stating that it may be considered to delegate legislative powers inappropriately and noted that the explanatory materials should clearly explain the rationale for the delegation of legislative power.¹⁷

1.24 In his response to the standing committee, the Treasurer advised that:

...the regulation making power is necessary as there may be a need for flexibility, and a quick response, to prescribe additional eligibility requirements for CSF offers, and different types of securities, depending on how the market develops.¹⁸

1.25 The standing committee requested that the key information provided by the Treasurer be included in the EM, noting the importance of these documents as a point of access to understanding the law and, if needed, as extrinsic material to assist with interpretation. In light of the information provided and the fact that the regulations will be subject to parliamentary disallowance, the standing committee made no further comment on this matter.¹⁹

1.26 The committee notes that the bill contains provisions designed to ensure that the legislation can be applied flexibly to the rapidly changing CSF environment.

Regulation impact statement

1.27 The bill's EM states:

16 Explanatory Memorandum, paragraph 9.7.

17 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 10 of 2016*, 30 November 2016, pp. 2–3.

18 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 1 of 2017*, 8 February 2017, p. 53.

19 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 1 of 2017*, 8 February 2017, p. 53.

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.²⁰

1.28 Furthermore, the EM notes that the CSF model in the bill is likely to have the highest net benefit of the options considered by the government and has 'lower estimated aggregate regulatory costs'.²¹

Human rights

1.29 According to the EM, 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'.²² The Parliamentary Joint Committee on Human Rights made no comment on the provisions of the bill.²³

Acknowledgements

1.30 The committee thanks all groups and individuals who took the time to make a written submission.

20 Explanatory Memorandum, pp. 4–5.

21 Explanatory Memorandum, paragraph 9.129.

22 Explanatory Memorandum, paragraph 10.11.

23 Parliamentary Joint Committee on Human Rights, *Human rights scrutiny report*, Report 10 of 2016, 30 November 2016, p. 8.

Chapter 2

Main issues

Introduction

2.1 As the committee found in its previous 2015 bill inquiry, for the most part, submitters welcomed the introduction a legislative framework for CSF as a means of providing an environment conducive to the growth of new businesses and their retention in Australia. However, many submitters did not support the bill in its entirety.

2.2 Many of the concerns raised by submitters in this inquiry were considered in the committee's previous report.¹ This chapter will examine views on the two main amendments to the previous bill: increasing the eligibility cap from \$5 million to \$25 million and reducing the cooling-off period from five working days to 48 hours. The chapter also explores the issues raised by submitters with regard to the potential expansion of the CSF framework to include proprietary companies.

Eligibility requirements

2.3 The bill sets out the criteria that businesses would have to comply with in order to be considered an eligible crowd-sourced funding 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

Assets and turnover test—\$25 million

2.4 The EM noted that, given the CSF regime is intended to assist small-scale businesses, restrictions have been placed on the size of company that can access the regime.⁴ The legislation makes clear that the value of the consolidated gross assets of the issuer and any related parties must be less than \$25 million at the time the

1 Senate Economics Legislation Committee, *Corporations Amendment (Crowd-sourced funding) Bill 2015 [Provisions]*, 1 March 2016, Chapter 3.

2 Explanatory Memorandum, pp. 13–16.

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

4 Explanatory Memorandum, paragraph 2.20.

company is determining its eligibility to crowd fund. The EM explained that the gross asset cap is based on:

...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.⁵

2.5 As well as satisfying the asset test, the company and related parties must also have consolidated annual revenue of less than \$25 million.⁶ Subsection 738(H)(2) of the bill defines the assets and turnover test which forms the 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. \$25 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. \$25 million; or
 - ii. if the regulations prescribe a different amount—the prescribed amount.⁷

2.6 In his second reading speech, the Treasurer, The Hon Scott Morrison MP, explained that setting the threshold at \$25 million would 'enable a broad range of companies to make use of crowd-sourced equity funding and provide investors with a wider range of investment opportunities.' The Treasurer also observed that as the market develops, the ongoing appropriateness of these thresholds can be reviewed.⁸

