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General Manager
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By email: smallptycompanies@treasury.gov.au

Dear Sir or Madam

Facilitating crowd-sourced equity funding and reducing compliance costs

The Australian Chamber of Commerce and Industry welcomes this opportunity to provide feedback on the consultation paper on equity crowdfunding and reducing compliance costs for proprietary companies.

The Australian Chamber is Australia's largest and most representative business association, comprising eight state and territory chambers of commerce and more than 30 national industry associations.

Summary

The Government is heading in the right direction with its efforts to facilitate crowd-sourced equity funding for proprietary companies and reduce compliance costs, but it could go further.

The first step should be to reduce regulatory barriers for proprietary companies by:

- increasing the non-employee shareholder limit for proprietary companies to at least 100 and increasing the shareholder limit in Australia to match other jurisdictions (for example the United States has a limit of 500);
- increasing the 20 investor cap for small-scale offerings in line with the overall non-employee shareholder cap; and
- substantially increasing the $2 million fundraising limit, which has not changed for more than 17 years.

However, general regulatory changes will not be enough to accommodate equity crowdfunding by proprietary companies. Equity crowdfunding relies on raising a small amount from a large number of investors, so there needs to be a separate regime for crowdfunding based on caps on the amount each individual can invest rather than the number of investors.

To enable higher limits on the number equity crowdfunding shareholders and investors without undermining broader fundraising rules, equity crowdfunding investors should be distinguished from other shareholders, just as they are in the United States. Proprietary companies that engage in equity crowdfunding should be subject to additional transparency obligations derived from the rules for public companies using equity crowdfunding. If necessary, tension between protecting investors and increasing

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regulatory costs for proprietary companies could be managed by placing lower investor and issuer caps on equity crowdfunding by proprietary companies. However, the Government should reconsider the need for a time limit on equity crowdfunding-related regulatory exemptions.

The Australian Chamber supports the other reductions in the compliance burden proposed by the Government, including the requirement to make a solvency resolution, the requirement to maintain a share register separate to ASIC and the clarification of rules around the execution of documents. There is also scope for further regulatory burden reductions, including allowing companies to have more than one registered agent, addressing problems with charging for registration of business names and simplifying ASIC forms.

Should the 50 shareholder limit for proprietary companies be increased?

Intuitively, it seems appropriate for companies with a larger number of shareholders to have greater governance and disclosure obligations. However, we are not aware of any empirical evidence that private companies with a larger number of shareholders are more likely to experience governance problems or deliver inferior outcomes for investors. Nor are we aware of examples where being at or near the shareholder limit has contributed to adverse outcomes for investors.

Significant improvements in communications technology mean it is easier for shareholders to access information about the performance of the business than it was in the past.

In the United States the shareholder limit for private companies is 500. In 2012, the Jumpstart Our Business Startups Act increased the shareholder limit to 2,000 accredited investors.[1] The Act also excluded employees and crowdfunding shareholders from the limit.

We acknowledge that the Australian and United States limits may not be directly comparable given other differences in the regulatory landscape. However, we encourage the Government to look more closely at how Australia compares with the United States and other leading global capital markets.

We have not heard concerns about the shareholder limit in Australia outside of multigenerational family companies and equity crowdfunding, but the fact the limit was increased in the US in 2012 suggests it could create broader problems for start-ups. The apparent absence of similar concerns in Australia may be because Australia has fewer high-growth start-ups, and a less developed early-stage capital market. It may also be that the strictness of the 50 shareholder limit means that start-ups seeking to raise capital from a broader range of investors rarely contemplate remaining a proprietary company.

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[1] As defined here: http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=8edfd12967d69c024485029d968ee737&r=SECTION&n=17y3.0.1.1.12.0.46.176

All these considerations suggest that the shareholder limit for proprietary companies should be increased to at least 100, as recommended by the Joint Committee. The Government should also consider increasing the shareholder limit in Australia to match other jurisdictions, pending further investigation of the link between shareholder numbers and governance problems.

Recommendation 1: Increase the non-employee shareholder limit for proprietary companies to at least 100 and consider increasing the shareholder limit in Australia to match other jurisdictions.

Should the 20 investor limit for small scale offerings be increased?

If the overall cap shareholder limit for proprietary companies is increased then it seems logical to proportionately increase the investor limit for small scale offerings.

Recommendation 2: The 20 investor cap for small scale offerings should be increased in line with the overall non-employee shareholder cap.

Should the $2 million cap on small scale offerings be increased?

An increase in the $2 million limit on the amount that can be raised through small-scale offerings is long overdue as the current limit was part of the *Corporate Law Economic Reform Bill 1998*.[2] On CPI alone, the threshold should now be more than $3 million. However, simply adjusting and then indexing the limit to account for changes in consumer prices would be simplistic.

