Crowd-sourced Equity Funding for Proprietary Companies

Early Assessment Regulatory Impact Statement

December 2016
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1. WHAT IS THE PROBLEM THAT NEEDS TO BE ADDRESSED?

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

1.1. REGULATORY BARRIERS TO CSEF FOR PROPRIETARY COMPANIES

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

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

The Government has already committed to introducing a CSEF framework for public companies, including as a part of its response to the Financial System Inquiry and in the National Innovation and Science Agenda. Legislation to implement this framework was introduced into Parliament in December 2015 but was not passed prior to the dissolution of the Parliament. The Government reintroduced this legislation on 24 November 2016.

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

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

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

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

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

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

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

Equity finance is therefore a more suitable option than debt for some businesses. Unlike debt finance, equity does not require immediate repayments and equity investors generally accept that returns are contingent on profits. A CSEF framework will improve access to equity financing for eligible companies.

### 2. WHY IS GOVERNMENT ACTION NEEDED?

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

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

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

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

A consistent theme resulting from the stakeholder consultation process was that many proprietary companies will not access the CSEF public company framework because:
• early-stage companies usually do not have the resources to comply with the regulatory burden (both perceived and real) of operating as a public company. Despite the temporary governance and reporting concessions granted under the public company framework, proprietary companies that convert under the framework must:
  – satisfy significantly higher financial reporting requirements (if a small proprietary company);
  – implement higher governance standards such as appointing a minimum three directors and must appoint a secretary;
  – hold an AGM, comply with all financial reporting requirements and appoint an auditor (regardless of the amount a company raises) after the concessions lapse.
• conversion may disrupt the normal lifecycle of the proprietary companies, as proprietary companies usually only convert when they intend to undertake an initial public offer. Further, future exit options may be more limited, as proprietary companies are generally a more attractive target for sophisticated bidders in trade sales (for example venture capital) due to the light regulatory nature of proprietary companies and the complexities of converting a public company back to a proprietary company;
• proprietary companies may be more suitable for early-stage high-growth companies where founders do not intend to cede significant control to shareholders (for example there is no statutory right for shareholders of a proprietary company to remove a director while public company shareholders have such a right);
• extensive disclosure obligations may not be appropriate for early-stage companies that have a business model heavily dependent on a technology or intellectual property which needs to be kept confidential.

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

3. OPTIONS

There are three main stakeholder groups with an interest in the development of a CSEF framework, including any extension to proprietary companies:

• 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 existing equity fundraising is prohibitively expensive. These companies would be issuers of CSEF offerings.
Under the legislation currently before Parliament, public companies with up to $25 million gross assets and annual turnover would be eligible to raise up to $5 million of equity per 12-month period via CSEF with reduced disclosure requirements.

- 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.

- Under the legislation currently before Parliament, investors would have certain protections such as a disclosure document and risk warning, with additional protections for retail investors such as an investment cap of $10,000 per issuer per 12-month period, a cooling off period of 48 hours and signature of a risk acknowledgement statement.

- A number of organisations are seeking to establish and operate a platform that allows issuers to list their CSEF offerings, bringing together issuers and potential investors. These organisations would operate as intermediaries in the CSEF market.

- Under the legislation currently before Parliament, intermediaries would be required to be licensed and have obligations such as undertaking certain due diligence on CSEF issuers and providing a communications facility for investors to communicate with the issuer.

3.1. OPTION 1: NO CHANGE

Under Option 1, there would be no change to the current requirements under the Corporations Act for proprietary companies, nor any change to the proposed CSEF framework for public companies as outlined in the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (CSEF public company Bill).¹

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

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

3.2. OPTION 2: EXTEND CSEF TO PROPRIETARY COMPANIES WITHOUT ADDITIONAL INVESTOR PROTECTIONS

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

Consistent with the public company framework, proprietary companies with less than $25 million in assets and annual turnover would be able to raise up to $5 million in any 12 month period through

¹ Reintroduced to the House of Representatives on the 24 November 2016.
crowdfunding platforms. Investors would be able to invest up to $10,000 per company per 12 month period.

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

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

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

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

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

### 3.3. OPTION 3: EXTEND CSEF TO PROPRIETARY COMPANIES WITH APPROPRIATE PROTECTIONS

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

Under Option 3, amendments would need to be made to the CSEF public company Bill to ensure that the reporting and governance concessions extended to proprietary companies that converted to
public companies for the purpose of accessing CSEF are removed. These concessions were initially granted on the assumption that proprietary companies would not have the opportunity to access CSEF under their current structure.

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

- rules around the CSEF offer and intermediaries;
- structural issues;
- corporate governance obligations; and
- financial reporting obligations.

