



Australian Government

**Facilitating crowd-sourced equity funding
and reducing compliance costs
for small businesses**

Consultation Paper
August 2015

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CONSULTATION PROCESS

Request for feedback and comments

The Government is seeking your views on whether to extend the crowd-sourced equity funding (CSEF) framework to proprietary companies, and ways to reduce compliance costs and make capital raising more flexible for small proprietary companies.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: Monday, 31 August 2015

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FOREWORD



The Government is pleased to release this consultation paper, which further delivers on our 2015-16 Budget commitments.

The \$5.5 billion *Growing Jobs and Small Business* package in the 2015-16 Budget will encourage entrepreneurship and the development of ideas that will translate into economic opportunity, jobs and success. It provides incentives for small businesses to invest, hire and grow.

The package includes the Government's commitment to introducing a legislative framework to facilitate crowd-sourced equity funding (CSEF) for public companies. Introduction of CSEF will improve the funding options for small businesses, particularly those in the crucial early growth stages. The Government has already conducted extensive consultations on CSEF and has listened to the feedback provided by stakeholders.

This consultation paper outlines for the first time the key elements of the Government's CSEF framework for public companies. Further details will be available in draft legislation that will be released for public comment later in the year. Introduction of legislation to Parliament is expected to follow in the Spring sittings.

Feedback from the CSEF consultation process indicated substantial stakeholder support for allowing proprietary companies to access CSEF, in addition to public companies. As proprietary companies have greater restrictions on the way they can raise capital, this consultation paper seeks feedback on whether proprietary companies should also be able to access CSEF and outlines a potential model.

The *Growing Jobs and Small Business* package also includes measures to reduce red tape and other impediments to small business growth. The Government recognises that regulatory burdens can stifle innovation and growth, and that more can always be done to free up time and resources for small businesses to direct into managing and ensuring the success of their business endeavours.

This consultation paper seeks the views of small businesses, industry, professional bodies and all interested parties to identify which areas of the *Corporations Act 2001* could be amended to reduce the burdens on small proprietary companies and make capital raising more flexible.

I encourage all interested stakeholders to provide comment on the matters raised in this consultation paper. The deadline for submissions is Monday, 31 August 2015.

The Hon Bruce Billson MP
Minister for Small Business

1. INTRODUCTION

1.1 CONTEXT

1. Small business makes a significant contribution to the Australian economy.
2. The Government recognises that reducing regulatory burdens for business is a critical step towards improving Australia's productivity. As part of the *Growing Jobs and Small Business* reform package announced in the 2015-16 Budget, the Government stated that it would examine the regulatory framework for small proprietary companies under the *Corporations Act 2001* (Corporations Act) to identify ways to reduce compliance costs and make capital raising more flexible.¹
3. Improving the regulatory framework may also make incorporation more feasible for new and existing small businesses. Incorporation provides protection for business owners from liability, and may allow for a more efficient allocation of risk.
4. In the 2015-16 Budget, the Government also re-iterated its commitment to introducing a CSEF regime for public companies.
5. In late 2014 and early 2015, the Government conducted a comprehensive consultation process on a potential CSEF framework. The Government held two industry roundtables, received 41 written submissions and conducted a number of bilateral meetings with stakeholders. Stakeholders were strongly supportive of the introduction of a CSEF framework in Australia and provided valuable feedback on aspects of the model relating to issuers, intermediaries and investors.
6. The Government has listened carefully and taken this feedback on board in developing its CSEF framework for public companies, which is set out in this paper.
7. A key element of the feedback from the earlier consultation process was support amongst stakeholders for proprietary companies to be allowed to access CSEF. Stakeholders noted that the majority of companies that are likely to consider using CSEF may be proprietary companies. However, current limitations on how these companies can raise funds would make it difficult for proprietary companies to use CSEF. While the Government has taken decisions in relation to a CSEF framework for public companies, this discussion paper seeks views on whether that framework should also be extended to proprietary companies.
8. This consultation paper therefore covers areas related to CSEF, fundraising and proprietary companies. It:
 - announces the Government's CSEF policy for public companies (Section 2);

1 See joint media release of 6 May 2015 by the Treasurer, the Hon Joe Hockey MP, and the Minister for Small Business, the Hon Bruce Billson MP, *Supporting start-ups and entrepreneurship*, available at <http://bfb.ministers.treasury.gov.au/media-release/041-2015> and joint media release of 12 May 2015 by the Prime Minister, the Hon Tony Abbott MP, the Treasurer and the Minister for Small Business, *Growing Jobs and Small Business Package to help small businesses invest more, grow more, and employ more*, available at <http://jbh.ministers.treasury.gov.au/media-release/044-2015>.