2.7 The Australian Small Scale Offerings Board (ASSOB) considered the increase in the threshold would be critical to the success of CSEF framework. ASSOBB noted that a significant proportion of the CSF issuers on its platform to date (over 170 companies) already had intellectual property valuations alone in excess of \$5 million, even though many did not have any turnover. It observed that the lower \$5 million cap would have precluded many companies from accessing CSF:

If it is the intention for this legislation to be used by innovative start-up and early stage companies to help develop new industries and jobs within

5 Explanatory Memorandum, paragraph 2.22.

6 Explanatory Memorandum, paragraph 2.24.

7 Subsection 738(H)(2), Corporations Amendment (Crowd-sourced Funding) Bill 2016.

8 House of Representatives, *Hansard*, 24 November 2016, p. 4307.

Australia, the \$5 million cap will preclude many and continue the trend of these companies seeking funding and talent offshore.⁹

2.8 Chartered Accountants Australia and New Zealand (CA ANZ) also supported the change of the turnover threshold to \$25 million, noting that it now aligns to the small company reporting threshold. CA ANZ had previously recommended that the thresholds be aligned to those in existing reporting frameworks.¹⁰

2.9 CA ANZ did raise concerns that the gross assets threshold has also been increased to \$25 million. It noted that the small company gross assets threshold is \$12.5 million. As such, it recommended the gross assets threshold be revised to \$12.5 million to align the CSF limits with existing reporting frameworks.¹¹

2.10 Fat Hen Ventures welcomed the revised asset/revenue threshold. Indeed, Fat Hen Ventures expressed the hope that threshold may be increased to \$50 million in the coming years as the CSF framework is reviewed. It submitted that it is the unlisted companies with revenue/assets to \$50 million that struggle to access equity capital for growth of up to \$5 million.¹²

2.11 Fat Hen Ventures stressed the need for vigilance to ensure that companies do not try to reduce their gross asset base to below the \$25 million threshold by 'creative means' in breach of Australian Accounting Standards—by writing down or writing off intangible assets to get below the \$25 million cap. Fat Hen Ventures advised:

It is important in our opinion for the Intermediary and possibly ASIC to review any sudden write down of assets to comply with the asset test for CSF. We believe it is important for CSF-aspirant companies to adopt Australian Accounting Standards in any event to ensure readers of a CSF Offer are properly informed about the profit and loss and balance sheet of the Issuer company.¹³

2.12 ASSOB raised similar concerns, noting the challenges for intermediaries to accurately assess a company's assets and turnover without audited accounts. ASSOB observed:

From our experience as a crowdfunding platform which has raised funds for over 170 companies in seven years, very few (if any) companies in the start-up and earlier stage have audited accounts at the time of first applying to list on the ASSOB platform. ASSOB insists that companies convert to a limited entity before they list, however their accounts are unlikely to be audited for a period of up to 12 months after that.¹⁴

9 Australian Small Scale Offerings Board (ASSOB), *Submission 9*, p. 3.

10 Chartered Accountants Australia and New Zealand, *Submission 3*, p. 1.

11 Chartered Accountants Australia and New Zealand, *Submission 3*, p. 1.

12 Fat Hen Ventures, *Submission 6*, p. 3.

13 Fat Hen Ventures, *Submission 6*, p. 4.

14 Australian Small Scale Offerings Board (ASSOB), *Submission 9*, p. 3.

2.13 BDO Australia raised concerns about the clarity of the wording of Section 738H(2)(b) of the draft bill in relation to the definition of the 12 month period for testing the \$25 million turnover cap. BDO Australia noted that the EM outlines the turnover cap as follows:

The turnover cap is based on the consolidated annual revenue for the 12-month period immediately prior to the time when determining eligibility to crowd fund. New companies that have not been operating for a full 12 months will still be able to crowd fund as long as their consolidated annual review for the period is under the \$25 million cap.¹⁵