Ideally, the factors taken into account when considering how the small scale offerings limit should change over time should be:

- changes in a typical investor's capacity to bear losses;
- changes in the probability of investor losses due to governance problems; and
- changes in a typical business's need for capital.

Both prices and volumes must be considered when determining a typical business's capital needs and the capacity of investors to bear a loss with a given nominal value.

From the perspective of investors, CPI is a poor proxy because it only considers changes in the prices that a typical household consumes. Income measures such as average weekly earnings (AWE) may be better alternative. However, AWE does not take into account changes in capital income or participation. These might be taken into account by looking at changes in household income. On the other hand, when considering a household's capacity to bear losses it may be more appropriate to focus on household wealth. The best measure of a typical business's capital needs also requires further consideration, but one approach may be to look at the typical size of bank loans or typical capital expenditure. We are unsure of the best approach to measure the likelihood of investor

[2] See http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3Alegislation%2Fbills%2Fr566_first%2F0001;rec=0

losses due to governance issues. One approach may be to consider insolvency rates, and related causes of failure. This appears to indicate business failures due to management problems are relatively this is likely to be very imprecise. Given these measurement difficulties, it may be necessary to disregard this consideration.

Clearly it is impossible to have a single measure that precisely captures changes in a typical investor's capacity to bear losses, a typical business's need for capital and the probability of investor losses due to governance problems and changes in a typical business's need for capital. However, developing a reasonable proxy seems feasible, and we would be happy to provide assistance if the Government decides to pursue this option.

Recommendation 3: The $2 million small-scale offerings cap has been in place since 1998 and should be substantially increased, and subsequently indexed by some measure that takes into account changes in a typical investor's capacity to bear losses, a typical business's need for capital, and the probability of investor losses due to governance problems.

Should proprietary companies should be able to access equity crowdfunding?

Equity crowdfunding is typically used by smaller and newer companies because it is has fewer overheads than other forms of equity fundraising. Smaller and newer companies are likely to be proprietary companies and if they must convert to a public company to access equity crowdfunding many will be discouraged from doing so by the costs of the transition, especially as the outcomes of an equity crowdfunding round are uncertain.

Recommendation 4: Changes should be made to enable proprietary companies to access equity crowdfunding without taking on the full obligations of a public company.

Could increasing the general regulatory flexibility for capital-raising provide sufficient fundraising flexibility for proprietary companies?

Increasing the general regulatory flexibility for capital-raising by proprietary companies may provide some scope for equity crowdfunding, but it seems likely that general caps on the number of shareholders and investors will make equity crowdfunding impractical in the majority of cases.

Even increasing the investor limit to 100 would barely accommodate the average funding round. UK crowdfunding platform Cloudcube reports an average of 149 investors as of July 2015.[3] Crowd Valley, a company which provides support for online investing platforms, reported that data presented at the 2014 Global Crowdfunding Expo estimated the average number of investors at 96.[4]

[3] See https://www.crowdcube.co.nz/pg/businessfinance-1395
[4] See http://news.crowdvalley.com/news/crowdfunding-84-of-investors-are-male-but-women-are-more-successful

The shareholder limit would also have to be drastically increased because it has to be able to accommodate potential equity providers outside of crowdfunding, as well as existing shareholders.

The creation of specific regulations to facilitate equity crowdfunding for public companies recognises that the distinctive character of equity crowdfunding justifies more limited regulatory obligations than other forms of public offering, partly because it is used by small companies that are less able to manage the regulatory overhead and partly because less capital is put at risk per investor.

Taking all of this into account, it seems better to set specific rules for equity crowdfunding rather than attempting to accommodate equity crowdfunding within the general fundraising regulations for proprietary companies.

Recommendation 5: Set specific rules for equity crowdfunding rather than attempting to accommodate equity crowdfunding within the general fundraising regulations for proprietary companies.

How should specific rules for equity crowdfunding be structured?

As equity crowdfunding seeks to raise a small amount from a large number of investors it seems more sensible to place limits on the total invested and the amount per investor, rather than the number of shareholders or investors.

For example, in Canada there is a cap on the issuer side. The limit on what any issuer group can raise is $1.5 million in any 12 months. In the United States, a small business cannot raise more than $1 million on 12 months through equity crowdfunding. Investor limits also apply and are based on an investor’s annual income.

To enable higher limits on the number equity crowdfunding shareholders and investors without undermining broader fundraising rules, equity crowdfunding investors should be distinguished from other shareholders, as they are in the United States.

Recommendation 6: To enable higher limits on the number equity crowdfunding shareholders and investors without undermining broader fundraising rules, equity crowdfunding investors should be distinguished from other shareholders.

Recommendation 7: Equity crowdfunding limits should be based on a cap on the amount per investors and the total invested rather than a cap on shareholder or investor numbers.