- examines ways to increase the ability of small proprietary companies to access finance to invest and grow without having to move into the more extensive disclosure and reporting regime of a public company (Section 4);
 - seeks views on whether the CSEF framework should be extended to proprietary companies and, if so, seeks feedback on the best approach (Section 5); and
 - examines the regulatory framework for small proprietary companies under the Corporations Act to identify ways to reduce compliance costs for such companies. It seeks to identify ways to free up time and resources for small proprietary companies to direct into operating and growing their businesses (Section 6).
9. Consultation on CSEF for proprietary companies is being conducted alongside the examination of the broader regulatory framework for small proprietary companies given the important cross linkages between the issues.
10. The consultation questions are provided in a table in the Appendix for convenience.
11. All references to legislation are references to the Corporations Act unless otherwise specified.
12. The scope of this consultation paper is limited to the regulatory framework set out in the Corporations Act. Other Commonwealth, State and Territory laws also impose obligations on proprietary companies and their directors.

1.2 NEXT STEPS

13. The consultation paper will be open for public comment for four weeks, with submissions due by Monday, 31 August 2015. The Government will consider stakeholder feedback before making decisions on whether to proceed with CSEF for proprietary companies, making capital raising more flexible, and ways to reduce compliance costs.
14. Regardless of whether the Government proceeds with CSEF for proprietary companies, the Government remains committed to facilitating CSEF for public companies. The Government intends to develop CSEF legislation with the aim of introducing it to Parliament in the Spring parliamentary sittings of 2015. Draft legislation will be released for public comment prior to its introduction.

2. CROWD-SOURCED EQUITY FUNDING FRAMEWORK FOR PUBLIC COMPANIES

15. CSEF is an innovative **unproven** form of fundraising that allows a large number of individuals to make small equity investments in a 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. **From someone who has been involved in equity-based crowdfunding for nearly 30 years and who's company (ASSOB) he founded was written up by the World Bank as "the world's most successful fraud-free equity-based crowdfunding platform," I think you are barking up the wrong tree. Who was it that had the authority and experience that made the assumption, "CSEF is an innovative form of fundraising that allows a large number of individuals to make small equity investments in a company."? For starters, Crowd Sourced Equity Funding (CSEF) is in itself a misnomer! Startup and early-stage funding, does not and never will, come from "the crowd". A more accurate description would be Equity-Based Crowd Funding (EBCF).**

You seemed to be focussed on the "crowd" instead of the startup or early-stage company that needs the funding. We have the experience and we know what will work and what doesn't work. If you care to ask us, or have us spend a half a day with your team, we can show you based on experience. Regards, Tony Puls.

16. The Government committed to introducing a CSEF legislative framework for public companies, including as part of the *Growing Jobs and Small Business* package in the 2015-16 Budget.
17. The Government conducted extensive consultation including the release of a discussion paper in December 2014 and industry roundtables in February 2015. Issues raised in consultation focused on:
- opening up fundraising opportunities for start-ups and small businesses;
 - the need to balance reduced compliance costs for issuers and intermediaries with appropriate levels of investor protection and education; and
 - exploring how proprietary companies, as well as public companies, could more flexibly raise capital.
18. The Government's CSEF framework incorporates this feedback by establishing a regime that balances the need for investor disclosures and protection with a more flexible framework for businesses.
19. In addition to the establishment of the Government's framework, investor education will also have an important role to play in the long term success of a CSEF regime in Australia. Investors will be able to better evaluate the risks and opportunities of CSEF investments when they are educated about the benefits and risks of those investments. In addition to required risk warnings and acknowledgements, education provided by intermediaries and other stakeholders will have an important role in improving investor understanding of CSEF.
20. Key elements of the Government's CSEF framework for public companies are outlined in Table 1.