2.14 BDO Australia considered that further clarity would be beneficial to explain what is meant by 'the 12-month period immediately prior to the time when determining eligibility to crowd fund', as in its view this could be interpreted in a number of ways. BDO Australia recommended that the test should be based on a 12 month period ending within three months of the turnover eligibility test being performed.¹⁶

Committee view

2.15 The committee notes that the proposed regulatory framework is specifically intended to assist small-scale businesses and specific restrictions on the size of the companies that can access the regime support this proposal. As the CSF regime is new and evolving, the committee suggests the government review eligibility requirements once the regime is in place to ensure the ongoing appropriateness of the thresholds.

Investor protection and the cooling off period.

2.16 The Treasurer, in his second reading speech, noted that the government had consulted extensively on the design of the proposed CSEF framework. He maintained that the model CSEF framework detailed in this bill 'strikes the right balance between supporting investment, reducing compliance costs and maintaining an appropriate level of investor protection'.¹⁷

2.17 The EM noted that in order for CSEF 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.¹⁸

2.18 The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) emphasised the need to provide strong investor protections as part of the CSF framework, as a crowd sourced equity market is likely to attract small, relatively

15 Explanatory Memorandum paragraph 2.25.

16 BDO Australia, *Submission 5*, p. 2.

17 House of Representatives, *Hansard*, 24 November 2016, p. 4306.

18 Explanatory Memorandum, paragraph 1.9.

unsophisticated and inexperienced investors to high-risk, generally illiquid¹⁹ venture capital style projects.²⁰

Cooling off period

2.19 The proposed cooling off period has been reduced to 48 hours. The cooling off period in the 2015 bill was 5 days. The EM noted that:

...a reduced cooling off period of 48 hours will provide issuers and intermediaries with greater certainty about the amount raised via a CSEF offer while retaining a reasonable period for investors to withdraw after making an investment.²¹

2.20 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.

2.21 CA ANZ did not support the change to the cooling off period from 5 days to 48 hours for investors. It noted:

Crowd sourced funding is a new form of investment for many investors in Australia, we recommend the cooling off period is 5 days at this initial stage of adoption. Once crowd-sourced funding becomes more established, this cooling off period can then be reviewed and revised as appropriate.²²

2.22 Some submitters, such as Fat Hen Ventures and ASSOBS, were supportive of the cooling off period being reduced to 48 hours, noting they had previously put forward recommendations to this effect.²³

2.23 Overall, Equitise supported the bill on the condition that the government conducts a review and looks to remove some of the restrictions that seek to limit the market. In particular, Equitise opposed the cooling off periods, regarding them as 'one of the greatest potential threats to the fair and orderly operation of the market'. Equitise explained further:

The Bill misses the fundamental tenant of equity crowdfunding, it occurs in an open and transparent fashion where all investors have the same access and opportunity to invest without and form of duress. 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

19 Illiquid refers to the state of a security or other asset that cannot easily be sold or exchanged for cash without a substantial loss in value.

20 Australian Small Business and Family Enterprise Ombudsman, *Submission 10*, pp. 1–2.

21 Explanatory Memorandum, paragraph 9.101.

22 Chartered Accountants Australia and New Zealand, *Submission 3*, p. 1.

23 Fat Hen Ventures, *Submission 6*, p. 2; Australian Small Scale Offerings Board (ASSOB), *Submission 9*, p. 1.

apply their own discretion for the cancelling of trades in situations where it is appropriate.²⁴

2.24 Similarly, CrowdfundUP did not support the inclusion of a cooling off period, arguing that it should be totally eliminated to provide the surety to live projects and remove the possibility of misrepresentation.²⁵

2.25 Equitise noted none of the established and functioning crowdfunding markets internationally use cooling off periods, arguing that the pragmatic approach would be to allow platforms to use their own discretion for the cancelling of trades in situations where it is appropriate. This is the way the New Zealand model operates and, in its experience, Equitise found that it had proven effective. Equitise encouraged the government to review, and ideally remove, cooling off periods in the future.²⁶

Committee view

2.26 The committee considers that the reduced cooling off period of 48 hours seeks to strike the right balance between providing intermediaries and issuers with certainty and maintaining an appropriate level of investor protection.