A. Rules around the CSEF offer and intermediaries

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

- **eligibility**: to be eligible to access CSEF a company must have less than $25 million in gross assets and annual turnover, not be listed on a stock exchange and the company’s principal place of business must be in Australia;

- **fundraising & investor caps**: an investor may invest a maximum $10,000 in a company over a 12 month period and a company accessing CSEF may raise a maximum $5 million over a 12 month period through a CSEF raise;

- **initial disclosure**: the regulations will prescribe certain information that a prospective CSEF issuer will need to disclose in the disclosure document. Companies may need to include some additional generic disclosures around company type, capital structure and financial reporting not currently contemplated in the regulations that were released for public consultation to accompany the previous CSEF public company Bill; and

- **role of the intermediary**: the intermediary will have the same gatekeeper obligations with respect to both proprietary and public companies that access CSEF. These include conducting certain checks on the issuer and management as well as ensuring disclosure documents are completed and clear.

B. Structural issues in relation to proprietary companies

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

- **‘tagging’ system**: a proprietary company will be subject to the additional governance and reporting obligations once it is tagged as a CSEF company. The CSEF tag will be triggered as soon as the company has a CSEF investor on its register and will continue until no CSEF investors remain. This information will be kept by ASIC, and will be accessible by the public through ASIC’s company records system. The tagging system will ensure that proprietary
companies that do not elect to use CSEF will not be subject to additional reporting and governance obligations;

- **shareholder limit:** the current proprietary shareholder limit of 50 non-employee shareholders will be amended (via section 113 of the Corporations Act) so that proprietary companies are restricted from having more than 50 non-employee or non-CSEF shareholders (rather than simply 50 non-employee shareholders). This will ensure that the crowd can access CSEF in proprietary companies;

- **no requirement to convert to a public company:** there will be no requirement for a proprietary company to convert to a public company after it accesses CSEF (unless an existing trigger in the Corporations Act requires that proprietary company to convert e.g. more than 50 non-employee or non-CSEF shareholders); and

- **takeover provisions:** the takeover provisions in Chapter 6 of the Corporations Act will not apply to CSEF proprietary companies. To ensure that CSEF investors are afforded rights to participate in exit events, the framework would mandate that a company’s constituent documents (e.g. a constitution or shareholders’ agreement) contain mechanisms to protect these rights (e.g. through the use of a ‘tag’ right which may provide a right to a minority shareholder to choose to sell their shareholding to a buyer that acquires a majority shareholders’ shareholding).

### C. Corporate governance obligations

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

- **annual general meetings:** proprietary companies will not be required to hold an annual general meeting;

- **number of directors:** proprietary companies will be required to have a minimum of two directors (rather than a minimum of one director); and

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

### D. Financial reporting obligations

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

It is proposed under Option 3 that:

- **ongoing financial reporting:** companies that issue equity via CSEF will be required to provide financial statements to CSEF investors in accordance with accounting standards; and
• **audit:** mirroring the public company legislation, a CSEF proprietary company would be required to undertake an audit where it raises more than $1 million from a CSEF raise or any other raise which did not require disclosure.

E. **Consequential amendments to public company legislation**

If CSEF is extended to proprietary companies, it is advisable to remove the governance and reporting concessions granted to proprietary companies in order to lower the cost of conversion to public companies under the public company CSEF framework. These concessions will be redundant if proprietary companies are able to retain their current structure to access CSEF.

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

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

Public companies that meet the eligibility threshold will all be able to access CSEF because they automatically satisfy the minimum standards required to access the regime.
### 3.4. **TABLE 1: REQUIREMENTS FOR CSEF COMPANIES UNDER OPTIONS 1-3**