Table 1: Key elements of CSEF framework for public companies

Issuers	Intermediaries	Investors
<p>Issuers must be incorporated as a public company in Australia.</p> <p>Limited to certain small enterprises that have not raised funds under existing public offer arrangements.</p>	<p>Must hold an Australian Financial Services Licence.</p> <p>This requirement will make the cost of CSEF and engaging the intermediary too expensive for the average SME. Suggest you stick with the current Class Order 02/273.</p>	<p>Investment caps for retail investors of:</p> <ul style="list-style-type: none"> • \$10,000 per offer per 12-month period; and • \$25,000 in aggregate CSEF investment per 12-month period, self-certified by investors. <p>Intermediaries would be responsible for monitoring compliance for investments made via their platform.</p> <p>Again, professional indemnity insurance, etc. will make this approach far too expensive for SME's to afford CSEF.</p>
<p>Relief from certain public company compliance costs would be available to newly registered or converted public companies. Reliefs include:</p> <ul style="list-style-type: none"> • exemptions from disclosing entity rules; • allowing annual reports to be only provided online; • exemption from holding an annual general meeting (AGM); and • exemptions from the need to appoint an auditor and have financial accounts audited, subject to a cap of \$1 million raised from CSEF or under a disclosure exemption. <p>Exemptions will be available for a period of up to five years, subject to annual turnover and gross assets thresholds of \$5 million (excepting the audit exemption).</p>	<p>Must undertake prescribed checks on the issuer.</p>	<p>Signature of risk acknowledgement statements prior to investment, including that:</p> <ul style="list-style-type: none"> • investing in early stage companies is risky and the investor may lose the entirety of their investment; • investors may not be able to sell their shares; • the value of the investment may be diluted over time; and • investors have complied with the investor caps.
<p>Issuer may raise up to \$5 million in any 12-month period, inclusive of any raisings under the small scale offerings exception but excluding funds raised under existing prospectus exemptions for wholesale investors.</p>	<p>Must provide generic risk warnings to investors.</p>	<p>Unconditional right to withdraw for 5 days after accepting offer.</p> <p>Additional rights in relation to material adverse changes during the offer period.</p>

Issuers	Intermediaries	Investors
<p>Permitted securities are one class of fully paid ordinary shares per CSEF offer. All shares in a particular CSEF offer must have the same price, terms and conditions. So this means that there is no rush to buy the first share if it is the same price as the last share so what's the hurry to come in early??? This approach never worked in the past. Why do you think it will work now??? Take it from someone that has been doing CSEF for 30 years.</p>	<p>No restrictions on fee structures; however, fees paid by an issuer must be disclosed. With no guarantee that an issuer will raise any funds the intermediaries will need to charge high upfront fees in order to cover their costs. SME's will not be willing or able to afford to take that risk.</p>	
<p>Reduced disclosure requirements, including a tailored CSEF disclosure document. Required disclosures will relate to:</p> <ul style="list-style-type: none"> • facts about the company and its structure, including financial statements; • facts about the CSEF raising; and • mandatory risk warnings. 	<p>Permitted to invest in issuers using their platform; however, details of any investments must be disclosed.</p>	
	<p>Prohibition on the provision of investment advice and lending to CSEF investors.</p>	<p>My final comments on what you propose. Having done crowdfunding for 30 years, we know absolutely that investors do not come from the "crowd at large" they come from 2 to 3 degrees of separation from the issuing company. They may be clients, suppliers or others wishing to firm up their relationship with the issuing company. You seem to think that if by creating this new CSEF framework, that investors will flock in large numbers to fill any offer put up. This is not reality. What you are proposing simply just won't work. What I believe you should do is to simply increase the "20" restriction in the 20/12 rule.</p>

3. FEATURES OF THE SMALL PROPRIETARY COMPANY

21. A proprietary company is a company registered under the Corporations Act which:
- must not have more than 50 shareholders, not counting shareholders who are also employees (or who were employees when they became shareholders); and
 - must not, except in limited circumstances, offer shares to the general public or undertake other fundraising activities that would require the issue of a disclosure document to investors.²
22. The Corporations Act also classifies proprietary companies as either large or small. A company's classification can change from one financial year to the next as its circumstances change. A proprietary company is classified as small if it meets at least two of the following criteria:³
- the company's consolidated revenue for the financial year is less than \$25 million;
 - the value of the company's consolidated gross assets at the end of the financial year is less than \$12.5 million;
 - the company has fewer than 50 employees at the end of the financial year.
23. There are approximately 2,188,000 Australian proprietary companies registered with the Australian Securities and Investments Commission (ASIC), making up 99 per cent of all registered Australian companies. The vast majority of proprietary companies meet the Corporations Act definition of small.⁴
24. The distinctions in the law between public and proprietary companies, and between large and small proprietary companies, recognise that companies and their shareholders have very different needs depending on the type and size of the company. Small proprietary companies are often single director/shareholder companies akin to a sole trader, while the limitation on proprietary companies' size and capital raising mean that they are closely held with shareholders generally having ready access to company management, such as in family businesses. Public companies, on the other hand, are unlimited in size and have fewer limitations on capital raising (and consequently a broader shareholder base).

2 Section 113.

3 Subsection 45A(2). Note that the definition of a small proprietary company in the Corporations Act is very different from (that is, significantly broader than) the definition of small business applying for tax purposes. For tax purposes, a small business (whether sole trader, partnership, company or trust) is one which has an annual turnover less than \$2 million.

4 There were approximately 2,188,000 registered proprietary companies as at March 2015. Data is not available on the proportion of proprietary companies which are large or small because companies are not required to notify ASIC of this status.