Access to crowd-sourced equity funding for proprietary companies

2.27 As at March 2015, approximately 99 per cent of all registered Australian companies were proprietary companies. There were approximately 2188000 proprietary companies (the vast majority likely to meet the definition of small proprietary company) and approximately 22100 public companies.²⁷

2.28 The EM noted that the government, in response to stakeholder feedback, began consulting on whether CSEF should be extended to proprietary companies. On 4 August 2015, the government released a public discussion paper on whether CSEF could be extended to proprietary companies. The EM noted that:

...the feedback from this consultation is being considered, and any policy options to facilitate CSEF for proprietary companies will be developed after the introduction of legislation to facilitate CSEF for public companies.²⁸

2.29 With regards to extending the CSEF framework to include proprietary companies, the Treasurer stated in his second reading speech:

...the government is continuing to consult on extending the regime to proprietary companies, which are generally prohibited from offering shares to the general public. I have instructed Treasury to continue developing a framework for proprietary companies as a priority and would expect that an extension of the framework will be introduced through subsequent legislation in the near future.

24 Equitise, *Submission 13*, p. 2.

25 CrowdfundUP, *Submission 11*, p. 3.

26 Equitise, *Submission 13*, p. 2.

27 Explanatory Memorandum, paragraph 9.30.

28 Explanatory Memorandum, paragraph 9.70.

In the meantime, this bill provides proprietary companies that wish to raise funds from the crowd access to the option to convert to a public company and receive exemptions from some of the more costly governance and reporting requirements for up to five years.²⁹

2.30 Overall, many submitters were of the view that the proposed eligibility criteria should be extended 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'.³⁰

2.31 In particular, submitters were keen to extend access to CSEF to proprietary companies. A number of submitters indicated they were currently participating in the Treasury consultation process with regards to proprietary companies.

2.32 Dr Marina Nehme observed that the bill 'excludes over 99.7% of companies from accessing CSF'. She noted:

Such a reality defeats the purpose for introducing legislation to facilitate CSF as only a very small minority of companies will be able to raise funds through this mode of finance.³¹

2.33 TMeffect, an independent intermediary, did not believe the CSEF framework went far enough to include early stage ventures in crowdfunding, stating:

We have worked on this too long to concur with the direction that has been taken, and believe that any proprietary company announcement will do little to relieve small CSF issuers from the true cost of this funding pathway.

This view is based upon Treasury's 'one size' model, grouping proprietary and public under a single umbrella, and a refusal to look at the alternate of a separate regime for small issuers (including crowd funders).

...

The failure to review alternate small business friendly models after this length of time is inexplicable.³²

2.34 Live Performance Australia (LPA), the peak body for Australia's live performance industry, submitted that, in the event that CSF arrangements are introduced for proprietary companies, its primary concern was that existing arrangements of small scale personal offers and sophisticated investor exemptions be preserved. LPA noted that under the current bill, the majority of its members would

29 House of Representatives, *Hansard*, 24 November 2016, p. 4307.

30 Business Council of Co-operatives and Mutuals *Submission 16*, p. 1; see also Employee Ownership Australia, *17.1 supplementary to submission 17*.