<table>
<thead>
<tr>
<th>Requirements for:</th>
<th>CSEF public companies</th>
<th>CSEF proprietary companies</th>
<th>CSEF proprietary companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Shareholder limits</strong></td>
<td>No limit</td>
<td>Max. 50 non-employee/non-CSEF shareholders</td>
<td>Max. 50 non-employee/non-CSEF shareholders</td>
</tr>
<tr>
<td><strong>Offers to the public</strong></td>
<td>Yes</td>
<td>Yes, through CSEF only</td>
<td>Yes, through CSEF only</td>
</tr>
<tr>
<td><strong>Company eligibility to crowdfund</strong></td>
<td>Yes, if unlisted Satisfy annual turnover (below $25 million) and gross assets (below $25 million) test</td>
<td>Yes Satisfy annual turnover (below $25 million) and gross assets (below $25 million) test</td>
<td>Yes Satisfy annual turnover (below $25 million) and gross assets (below $25 million) test</td>
</tr>
<tr>
<td><strong>Fundraising amount</strong></td>
<td>Companies can raise up to $5 million in a 12-month period</td>
<td>Companies can raise up to $5 million in a 12-month period</td>
<td>Companies can raise up to $5 million in a 12-month period</td>
</tr>
<tr>
<td><strong>Investor cap</strong></td>
<td>Retail investors can invest up to $10,000 in a company per 12-month period</td>
<td>Retail investors can invest up to $10,000 in a company per 12-month period</td>
<td>Retail investors can invest up to $10,000 in a company per 12-month period</td>
</tr>
<tr>
<td><strong>Disclosure for public offers</strong></td>
<td>Low-level disclosure document plus communication facility</td>
<td>Low-level disclosure document plus communication facility</td>
<td>Low-level disclosure document plus communication facility</td>
</tr>
<tr>
<td><strong>Conversion to public company</strong></td>
<td>Convert prior to making CSEF offer</td>
<td>Access to CSEF does not require conversion</td>
<td>Access to CSEF does not require conversion</td>
</tr>
</tbody>
</table>
| **Financial reporting obligations (in accordance with accounting standards)** | • Annual financial report  
• Directors’ report  
• Auditors’ report, if raising above $1 million from public | Not required | • Annual financial report  
• Directors’ report  
• Auditors’ report, if raising above $1 million from public |
| **AGM**                       | Not required – up to 5 years | Not required | Not required |
| **Number of directors**       | At least three (two residing in Australia) | At least one (residing in Australia) | At least two (both residing in Australia) |
| **Application of Ch 2E rules about related party transactions** | Yes | No | Yes |
| **Application of Ch 6 takeover provisions** | Yes | No | No, but company required to adopt minimum shareholder participation rights |
4. WHAT IS THE LIKELY NET BENEFIT OF EACH OPTION?

4.1 OPTION 1: NO CHANGE

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

- **Maintaining public / proprietary distinction**: By only extending CSEF to public companies, the current legal distinctions between public and proprietary companies will be maintained. The legal framework for public companies is designed to support investment by the general public, whereas the regulatory framework for proprietary companies assumes the company is closely held. This option would preserve the notion that only public companies are able to raise from the public while lowering the cost of transitioning to a public company for a period of time.

- **Lower risk**: This option will ensure that public investors are afforded greater protection compared to any investment in a proprietary company. Companies that access CSEF will be required to produce more comprehensive financial information and comply with higher governance standards. This may reduce the risk of fraud and increase investor, which may be critical to the ongoing sustainability of any CSEF market.

- **Secondary market**: As public companies maintain a more consistent flow of information to the public, it is more likely that a secondary market in shares of public CSEF companies could be developed in time. Information about proprietary companies is closely held and it would be difficult for public investors at arms’ length to value the shares in a secondary market.

The disadvantages and risks of this option include:

- **Regulatory burden**: Approximately 98% of Australian-registered companies are proprietary companies, and start-ups in particular usually adopt this company structure. The regulatory burden of operating as a public company, in particular for companies that do not have adequate resources (for example time and money used to meet higher reporting and governance obligations), may deter proprietary companies from converting to access CSEF, limiting the effectiveness of the policy in increasing access to finance.

- **Disruption to the normal lifecycle of a company**: Many of the types of companies the CSEF framework is targeting would not usually consider converting to a public company at the point in time they intended to access CSEF. There may be unintended negative consequences for companies that convert earlier than other similar companies. For example, companies that intend to exit via a trade sale may find it more challenging to find bidders as a public company because investors (especially venture capital) generally consider public companies a less attractive target due to the complexities and shareholder consent associated with takeover laws.

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

4.1.2 Net benefit

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

4.2 OPTION 2: EXTEND CSEF TO PROPRIETARY COMPANIES WITHOUT ADDITIONAL INVESTOR PROTECTIONS

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

The key benefits of Option 2 include:

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

• **Removing regulatory burden**: This option would remove a key disincentive for these companies to use CSEF. As discussed in paragraph 4.1, proprietary companies interested in using CSEF may be unwilling or unable to convert to a public company due to the higher regulatory obligations imposed on public companies or because it might limit their ability to find investors or buyers in the future.

• **More effective use of resources**: Secondary to the above point, early-stage high-growth companies will be able to focus on developing their businesses (and subsequently returns for investors) if they do not have to allocate resources to increased compliance obligations.

• **Commercially sustainable**: Intermediaries will play a critical role in any CSEF framework, and will be regarded as the ‘gatekeepers’ to CSEF issuers. It is important that any CSEF framework enables platforms to be commercially viable and offer a good level of service to companies...
and investors. Extending CSEF to proprietary companies will increase the amount of companies accessing CSEF, which will strengthen the commercial viability of the industry.