25. This principle that proprietary companies have a relatively small and closely held shareholder base underpins the regulatory framework for proprietary companies. The law relieves proprietary companies of a number of regulatory obligations which apply to public companies to ensure that shareholders have regular access to reliable information, that there is appropriate external oversight, and that shareholder interests are protected. Generally, the greater the economic significance, the more onerous the regulatory requirements, so small proprietary companies are subject to fewer reporting and disclosure obligations under the Corporations Act than large proprietary companies.
26. Further aspects of the regulatory framework for small proprietary companies are outlined in Sections 4.1 and 6.1 of this consultation paper.

4. INCREASING FLEXIBILITY IN CAPITAL RAISING ACTIVITY

27. This section considers ways in which the existing regulatory framework may be unnecessarily restricting the ability of small proprietary companies to raise capital.

28. Section 5 considers specific issues related to CSEF for proprietary companies.

4.1 REGULATORY RESTRICTIONS: WHAT ARE THE LIMITS ON HOW SMALL PROPRIETARY COMPANIES RAISE CAPITAL?

29. As outlined at paragraph 21, the Corporations Act puts some restrictions on proprietary companies:

- the limit of 50 non-employee shareholders — this limit is discussed in further detail in Section 4.2 of this consultation paper; and
- restrictions on offering shares to the public, except in limited circumstances.

30. A proprietary company must not engage in fundraising that would require a disclosure document such as a prospectus, an offer information statement, or a profile statement to be issued to investors under Chapter 6D of the Corporations Act (which deals with fundraising), other than offering its shares to existing shareholders of the company or employees of the company or of a subsidiary of the company.⁵

31. A disclosure document is not required in a small number of situations. These situations provide proprietary companies with capacity to raise capital from new investors. Section 4.3 of this consultation paper considers one such situation, namely the exception for small scale offerings.

4.2 THE SHAREHOLDER LIMIT

Current law

32. To be registered or remain registered as a proprietary company, a company must have no more than 50 non-employee shareholders.

33. If a company breaches this requirement (that is, if at any time it has more than 50 non-employee shareholders) then ASIC can direct the company to convert to a public company.⁶ Non-compliance with ASIC's direction is an offence.

34. Converting to a public company imposes significant additional governance, reporting and disclosure requirements such as the need to prepare audited financial statements.

⁵ Subsection 113(3).

⁶ Section 165.

35. The limit of 50 non-employee shareholders existed when Australia first adopted a national regime for corporate regulation in 1982. In the past, this limit has been seen as striking the appropriate balance between the notion of proprietary companies being ‘closely held’ (with commensurate reporting and disclosure obligations) while not restricting unnecessarily the potential for small companies to raise funds from an appropriate base to grow their business.
36. The limit has been reviewed a number of times but in each case no amendments were made. For example, it was reviewed as part of the Corporations Law Simplification Programme in 1994. Most recently, the Parliamentary Joint Committee on Corporations and Financial Services recommended in its June 2008 report *Better shareholders — Better company: Shareholder engagement and participation in Australia* that the limit for shareholders in a proprietary company should be increased to 100, believing this limit would not have any ‘deleterious regulatory consequences’. The report cited one submission which called for the limit to be raised to address the difficulty that some family companies face when new generations acquire an interest in the company. Becoming an unlisted public company triggers reporting obligations that, it argued, may be unsuited to family-run operations.
37. Raising the shareholder limit would enable proprietary companies to raise funds from a larger base. However, without additional changes to the law, the types of investors that a proprietary company can raise funds from would remain limited by the requirements to issue disclosure documents under Chapter 6D.
38. As outlined in paragraph 30, proprietary companies are prohibited from engaging in any activity that would require disclosure to investors under Chapter 6D, other than offers of shares to:
- existing shareholders; or
 - employees of the company or its subsidiary.
39. The Corporations Act outlines circumstances in which issues or offers of shares do not need disclosure to investors (that is, it outlines exceptions to the mandatory disclosure requirements). Accordingly, proprietary companies are able to raise funds from only certain people or entities by making those issues or offers. These exceptions provide proprietary companies with scope to raise funds from investors who are outside the company.
40. One such exception is the exception for small scale offerings, which is discussed in Section 4.3. Small scale offerings can only be made to people who are likely to know about the company offering the shares and who can make inquiries directly and personally of the company.
41. The other exceptions apply to offers of shares to specified people who are presumed not to need the degree of disclosure required by Chapter 6D because of their financial capacity, experience, or wholesale status; for example, sophisticated investors, professional investors, investors receiving the offer through a financial services licensee, investors who are associated with the company or investors who are existing shareholders in the company.⁷

7 Subsections 708(8), (10), (11), (12) and (13).

42. Raising the shareholder limit could benefit some small unlisted public companies which may be newly eligible to be registered as proprietary companies. Given that public companies can raise funds in circumstances where disclosure to investors is required under Chapter 6D, a question arises as to how the transition would be managed for companies which would become eligible to be registered as proprietary companies if the shareholder limit were raised but which have previously issued shares under a disclosure document.