31 Dr Marina Nehme, *Submission 8*, p. 2.

32 TMeffect, *Submission 1*, p. 4.

not be in a position to benefit from CSF as they are proprietary companies and therefore would not be eligible to make CSF offers.³³

2.35 LPA considered that despite corporate governance and reporting concessions for up to five years for companies that register as, or convert to, a public company limited by shares after the commencement of the CSF framework, the significant burden of becoming a public company would most likely be prohibitive for its members.³⁴

2.36 In relation to expanding the CSF framework to include proprietary companies, LPA proposed increasing the current shareholder limit of 50 for proprietary companies. In addition, LPA explained:

...reform would be necessary to ensure proprietary companies are not subjected to onerous administrative and reporting requirements - for the simple reason that many small businesses do not have sufficient resources to meet those requirements, and the reform would become counterproductive.³⁵

2.37 ASBFEO agreed that in order to enable crowd-sourced funding as an option for small businesses, any effective CSF framework must extend to those that are now structured as proprietary companies.³⁶ ASBFEO noted that the government had indicated a further round of amendments addressing the participation of proprietary companies in the coming months. ASBFEO also noted that the vast majority of potential small business users of the new CSF framework will therefore have to wait for the:

...soon-to-be-announced round of amendments and regulations before they can begin to make the necessary decisions and adaptations, including possibly taking the decision to switch legal structures and become a public company. The incomplete nature of the current proposal imposes a burden of uncertainty on small businesses who may wish to avail themselves of new fundraising opportunities.³⁷

2.38 While ASBFEO supported the legislation, it contended that if a further round of amendments is only months away, as indicated, it may be simpler, more certain and more straightforward for small business if the current bill was held off so that the full package of amendments could be introduced at the same time.³⁸

2.39 Fat Hen Ventures did not share ASBFEO's view, submitting that the most pressing matter was to pass the current bill and establish the CSF framework, before any assessment extending the CSF regime to proprietary companies:

33 Live Performance Australia, *Submission 4*, p. 2.

34 Live Performance Australia, *Submission 4*, p. 2.

35 Live Performance Australia, *Submission 4*, p. 2.

36 Australian Small Business and Family Enterprise Ombudsman, *Submission 10*, p. 3.

37 Australian Small Business and Family Enterprise Ombudsman, *Submission 10*, p. 3.

38 Australian Small Business and Family Enterprise Ombudsman, *Submission 10*, p. 3.

The priority is to get a CSF regime up and running in this country as soon as possible to deliver on the Innovation Statement and make it easier for fast growing/emerging companies to access capital in a more efficient manner. Australia is behind many other countries in relation to CSF and part of Australia's economic outcomes depends on a CSF regime being in place. Australia will lose fast growth enterprises to jurisdictions with CSF if we delay much longer.

Once the legislation is in place and running smoothly, we would be happy to see the Government assess extending the CSF legalisation to proprietary companies but such a 'stage two' movement would need to be coupled with major changes to Corporations Act (i.e. extending the current 50 non-employee cap and Offer logistics etc) and therefore it is our strong recommendation to get the current Bill into legislation soonest with a genuine intention to assess Pty Ltd company application some time thereafter.³⁹

2.40 CrowdfundUP also supported the inclusion of proprietary companies in the CSF framework. In addition, it pointed out that the issue of debt crowdfunding had yet to be addressed, noting 'Australia is fast falling behind its regional neighbours in the aspect. This month, Indonesia launched its debt crowdfunding framework'.⁴⁰

2.41 Equitise acknowledged that the government and Treasury had shown good speed and that there appears to be momentum to having the complementary proprietary framework come through in the first half of 2017.⁴¹

2.42 CPA Australia expressed the view that if proprietary companies are permitted to access CSEF, it would be appropriate that they be subject to additional transparency obligations that would be comparable to public companies accessing CSEF. It reasoned that such a change is necessary to provide an appropriate balance between the financing needs of business and investor protections. It noted that, unfortunately, this would inevitably have regulatory burden consequences.⁴²

Proposed new company type

2.43 Dr Marina Nehme observed that one of the core challenges for extending the CSF regime to proprietary companies is that they are not designed to raise funds from a large group of shareholders. The two main characteristics of proprietary companies are that they cannot raise capital from the public and they are limited to having 50 non-employee shareholders. Dr Nehme noted:

This is part of the reason why proprietary companies face fewer regulations – they provide very little protection to shareholders. They are not required to hold an annual general meeting, for instance, and do not need to provide their shareholders with financial statements or comment on the company's

39 Fat Hen Ventures, *Submission 6*, p. 2.

40 CrowdfundUP, *Submission 11*, p. 3.

41 Equitise, *Submission 13*, p. 1.

42 CPA Australia, *Submission 14*, p. 2.

performance. Further, a shareholder might find it very difficult to sell their shares in a proprietary company as this may require not only finding a buyer but also getting the board of directors' approval.