- **Increased diversity**: Extending CSEF to proprietary companies will encourage a greater number of entrants to the market. This may result in a wider range of business models to meet issuer and investor needs and potentially greater competition.

- **Minimum legislative changes**: This option would require the fewest legislative amendments to the Corporations Act.

The disadvantages and risks of Option 2 include:

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

- **No change to company habits**: Requiring companies to comply with higher corporate governance and reporting standards encourages companies to adopt better practices. There are associated benefits with imposing higher standards and creating an expectation of better practices, including greater engagement with shareholders, transparency, better decision-making and more comprehensive and accurate financial records (which feed into the company’s strategic planning).

- **Tax incentives**: Retail investors may be incentivised to invest in CSEF companies to obtain the incoming tax offsets for early-stage innovation companies, of which a proportion of eligible investments will be in proprietary companies. Consumers may not assess the risk weight of the company relative to immediate tax considerations.

### 4.2.1 Costing

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

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

- Costs per issuer are expected to increase by $730 per year for proprietary companies using CSEF driven primarily by costs associated with monitoring compliance with the CSEF framework. Costs per issuer are expected to increase by $1,050 for public companies using CSEF as they will not have the costs associated with monitoring compliance with the CSEF framework offset by the temporarily reduced costs associated with exemptions from annual general meetings and audit requirements contemplated in the legislation for public companies currently before Parliament.

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

- Costs per investor are expected to be the same as under the public company framework currently before Parliament.

Using the regulatory burden measurement framework, it has been estimated that the indicative model would increase compliance costs by $6.9 million per year. This is due primarily to the assumption that a greater number of companies will use the CSEF framework if they can remain proprietary companies rather than switching to public companies, as required under the status quo. For all reporting periods, the Treasury portfolio has reported net compliance cost reductions and there is no reason why the portfolio will not continue to deliver on its red tape reduction targets this year, in line with the Government’s regulatory reform agenda.

Table 1: Regulatory burden estimate (RBE) table

<table>
<thead>
<tr>
<th>Average annual regulatory costs (from business as usual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in costs ($ million)</td>
</tr>
<tr>
<td>Total, by sector</td>
</tr>
</tbody>
</table>

4.2.2 Net benefit

Out of the three options, Option 2 is the most significant departure from the current operation of the Corporations law. This option is likely to have the greatest take-up by potential CSEF companies as companies would not incur many additional costs by accessing CSEF under this option. However, the risk exposure of retail investors is the greatest under this framework. There is a higher chance of fraudulent activity which may diminish investor confidence and undermine the credibility of the CSEF sector. On balance, the lack of a minimum standard for companies in terms of their transparency and responsibility toward investors is a significant departure from the existing mechanisms that support a stable market and confident investors in Australia.
4.3 OPTION 3: EXTEND CSEF TO PROPRIETARY COMPANIES WITH APPROPRIATE PROTECTIONS

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

Many of the benefits discussed in paragraph 4.2 apply to this option to varying degrees including ‘Commercially Sustainable’, ‘Increased Diversity’, ‘Effective Allocation of Resources’ and ‘Opening up New Sources of Funding’. However, these benefits are achieved in Option 3 without the risk exposure of retail investors is not irresponsibly heightened. The benefits of Option 3 include:

- **Reduced regulatory burden**: As discussed in paragraph 4.2, permitting proprietary companies to access CSEF will eliminate the regulatory burden of changing company types. The regulatory burden of converting to a public company includes costs associated with the additional reporting and governance obligations required of public companies (such as the cost of additional directors, preparing full financial records and eventually holding AGMs after the concessions lapse). Although there is relief under the public company CSEF framework for some of these costs for up to five years for proprietary companies that convert, the costs will be incurred fully after five years. Option 3 will ensure that the CSEF framework does not interfere with the normal lifecycle of a company. Importantly, proprietary companies that access CSEF would be able to smoothly transition back to normal proprietary company status if no CSEF investors remain on the register. Clear transition paths between company types are crucial to ensuring that companies can use CSEF to support their development.

- **Responsible practices**: Requiring companies to comply with higher governance and reporting standards is likely to promote investor confidence and facilitate a successful CSEF market. Proprietary companies which access the ‘crowd’ will no longer be closely held, and external investors will expect disclosure of certain financial and non-financial information as well as higher governance practices. These higher standards will support meaningful shareholder engagement, better decision-making, greater transparency and more comprehensive and accurate record keeping habits.