Consultation questions — appropriateness of the shareholder limit	
1	Should the law be amended to increase the permitted number of non-employee shareholders in a proprietary company and what would be an appropriate limit? Or do companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base with limited access to information or ability to influence the affairs of the company to justify the greater governance requirements currently placed on them? No.
2	What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection? Yes.
3	Have there been changes to market practice or the broader operating environment such that shareholders and investors now have greater access to management or information about a company's performance? What are the ways by which management now remains accountable to shareholders or shareholders otherwise have access to information about a company? There is the internet and the ability to set up a 'shareholder' link on the company's web site, but the shareholders would be relying on the company's officers to disclose material changes (both good and bad). So it gets back to the old saying, "there's nothing more worthless than a minority shareholding in a proprietary company."
4	If the shareholder limit were increased, how should the law treat public companies which become eligible to be registered as proprietary companies but have issued shares under a disclosure document? The law should still hold the company's officers accountable to make good any statements or obligations made to investors under a previous disclosure document whilst a public company.

4.3 SMALL SCALE OFFERINGS

Current law

43. As noted above, one exception to the disclosure requirements is the exception for small scale offerings. This exception is of particular relevance to proprietary companies. It provides that personal offers do not require disclosure to investors if:
- none of the offers results in the number of people to whom securities have been issued exceeding 20 in any 12-month period (the 20/12 rule); and
 - none of the offers results in the amount raised by issuing securities exceeding \$2 million in any 12-month period.⁸

⁸ Subsections 708(1) to (7).

44. A 'personal offer' is defined in the law as one that may only be accepted by the person to whom it is made and is made to a person who is likely to be interested in the offer given previous contact or connection with the company.⁹
45. The exception to the disclosure requirements is justified in this case on the basis that when an offer is private or personal the person being offered shares is likely to know about the company offering the shares already and can make inquiries directly and personally of the company. The value of preparing a prospectus or other disclosure document in these cases is therefore unlikely to be high and may not offset the cost of preparing the document. Furthermore, the cost of requiring a disclosure document is likely to be disproportionately high in the case of small scale offerings.

Consultation questions — small scale offerings and other exceptions to the disclosure requirements	
5	Should the law be amended to increase the 20 investor limit and/or the \$2 million cap? What would be an appropriate limit? Should the \$2 million cap be linked to increase in line with the consumer price index (CPI)? In order for equity-based crowdfunding to work the limit needs to be increased to at least 40. The cap could remain at \$2 million or be increased, but with a cap of just 20, or \$100,000 average investment for retail investors, it just doesn't work in a CSEF ecosystem.
6	What are the benefits and risks of increasing the 20 investor limit and/or the \$2 million cap? Who would benefit or bear the risk? Could there be unintended consequences from altering these limits, for example in terms of the definition of a sophisticated investor? Really, after nearly 30 years doing CSEF, I can confidently advise that if the investor limit was to increase to 40 it lessens the risk because it gets the average investment amount down so less exposure per retail investor. Probably best to leave the \$2 million as is and if the issuing entity needs more funding, they then go to disclosure.
7	Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended? No. You have to consider investor protection and managing the risk of fraud.

Consultation question — increasing flexibility in capital raising	
8	Would increasing the shareholder limit to 40 for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements provide small proprietary companies with sufficient additional flexibility to raise capital? Definitely.

⁹ Subsection 708(2).

5. EXTENDING CROWD-SOURCED EQUITY FUNDING TO PROPRIETARY COMPANIES

46. As part of the Government's consultation on CSEF in late 2014 and early 2015, a number of stakeholders expressed a preference for allowing proprietary companies to access CSEF. This was on the basis that the need to convert from a proprietary to public company structure would be likely to continue to pose a barrier to start-ups and small businesses.
47. This section examines whether the CSEF framework should be extended to proprietary companies and considers a potential model, drawing on the Government's framework for public companies outlined in Table 1.