Historically, when a company required more funds than 50 non-employees could provide, they would convert into a public company. Counting on a wider base of investors and owners, public companies are more heavily regulated, addressing many of these concerns.⁴³

2.44 Dr Nehme explained that new sources of funding, such as CSF, were beginning to blur the lines between public and proprietary companies. As a result, we should consider introducing an intermediary form of corporation that sits between the two.⁴⁴ Dr Nehme did not consider that removing the shareholder cap or adapting the format of proprietary companies would be the best approach to enable access to the CSF regime for proprietary companies. Instead, she argued that the establishment of a new form of company may be necessary. Such a company may:

...allow entrepreneurs to access CSF when they outgrow a proprietary company, while also providing some protection to investors. Designing such a company form will ensure Australia does not fall behind the rest of the world, and will promote a different type of entrepreneurship. The foundation of such a company can be found to a certain extent in the proposed exempt company put forward by the Bill.⁴⁵

2.45 CPA Australia also raised the possibility of introducing a new type of corporate entity. It noted:

Such an entity could also be subject to new rules such as giving it a limited life of say five years unless shareholders agree to extend its life, say for another five years, or agree to change to a different type of company structure (on the condition that it meets the tests for that structure).

In relation to changing company type, Part 2B.7 of the Corporations Act 2001 (s 162 etc.) is fairly permissive about change of company type and could with amendment accommodate the idea of allowing the CSEF entity to change form.⁴⁶

43 Dr Marina Nehme, *Submission 8*, p. 3.

44 Dr Marina Nehme, *Submission 8*, p. 2.

45 Dr Marina Nehme, *Submission 8*, p. 2.

46 CPA Australia, *Submission 14*, p. 2.

Review of legislation

2.46 In its report on the 2015 bill, the committee recommended careful monitoring of the implementation of the legislation. The EM noted that the government and ASIC will continue to monitor the development of the CSF market to ensure that the changes to the law are operating as intended.⁴⁷ The committee notes the government has also committed to undertake further consultation on extending the regime to proprietary companies.

2.47 Some submitters emphasised the importance of undertaking a post implementation review.

2.48 CPA Australia urged the committee to recommend that the government conduct a post-implementation review of the CSEF legislation within its first three years of operation. CPA Australia stated that the post-implementation review should consider whether the changes to disclosure, governance and audit requirements for eligible companies under the bill are effective in protecting and informing investors, and have also supported the creation of secondary markets where investors can on sell of their investment.⁴⁸

2.49 The Australian Institute of Company Directors also reasoned that a post-implementation review would benefit the industry by improving confidence in CSF for Australian business and investors as well as ensuring it is operating as intended.⁴⁹

Recommendation 1

2.50 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.

Committee view

2.51 The committee understands the important role that CSF can play as a means of providing emerging innovative businesses with access to the capital they need to, establish, grow and remain in Australia.

2.52 The committee acknowledges that, overall submitters welcomed the introduction of a legislative framework for CSF. The committee also recognises CSF's role in facilitating an environment conducive to the future growth of new Australian businesses, including CSF's ability to provide investors with a wider range of investment opportunities. Coupled with the recognition of the benefits of the CSF, the committee notes the cautionary advice of some submitters who highlight the need to adequately monitor and review the implementation to ensure CSF's success.