- **Simplicity in public company structure**: By removing the concessions granted to proprietary companies which convert to a public company, all public companies that access CSEF will be subject to the same set of rules.

- **Stakeholder support**: On balance, this option is the most compatible with the views of stakeholders which were expressed during the consultation. This option strikes the responsible middle ground by opening up CSEF to a greater range of companies, creating a manageable framework for intermediaries while also acknowledging concerns about a lowering of investor protections.

The disadvantages and risks include:
• **Increased costs:** Proprietary companies will be required to comply with additional obligations. This will mean increased compliance costs, particularly in relation to: appointing an additional director; preparing an annual financial report; appointing an auditor; and having financial statements audited once the proprietary company exceeds the audit threshold. However, these obligations (and costs) are in aggregate lower than those placed on public companies.

• **No secondary market:** Due to the reduced ongoing reporting obligations it is unlikely that a secondary market will emerge under this option. The public will have no information to value shares or understand the business plans of these companies.

• **Legislative ambiguity:** It is possible that repealing the exemptions for transitioning companies built into the CSEF public company Bill may create short-term confusion or cost for a small number of companies using CSEF under the public company framework.

### 4.3.1 Costing

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

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

Under this option:

• Costs per issuer are expected to increase by $15,700 per year for proprietary companies using CSEF driven primarily by costs associated with additional reporting requirements associated with having a wider range of investors and to a lesser extent governance and monitoring requirements. Costs per issuer are expected to increase by $1,050 for public companies using CSEF as they will not have the costs associated with monitoring compliance with the CSEF framework offset by the temporarily reduced costs associated with exemptions from annual general meetings and audit requirements contemplated in the legislation for public companies currently before Parliament.

• Fixed costs for intermediaries are expected to be the same as under the public company framework currently before Parliament. Intermediary costs that vary with the number of issuers raising funds are also expected to be the same as under the public company framework, with overall costs increasing in line with the expected increase in businesses raising funds via CSEF.

• Costs per investor are expected to be the same as under the public company framework currently before Parliament.
Using the regulatory burden measurement framework, it has been estimated that the indicative model would increase compliance costs by $29.2 million per year. This is due primarily to the assumption that a greater number of companies will use the CSEF framework if they can remain proprietary companies rather than switching to public companies, as required under the status quo. For all reporting periods, the Treasury portfolio has reported net compliance cost reductions and there is no reason why the portfolio will not continue to deliver on its red tape reduction targets this year, in line with the Government’s regulatory reform agenda.

Table 1: Regulatory burden estimate (RBE) table

<table>
<thead>
<tr>
<th>Change in costs ($ million)</th>
<th>Business Community organisations</th>
<th>Individuals</th>
<th>Total change in costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total, by sector</td>
<td>$28.8 million</td>
<td>$0</td>
<td>$0.4 million</td>
</tr>
</tbody>
</table>

4.3.2 Net benefit

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

5. CONSULTATION

5.1. CONSULTATION PAPER

In August 2015, the Government released a consultation paper – ‘Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses’ – that sought feedback on the proposed public company CSEF framework and whether it should be extended to proprietary companies.² 53 submissions were received for this consultation (including nine confidential submissions) from a broad range of stakeholders including businesses, crowdfunding and trading platforms, industry bodies, advisory and legal firms, public organisations, individuals and universities.

² Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses, Department of The Treasury website
Most stakeholders agreed that crowdfunding should be extended to proprietary companies. However, some stakeholders suggested to either first assess the operation of the CSEF public company framework before considering any extension, or to not extend the framework at all.

Other feedback included:

- Stakeholders generally agreed that additional reporting obligations should apply to proprietary companies undertaking CSEF, but views diverged on the level and detail of these obligations.

- Stakeholders held diverse views on the fundraising cap that should apply if proprietary companies use CSEF.

- Stakeholders who supported extending crowdfunding to proprietary companies generally agreed the current non-employee shareholder limit is too low to facilitate crowdfunding. Stakeholders suggested a range of potential limits.

5.2. INDUSTRY ROUNDTABLES

Given the diversity of stakeholder views received in response to the August 2015 consultation, Treasury hosted two industry roundtables over October and November 2016 with respondents to the public consultation to seek more detailed views on a potential model for extending CSEF to proprietary companies. Treasury also undertook bilateral discussions to understand issues raised at the roundtables.