5.1 PROPRIETARY COMPANIES AND CSEF

48. As noted at paragraph 21, proprietary companies have limitations on the way they can raise funds, including:
- they must not have more than 50 non-employee shareholders; and
 - they must not, except in limited circumstances, offer shares to the general public or undertake other fundraising activities that would require the issue of a disclosure document to investors.
49. These limitations would make it difficult for proprietary companies to effectively use CSEF to raise funds from a large number of small shareholders.
50. A strong theme in the stakeholder feedback from the earlier CSEF consultation process was a preference for proprietary companies to be able to use CSEF. This was on the basis that many companies that might otherwise consider using CSEF would wish to retain their proprietary company status, including to benefit from the lower compliance costs and to maintain flexibility for future funding rounds, such as from angel or venture capital investors.
51. In considering whether proprietary companies should be able to access CSEF, consideration needs to be given to the current regulatory approach to proprietary companies.
52. As noted at paragraph 24, the limitation on proprietary companies' size means that they are closely held with shareholders generally having ready access to company management. In recognition of these features, proprietary companies are subject to lower reporting, governance and disclosure obligations than public companies.
53. However, raising funds via CSEF necessarily involves making equity offers available to a wide range of potential investors, with the consequence that an issuer company would be likely to have a large number of shareholders. Many of these shareholders may not have any other connection to the company, and consequently little access to ongoing information about its performance or ability to influence its affairs.
54. This outcome would be a substantial departure from the concept of proprietary companies being small and closely held.

55. Notwithstanding these concerns, the Government is open to considering allowing proprietary companies to access CSEF but wishes to gain the views of a wider range of stakeholders to understand the potential regulatory implications. Particular issues that would arise in any CSEF model for proprietary companies are outlined below.
56. If proprietary companies were to gain access to CSEF, specific implementation of some aspects of the model may depend on other matters considered in this consultation paper, in particular the possibility of increasing the shareholder limit for all proprietary companies. The Government will evaluate stakeholder feedback on the matters discussed in this consultation paper before making a final decision on whether to extend CSEF to proprietary companies.
57. The establishment of a CSEF regime for public companies may also, as a consequence, support more flexibility in capital raising for proprietary companies. For example, by making investments in CSEF offers by public companies, investors may be able to identify themselves as being interested in investing in start-ups or other small businesses. Identifying themselves in this way may mean that these investors could more easily meet the criteria in the small scale offerings exception of being a person who is likely to be interested in such offers (as outlined in paragraph 44). As a consequence, over time proprietary companies may gain access to a wider pool of potential investors even in the absence of a dedicated CSEF regime for proprietary companies.¹⁰

5.2 POTENTIAL MODEL FOR PROPRIETARY COMPANIES

58. In general, the framework for proprietary companies using CSEF could take the same approach as that outlined for public companies. This includes obligations for intermediaries and measures to protect investors. However, some specific adjustments to arrangements applying to issuer companies may need to be considered in light of the reduced reporting obligations and shareholder limitations that apply to proprietary companies.

Shareholder limit

59. As part of the consultation on the December 2014 CSEF discussion paper, a number of stakeholders noted that, if CSEF were to be extended to proprietary companies, the current shareholder limit of 50 non-employee shareholders would likely impose a barrier to proprietary companies being able to effectively use CSEF.

Where the shareholder limit is increased for proprietary companies

60. As outlined in Section 4.2 of this consultation paper, the Government is seeking feedback on the appropriateness of the shareholder limit for all proprietary companies. Increasing the limit would increase the base of investors from which a proprietary company could raise funds and may be sufficient to address this barrier to proprietary companies using CSEF.
61. The Government is also seeking feedback on the appropriateness of the caps on the small scale offerings exception (Section 4.3 of this consultation paper). Any changes to increase

10 ASIC Class Order 02/273: *Business Introduction and Matching Services* facilitates an intermediary introducing of potential investors to small scale issuers by providing relief from certain obligations under the Corporations Act. This class order is scheduled to sunset on 1 April 2017. Intermediary facilitation of any small scale offers following an introduction would need to comply with relevant regulatory requirements, which may include an Australian Financial Services Licence or Australian Market Licence.

either or both the shareholder limit or the small scale offerings exception may effectively facilitate fundraising by proprietary companies without the complexity of introducing a specific CSEF regime for these companies.