There is recognition that equity crowdfunding should require more limited transparency obligations than other forms of public offering. However, it is appropriate for proprietary companies that engage in equity crowdfunding to have additional transparency obligations. The equity crowdfunding obligations for public companies provide a useful starting point for determining the nature of these obligations.

Recommendation 8: Equity crowdfunding obligations for public companies should provide the starting point for additional transparency obligations for proprietary companies that wish to engage in equity crowdfunding.

If necessary, tension between maintaining appropriate protections for investors and avoiding unacceptable increases in regulatory costs for proprietary companies could be managed by placing lower investor and issuer caps on equity crowdfunding by proprietary companies.

Recommendation 9: If necessary, tension between maintaining appropriate protections for investors and avoiding unacceptable increases in regulatory costs for proprietary companies could be managed by placing lower investor and issuer caps on equity crowdfunding by proprietary companies.

The discussion paper proposes removing any regulatory exemptions applying to equity crowdfunding after five years. However, it is not clear that there is a compelling case for imposing this time limit. It seems that if equity crowdfunding investors are distinguished from other shareholders, then there is no need for a time limit to preserve the broader integrity of fundraising rules. Taking on additional disclosure obligations may make sense where a company has grown, but such cases would be captured anyway under the size based eligibility criteria. It is less clear that imposing increased disclosure obligations would be helpful where companies are already struggling.

Recommendation 10: Reconsider the need for a time limit on equity crowdfunding related regulatory exemptions.

Should the Government proceed with the proposed red tape reductions?

We support:

- removing the solvency resolution requirement because it is just seen as a compliance obligation by many directors and does not prompt genuine consideration of a company's solvency;
- removing the requirement to maintain a share register, because in practice the register is often only updated when it is updated with ASIC and interested parties can rely on ASIC's records;
- allowing sole directors who are not company secretaries to execute documents
- explicitly allowing identical copies of a document to be treated as one for the purposes of the execution of documents that need to be signed by more than one office holder; and
- allowing documents or deeds which are executed by a foreign company in accordance with the laws of the jurisdiction in which the company is incorporated are deemed compliant with Australian law (rather than requiring the foreign company to execute in accordance with Australian law).

Recommendation 11: The Government should proceed with the removal of the requirement to make a solvency resolution, the requirement to maintain a share register separate to ASIC and the clarification of rules around the execution of documents.

Are there any other ways that the Government could reduce the regulatory burden on proprietary companies?

In addition to the proposed changes, we contend that:

- ASIC form 370 which allows the officer resigning to sign their own form is not necessary.
    - An ASIC 484 Form signed by the outgoing officer would be sufficient. There could be measures in place to stop any other sections of a 484 Form (share structure changes, appointment of directors etc.) being acted on if it is signed by an outgoing officer who is effecting their own resignation in the same form as any other change.
- ASIC 201 Forms should be linked to the ATO's ABN and TFN application
    - This would be more efficient and minimise confusion for new businesses and start-ups. At bare minimum, the information pages on the ASIC website should clearly refer to the ATO as the department that provides ABN's and TFN's.
- Companies should be able to have more than one registered agent.
    - Many companies have at minimum an accountant and a lawyer. Some companies will have several law firms depending on the transaction.
- All ASIC forms should be available online.
    - Currently, only some of the most common forms are available for electronic submission. There should also be more encouragement and training for businesses to use the online system which is more efficient and cost effective. Particularly since company details can be updated immediately online, which is useful when the company details need to be corrected instantly to allow businesses to give correct information to insurers, banks and other government departments such as the ATO.

We also note:

- The high cost of incorporating ($377-$457) and maintaining ($243) a company, and the high late fee penalties ($308 if a document is more than one month late).
- The high cost of changing a company name ($377) is a problem when a company has had to incorporate using an alternative name to get the business off the ground immediately (generally to arrange ABN, TFN and banking details) and it is waiting for:
    - ministerial consent; or
    - permission from a business already using that name or a seller (in a business sale)

  before it can use the company name it originally intended and submit a Form 205. Reserving a company name does not solve this problem as company details such as an ACN are requirements for insurers, banks and the ATO.
- The cost of registering multiple business names ($74 each) as the registration systems can 'accidently' allow a competitor to unlawfully register a business name if they use capital letters or spaces to register the same name. For example, JETBOAT, Jet Boat, jet boat, JETboat.

Recommendation 12: There is scope for further regulatory burden reductions, including allowing companies to have more than one registered agent, addressing problems with charging for registration of business names and simplifying ASIC forms.

Thank you again for the opportunity to provide comments on this consultation paper. If you would like to discuss the issues raised in this letter, please contact me on 02 6270 8042 or at tim.hicks@acci.asn.au.

Yours sincerely

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