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

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

If the Government proceeds, stakeholders will be consulted again on draft legislation and any post-consultation adjustments, in accordance with the requirements of the Corporations Agreement 2002.
5.3. BALANCE OF FEEDBACK AT THE ROUNDTABLES AND FROM BILATERAL DISCUSSIONS

The table below sets out the balance of feedback that Treasury received from two roundtables held with stakeholders following the initial consultation paper. For each characteristic, the option that best aligns with the balance the stakeholder feedback is indicated with a *. The details of Option 3 can vary from the balance of feedback at the time of the roundtables due to subsequent consultation.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>No.</th>
<th>Option</th>
<th>Balance of feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fundraising cap</strong></td>
<td>1</td>
<td>Lower than CSEF public model fundraising cap (e.g. $2 million per 12 month period).</td>
<td>A potential advantage of this approach is that the lower reporting requirements of proprietary companies could be balanced by lower fundraising limits. However, no strong arguments were raised that this was necessary.</td>
</tr>
<tr>
<td></td>
<td>2*</td>
<td>Same as CSEF public model fundraising cap ($5 million per 12 month period).</td>
<td>A strong theme is that (to the extent possible) the thresholds in any proprietary regime should mirror the existing public company regime (subject to having appropriate investor protections) to reduce complexity.</td>
</tr>
<tr>
<td><strong>Investor cap</strong></td>
<td>1</td>
<td>Lower than CSEF public model fundraising cap.</td>
<td>In many cases, investors will choose to invest less than $10,000 in each company, so that lowering the limit does not necessarily lower the risk. It could also have the unintended effect of decreasing the likelihood of filling the CSEF offer.</td>
</tr>
<tr>
<td></td>
<td>2*</td>
<td>Same as CSEF public model fundraising cap ($10,000 per company per 12 month period).</td>
<td>Consistent with the principle that (to the extent possible) the thresholds in any proprietary regime should mirror the exempt public company legislation (subject to having appropriate investor protections). No strong objections were raised.</td>
</tr>
<tr>
<td><strong>Initial disclosure</strong></td>
<td>1*</td>
<td>Same disclosure requirements as the CSEF public reporting model. For both types of companies, include additional generic disclosures around company type, capital structure and intended financial reporting/audit for both company types.</td>
<td>This is the simplest option and aligns with the first CSEF principle. The level of disclosure required of public CSEF companies is balanced for cost and investor caps and includes risk statements.</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>More than CSEF public reporting but less than a full prospectus.</td>
<td>Not consistent with the CSEF public model and creates unnecessary complexity.</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Same disclosure requirements as a prospectus for retail investors.</td>
<td>A full prospectus would be too burdensome for small proprietary companies.</td>
</tr>
</tbody>
</table>
## 3.3B – Structural issues in relation to proprietary companies

<table>
<thead>
<tr>
<th>Shareholder limit</th>
<th>1</th>
<th>Current proprietary shareholder limit to remain the same for all proprietary companies (50 non-employee shareholders).</th>
<th>This would not allow for an effective CSEF regime.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2</td>
<td>Increase shareholder limit for all proprietary companies.</td>
<td>Although there was some support to increase the non-employee shareholder limit from 50 to a higher number for all proprietary companies, changes to this threshold fall outside the ambit of these reforms. This would be a significant departure from existing law for a bespoke fundraising regime which will only be used by approximately 2% of companies. It would be more appropriate to consult more widely before making changes that apply more broadly to proprietary companies. There may be unintended consequences in the corporations law of raising the limit for all proprietary companies.</td>
</tr>
<tr>
<td></td>
<td>3*</td>
<td>Increase limit of CSEF investors. To facilitate the entry of the crowd to proprietary companies, the preference is for section 113 of the Corporations Act to be amended so that proprietary companies are restricted from having more than 50 non-employee or non-CSEF shareholders.</td>
<td>If CSEF is extended to proprietary companies, it will be necessary to amend the current shareholder restrictions imposed on proprietary companies. This option is consistent with the principles. Allowing for an unlimited number of CSEF shareholders will allow for free access to fundraising but ensure that those members of the crowd putting up funds will have had the benefit of the gatekeeper role of platforms and the disclosure at the time of the offer. It is also likely to have the minimum of unintended consequences for other proprietary companies.</td>
</tr>
<tr>
<td>Transition to public company status</td>
<td>*</td>
<td>No special requirement to convert to a public company.</td>
<td>The preference is for proprietary companies to transition to public companies using the existing architecture of the corporations law.</td>
</tr>
<tr>
<td>Takeover provisions</td>
<td>1</td>
<td>Usual takeover provisions would not apply. Option to use a shareholders’ agreement (no prescribed form) to regulate takeover offers as is common for proprietary companies.</td>
<td>Difficult to co-ordinate a shareholders agreement across such a wide range of shareholders and a typical shareholders agreement may be more than required.</td>
</tr>
<tr>
<td>---------------------</td>
<td>---</td>
<td>------------------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>2*</td>
<td>Usual takeover provisions would not apply if the issuer meets minimum mandated shareholder provisions that are stipulated in law. These provisions will aim to ensure that exits are run smoothly and allow CSEF shareholders to participate in major exit events through the stipulation of drag and tag rights.</td>
<td>It was considered that takeover provisions (Chapter 6 of Corporations Act) were not appropriate for CSEF proprietary companies due to their complexity and the associated cost / time burden required navigating the regime. However, the regime should ensure that CSEF investors are afforded certain rights to participate in major exit events (e.g. ‘tag’ rights). Companies will also need some ability to manage exits with a larger group of shareholders (e.g. through ‘drag’ rights).</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Current takeover rules apply.</td>
<td>Potentially too costly for companies to manage successful exits if the laws apply.</td>
</tr>
</tbody>
</table>