Where the shareholder limit for all proprietary companies is unchanged

62. If the Government chose not to change the shareholder limit for all proprietary companies, a question arises as to whether there would be significant benefits to enabling proprietary companies to access CSEF. With a cap of 50 non-employee shareholders any proprietary company using CSEF would be able to raise funds from a relatively small investor base. Such raisings may already be sufficiently accommodated under existing regulatory arrangements, including the exemptions from the need to provide a disclosure document to sophisticated investors and for small scale offerings. Any changes to the small scale offerings exception, as discussed in Section 4.3, may further enhance proprietary companies' ability to raise funds.
63. An alternative approach would be to implement changes to the shareholder limit specifically for proprietary companies using CSEF. While supporting more flexible fundraising for some proprietary companies, this approach is likely to add to the complexity of the corporate law framework.
64. Such a change could involve increasing the cap from 50 non-employee shareholders to a higher number, such as 100, for companies using CSEF. A higher cap would enable proprietary companies using CSEF to raise funds from a wider group of investors. However, shareholders in proprietary companies using CSEF would continue to have reduced protections compared to public companies; it would therefore be appropriate for these companies to continue to have some form of limit on the size of their investor base, rather than permitting an unlimited number of shareholders.
65. To avoid the complexity of creating an additional permanent type of company, and regulatory arbitrage, any increased shareholder limit could be available for a limited period and while the company remains small. An approach that would be consistent with the exemption arrangements for public companies using CSEF would be for the increased shareholder cap to be available for up to five years after a proprietary company's first CSEF raising for companies with annual turnover and gross assets of less than \$5 million.
66. Once the company exceeds the time or size limits, the company would need to convert to the public company form and consequently comply with additional governance and reporting obligations. Alternatively, the company could seek to comply with the general obligations for proprietary companies, including the cap of 50 non-employee shareholders. However, a proprietary company would be expected to face practical difficulties in reducing its membership to meet the lower non-employee shareholder limit.
67. The prospect of either mandatory conversion to a public company or a reduced shareholder limit within five years of its first CSEF campaign may therefore be a disincentive to proprietary companies using CSEF.
68. This disincentive may be exacerbated by reasonable transparency obligations that would go with proprietary companies using CSEF to ensure that new shareholders have access to a similar amount of information to shareholders in public companies using CSEF.
69. Consequently, a question arises as to whether the complexity of enabling proprietary companies using CSEF to access a temporary increase in the shareholder limit would outweigh the benefits.

Additional transparency obligations

70. As noted in Section 3 of this consultation paper, small proprietary companies have reduced governance and reporting obligations compared to public companies (see also Section 6.1 of this consultation paper.) This includes only needing to provide a financial report to members in response to a direction from ASIC or from shareholders with at least five per cent of the votes in the company, which must only be audited if the direction asks for it. Other reduced obligations include: not being required to hold AGMs; only requiring a minimum of one director; and not being subject to requirements for shareholder approval for related party transactions.
71. This level of reduced reporting may not be appropriate if a proprietary company were to access CSEF. For example, small CSEF shareholders may have difficulty exercising influence over a company they invest in, including coordinating to request financial reports.
72. To address concerns that small CSEF investors may lack ongoing access to information about the company and its performance, additional transparency obligations similar to those applying under the public company CSEF regime could be placed on proprietary companies using CSEF, including:
- a requirement for financial and directors' reports to be prepared and made available to shareholders online; and/or
 - a requirement to appoint an auditor and have financial statements audited once the company has reached certain thresholds, such as raising \$1 million from CSEF or from other offers that do not need disclosure under Chapter 6D of the Corporations Act.
73. These additional obligations could be implemented by requiring proprietary companies that have conducted a CSEF offer to comply with large proprietary company obligations, but with adjustments to provisions relating to hard copy reports and conduct of audit to match the exemption arrangements that will apply to new public companies using CSEF.
74. These additional transparency obligations would be ongoing. In a similar way to how relief for public companies using CSEF expires after five years, the obligations of a proprietary company that has used CSEF could be fully aligned with those for large proprietary companies after five years. This would require the company to:
- provide its annual report in hard copy form where a shareholder requests it; and
 - appoint an auditor and have its financial statements audited if the company has not already raised \$1 million from CSEF or under an exemption from the need to provide a disclosure document.
75. The CSEF framework for public companies will include reduced obligations for newly registered or incorporated public companies, for a limited period, to address some of the cost barriers of the public company structure for early stage businesses. If, as proposed, mirrored obligations in relation to financial reporting and audit were introduced for proprietary companies using CSEF, this would align key aspects of the two regimes.
76. If the compliance costs of the two types of companies within the CSEF framework are similar, a question arises as to whether establishing a bespoke proprietary companies CSEF regime would in practice improve fundraising opportunities over and above a public company CSEF regime.

Eligibility

77. Eligibility criteria for public companies using CSEF are limited to certain small public companies that have not previously conducted a regulated public offer under Chapter 6D of the Corporations Act. Public companies seeking to use CSEF would need to have annual turnover and gross assets of less than \$5 million.
78. The intent of these limitations is to minimise distortions in the existing company fundraising regime that may arise if larger companies were permitted to use CSEF, while targeting CSEF to small issuers that are less likely to be able to absorb the costs currently involved in raising funds from the public.
79. For consistency with the public company arrangements, eligibility for proprietary companies using CSEF could also be limited to companies with annual turnover and gross assets of less than \$5 million.