2.53 Finally, the committee supports the recent adjustments to the CSF framework which were included in this bill, as well as the commitment by the government to

47 Explanatory Memorandum, paragraph 9.143.

48 CPA Australia, *Submission 14*, p. 2.

49 Australian Institute of Company Directors, *Submission 15*, p. 2.

consult further on extending and fine tuning the framework to include proprietary companies to ensure the CSF is fit for purpose.

Recommendation 2

2.54 The committee recommends the Senate pass the bill.

**Senator Jane Hume
Chair**

Dissenting Report by Labor Senators

Background and overview

1.1 Labor Senators recognise the importance of opening up capital pathways for early-stage innovators to drive employment and economic growth in Australia.

1.2 Traditionally early stage innovation firms and start-ups have relied upon support of venture capital and angel investors. However Australia has lagged behind other countries that have begun introducing regimes to facilitate the operation of equity crowdfunding platforms as an alternative method of accessing investor support.

1.3 In 2013 the previous Labor Government tasked the Corporations and Markets Advisory Committee (CAMAC) to recommend an appropriate framework to allow crowd-sourced equity funding - or equity crowdfunding, as it is popularly referred - to operate in Australia. Its final recommendations were delivered to the Abbott Government in May 2014.

1.4 It took the Abbott-Turnbull Government an additional 18 months to bring forward its first version of equity crowdfunding legislation in December 2015 – legislation that was so flawed it was roundly criticised for being unwieldy, costly and too cumbersome for many start-ups and small businesses seeking to access crowdfunding. This criticism emerged despite government claims that it had consulted widely with stakeholders and that the legislation reflected the stakeholder views.

1.5 As a result of criticisms of its previously proposed equity crowdfunding regime, the Turnbull Government has now introduced this revised Bill.

1.6 While Labor Senators remain open to working constructively with the Turnbull Government to advance the development of a viable equity crowdfunding framework, the changes to the proposed equity crowdfunding bill are either simply cosmetic or present a watering down of retail investor protections.

1.7 Labor Senators also note remarks made in the second reading speech to the Bill that indicate the Turnbull Government is proposing to introduce a new equity crowdfunding regime in the near future that would make the framework proposed include privately held companies in addition to publically held companies.

Key contributions from the written submission process

1.8 Labor Senators note that the Government's decision to introduce this legislation late in the last sitting week of 2016 and have a final report delivered just after the first sitting week in 2017. This has limited scrutiny of a flawed Bill in an effort to rush through legislation that is likely to be superseded by a revised framework that will be introduced through new legislation during the course of the year. This is a remarkably poor approach by a government that has presented itself as business-friendly and wanting to avoid the imposition of red tape and extra business costs.

1.9 Having reviewed the submissions and taking note of the views expressed previously, it is very clear that the Government's proposals have, once again, drawn a mixed reaction.

1.10 References to the bill excluding privately held companies were common.

1.11 Dr. Strong (UNSW Law Faculty) notes that:

Currently the Bill excludes over 99.7% of companies from accessing CSF. Such a reality defeats the purpose for introducing legislation to facilitate CSF as only a very small minority of companies will be able to raise funds through this mode of finance.

1.12 The Australian Small Business and Family Enterprise Ombudsman comments that:

As noted in the prior consultation papers around 99% of Australian companies are proprietary companies and a majority are small businesses.

...

This means that the vast majority of potential small business users of the new framework must wait for another, soon-to-be announced round of amendments and regulations before they can begin to make the necessary decisions and adaptations, including possibly taking the decision to switch legal structures and become a public company... we believe it would be more straightforward for small business if the current amendments were held off so that the full package of amendments were introduced at the same time.

1.13 Employee Ownership Australia and New Zealand said:

Most companies only move themselves into the public company domain as a precursor to listing or when they reach a size that they are equivalent to a listed company. The key reason for this is the increased requirements on the company around reporting, disclosure, financials etc. and the costs associated with this. One of the key costs is the requirement to have an auditor and audited accountants (which smaller companies may not need). This can be significant costs for a smaller organisation, from \$15,000 per annum. The financial statement and content requirements also may cause some concerns for entities that do not wish to give full disclosure for competitive advantage. The current transition period does not deal with the fundamental issue, which is the cost and complexity of this regime.