**Option 3.3C – Corporate Governance**

<table>
<thead>
<tr>
<th>Annual general meetings</th>
<th>1*</th>
<th>No requirement to hold an AGM.</th>
<th>It is important that proprietary companies using CSEF have greater engagement with their shareholders compared to normal small proprietary companies. However, there was no compelling feedback to suggest that the benefit of holding AGMs outweigh their administrative burden. Greater shareholder engagement will be driven through financial and non-financial disclosure requirements. CSEF companies have alternative communication options with shareholders.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2</td>
<td>Grace period to not hold an AGM.</td>
<td>See below.</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Must hold an AGM.</td>
<td>Not appropriate in the context of a start-up – the cost does not match the benefit. However, it would be important to require other disclosure requirements to engage and inform shareholders.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of directors</th>
<th>1</th>
<th>Current minimum number of directors for proprietary companies (one director).</th>
<th>Not appropriate as there needs to be greater accountability within a company that raises funds from the public.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2*</td>
<td>Minimum 2 directors.</td>
<td>It is appropriate to expect companies that fundraise from the public to adhere to higher governance standards to foster accountability and better decision-making. It was generally accepted that increasing the minimum number of directors from 1 to 2 would promote greater transparency, more robust decision-making and greater certainty around succession planning.</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>More than one director and a requirement for a director to be an independent non-executive director.</td>
<td>Non-executive/independent directors may be too expensive in the context of a start-up – costs may represent too high a proportion of the amount raised through CSEF.</td>
</tr>
<tr>
<td>Related party transactions</td>
<td>1</td>
<td>Current rules applicable to proprietary companies (i.e. no general prohibition) but companies are required to disclose related party activities.</td>
<td>Consistent feedback that companies that raise from the public should be held to a higher standard in relations to related party transactions. Directors should have responsibility to act in the best interests of the company and its investors.</td>
</tr>
<tr>
<td>----------------------------</td>
<td>---</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>2*</td>
<td>Application of Chapter 2E regime to CSEF proprietary companies. Chapter 2E generally imposes the requirement of no related party transactions without shareholder approval, with several exemptions such as the transaction being conducted at arm’s length.</td>
<td>It is important that the framework include mechanisms that mitigate fraud or mismanagement due to bias. It is appropriate that the related party regime in Chapter 2E applies to proprietary companies that use CSEF. Stakeholders from law firms were particularly strong in their view that this regime should apply. Through discussion it was resolved that the exemptions provided in Chapter 2E were sufficient to allow the transactions that start-ups and other companies were concerned would be prevented. Thus, there are no remaining stakeholder objections to the imposition of rules about related party transactions.</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Bespoke regime for CSEF proprietary companies.</td>
<td>Too complicated and not necessary in context of the reforms.</td>
</tr>
<tr>
<td><strong>Option 3.3D – Financial reporting</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ongoing financial reporting</td>
<td>1</td>
<td>Mandate Tier 2 (Reduced Disclosure Regime) reporting.</td>
<td>Feedback is that this is more appropriate than Tier 1, but that mandating Tier 2 would be too burdensome for many small companies and would deter the use of the regime.</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Bespoke regime with a low level of reporting tailored to the needs of CSEF investors.</td>
<td>Feedback is that a lower level of reporting balances the call to provide some information to shareholders to provide them confidence in the regime with the need to keep costs low for small companies. As CSEF shares would be non-transferable to the public, the need to report is also balanced by what is contained in the initial disclosure. However, it would create another layer of complexity for a small group of companies.</td>
</tr>
<tr>
<td></td>
<td>3*</td>
<td>Require companies to report to CSEF investors by providing financial statements in accordance with accounting standards. This retains the option for further guidance to be provided in the future.</td>
<td>Feedback is that CSEF users are similar to public shareholders and require some level of transparency and accountability through financial reporting in order to make decisions with regards to their investment. This option would be consistent with the current approach in the law.</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Require financial statements (without reference to ‘in accordance with accounting standards’).</td>
<td>Feedback is that reports are not particularly useful if it is not clear what accounting standards are used to create them.</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>No mandated reporting (same as current small proprietary company reporting requirements).</td>
<td>Feedback is that financial reporting may not necessarily be valuable because of other controls in place to limit risks and exposure, particularly the retail investor limit of $10,000, and that the ability of the shareholders to influence outcomes may be low. There is a commercial reason for companies to maintain transparency and companies may choose to produce cut-down financial statements, as is the case in New Zealand.</td>
</tr>
</tbody>
</table>
| Audit requirements | 1 | No audit requirements.  
The objective of an audit of a financial report is to enable the auditor to express an opinion whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework. | Independent audits are an important shareholder protection measure, yet they can be relatively expensive for small companies. |
|-------------------|---|---|---|
|                   | 2*| Require an audit or a review of financial reports.  
In a review, the reviewer states whether there is or is not anything that has come to their attention that causes them to believe the financial report does not meet requirements. | Feedback is that reviews are less costly than full audits. Reviews are currently used in Australia by disclosing entities (usually for half-year reports), medium-sized charities, and small proprietary companies (when members or ASIC direct them to).  
The opposing view is that reviews provide too low a level of assurance. Accounting firms also indicate that there are practical difficulties with holding reviews if no audit has previously been conducted. |
|                   | 3 | Require a review of agreed upon procedures (set by the regulator and provided to investors).  
Agreed upon procedures engagements do not provide explicit assurance (audit or review assurance). The regulator would set the scope and extent of tests to be performed on a limited subject matter. Findings are reported without any opinion. | Feedback is that this option would add complexity. |
|                   | 4 | Full audit requirements once a threshold is reached (e.g. to line up with any threshold for general purpose reporting). | Feedback is that while this option is similar to the CSEF public company model, an extra (and arbitrary) threshold would add further complexity to the regime. |
6. APPENDIX

6.1. CURRENT REGULATORY ARRANGEMENTS FOR COMPANIES

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

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

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

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

- Auditors who assist in the monitoring of managers by attesting to the accuracy of companies’ financial statements.
- A board of directors, each of whom has fiduciary duties to act with reasonable care and diligence, in the interests of the company, and for a proper purpose.
- Disclosure of information by companies allows shareholders to properly monitor managers and directors. Obligations such as annual financial reports, prospectus (or offer information statements in some cases) and continuous disclosure obligations seek to address the asymmetry in access to information regarding the operation and prospects of a company that exists between the managers and the owners. This information is used to determine whether a person wishes to become, remain or exit from being a shareholder of a company.
- Annual general meetings, which provide a forum for shareholders to be informed about financial and other matters, ask questions of management and make decisions relating to matters that need to be considered.
- Members’ rights to call a meeting, undertake litigation against the company, and vote when resolutions are put forward by the company.
- Restrictions on related party transactions including processes where a company intends to enter into a related party transaction that falls within a permitted exemption.

There are also a range of requirements in relation to the contents of disclosure documents, the process for making equity offers, liability of directors for misleading statements in offer documents and restrictions on advertising to ensure the disclosure is clear, effective and reliable.
**Proprietary companies** are intended to be closely-held companies where the shareholders have access to the management and consequently information asymmetries and agency costs are likely to be lower than in more widely-held public companies. Proprietary companies are subject to lower compliance and transparency obligations than public companies. Proprietary companies are defined as either small proprietary companies\(^3\) or large proprietary companies\(^4\), with small proprietary companies having lower compliance obligations than large proprietary companies.

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

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

For both public and proprietary companies, there are certain exemptions from the requirement to use a disclosure document in primary capital raisings. These exemptions include wholesale (professional, sophisticated and experienced) investors (who are less likely to suffer from information asymmetries) and ‘small scale personal offers’ (where a personal offer is made and no more than $2 million is raised in any 12 month period from no more than 20 Australian investors, to facilitate small capital raisings that may not occur if a disclosure document were required).

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\(^3\) Corporations Act, s45A(2) defines a small proprietary company as a proprietary company with at least two of: consolidated financial revenue of less than $25 million; consolidated gross assets of less than $12.5 million; and fewer than 50 employees.

\(^4\) Corporations Act, s45A(3) defines a large proprietary company as a proprietary company with at least two of: consolidated financial revenue of $25 million or greater; consolidated gross assets of $12.5 million or greater; and 50 or more employees.