1.14 The Business Council of Co-operatives and Mutuals also raised concerns that the Bill:

...does not serve the capital needs of small or start up enterprises, particularly those using co-operative or social enterprise models.

1.15 Regarding the lifting of the eligibility cap from \$5 million to \$25 million, the Australian Small Scale Offerings Board states:

ASSOB considers this increase to be critical to the success of the legislation.

1.16 The changes to the cooling off period attracted attention as well. Chartered Accountants Australia and New Zealand raised concerns about the reduction of the cooling off period for equity purchases from five days to two days:

We also note the change to the cooling off period from 5 days to 48 hours for investors. Crowd-sourced funding is a new form of investment for many investors in Australia; we recommend the cooling off period is 5 days at this initial stage of adoption.

Specific Measures

1.17 Labor Senators note the changes to increase asset and turnover caps and Labor Senators welcome this. Labor had proposed amendments to the previous legislation liberalising these caps.

1.18 Labor Senators remain concerned that the legislation fails to deal with the biggest shortcoming of the previous legislation: that it continues to lock out start-ups and small businesses by requiring them to convert into public companies. Evidence submitted to the inquiry pointed out that this would also translate to higher costs for companies – meaning businesses would have to spend a lot of money for the sake of raising funds. We presume the government knows how self-defeating this is, which is why it has publicly acknowledged that it is contemplating future changes to this regime even before this Bill is debated by the Senate.

1.19 Labor Senators are also concerned by the changes to reduce the cooling off period from five days to just two days. In the Australian context, equity crowdfunding represents a new investment platform offering securities that are of a considerably higher risk. Mum and dad investors should have time to re-consider their decision to make a sizeable investment into higher risk companies. Labor Senators believe the Turnbull Government is putting mum and dad investors at risk by watering down the cooling off period and we urge that a five day cooling off period be instituted, as envisaged by the previously proposed legislation.

1.20 Labor Senators note the comments that the Government is working on a crowd-sourced equity funding framework for private firms. Given that this bill with its current requirements will not meet the needs of small businesses and start-ups looking for capital, this bill should be amended to allow for crowd-sourced equity financing for privately held companies.

Conclusion

1.21 This Bill addresses some shortcomings of the old bill, but introduces new problems and still fails to address the needs of start-ups and small businesses. The Government should go back to the drawing board, consult with industry and come back with a framework that is suitable for both private and public companies.

Recommendation 1

1.22 Amendments be made to the Corporations Amendment (Crowd-sourced funding) Bill 2016 to ensure that the compulsion to convert to an unlisted public company is dropped and the government amend the Bill to allow for a wider range of start-ups and small businesses to access the equity crowdfunding regime.

Recommendation 2

1.23 Make amendments to the Corporations Amendment (Crowd-sourced funding) Bill 2016 to strengthen retail investor protections, by ensuring that a five day cooling off period is instituted.

Senator Chris Ketter
Deputy Chair

Senator Jenny McAllister
Senator for New South Wales

Appendix 1

Submissions received

No.	Submitter
1	TMeffect
2	Mr Tony Puls
3	Chartered Accountants Australia and New Zealand
4	Live Performance Australia
5	BDO Australia
6	Fat Hen Ventures
7	Mr Paul Niederer
8	Dr Marina Nehme
9	Australian Small Scale Offerings Board (ASSOB)
10	Australian Small Business and Family Enterprise Ombudsman
11	CrowdfundUP
12	Dr Yongqiang Li
13	Equitise
14	CPA Australia
15	Australian Institute of Company Directors
16	Business Council of Co-operatives and Mutuals
17	Employee Ownership Australia
18	Pitcher Partners Advisors Pty. Ltd.
19	Confidential
20	Confidential