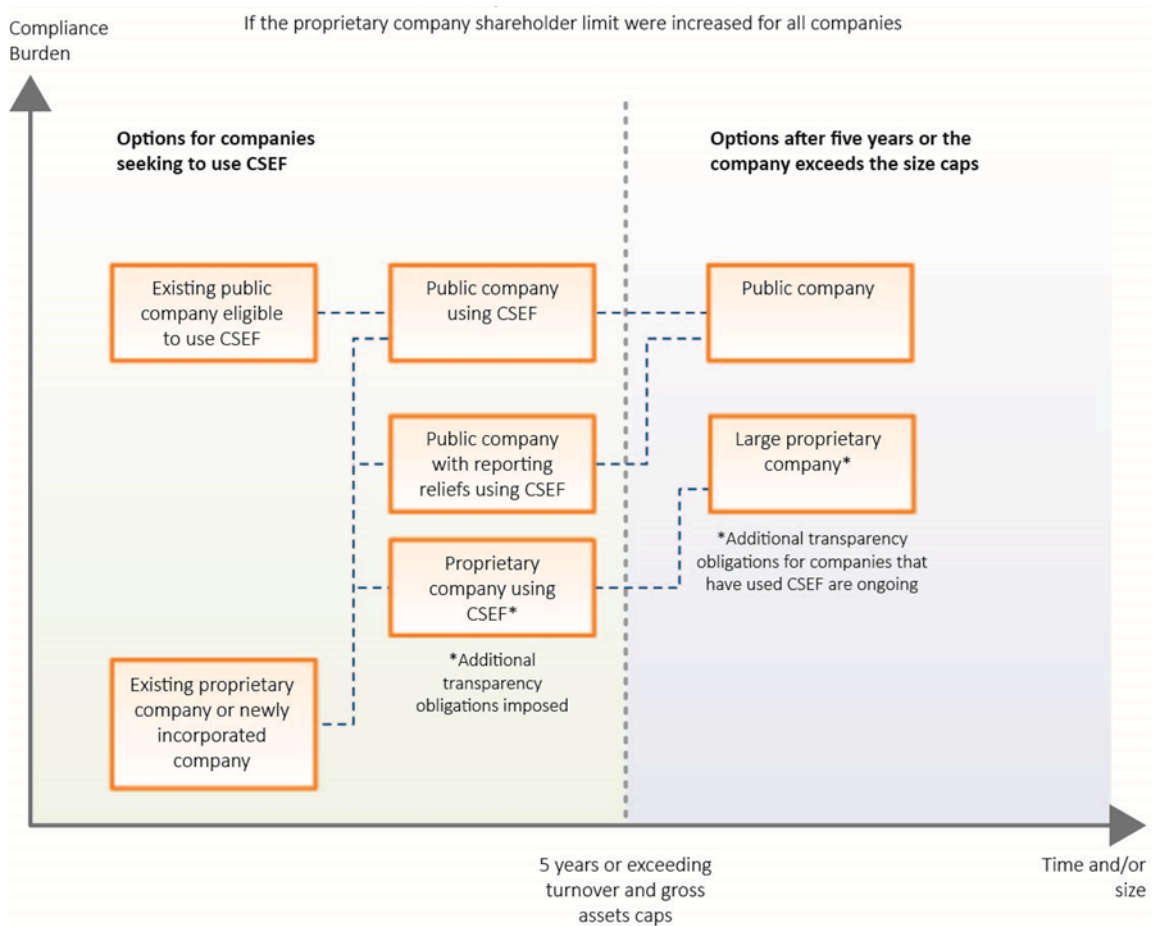
Fundraising

80. Proprietary companies are currently prohibited from making offers that would require the use of a disclosure document under Chapter 6D of the Corporations Act, other than in limited circumstances.
81. Public companies that undertake CSEF will be required to provide a tailored CSEF disclosure document. The types of information required to be disclosed will be outlined in the CSEF regulatory framework. If proprietary companies were to be able to access CSEF, it would be appropriate for these companies to be obliged to provide a disclosure document similar to that provided by public companies to ensure potential investors have access to adequate information about the company, investment opportunity and risks. Proprietary companies using CSEF would also be able to make offers to investors using a CSEF disclosure document without breaching the existing prohibition on proprietary companies making offers that would require the issue of a disclosure document.
82. Public companies making a CSEF offer will be limited to raising \$5 million over a 12-month period, inclusive of any raisings under the small scale offerings exception but exclusive of funds raised in other situations where a disclosure document is not required, such as from sophisticated investors. As for the eligibility limits, the intent of the fundraising cap is to ensure CSEF is targeted at small issuers and to minimise the risk of companies using CSEF to avoid the disclosure requirements of regulated public offers.
83. Similar to the arrangements for public companies, offers made under the CSEF disclosure document would be subject to an annual fundraising cap. To align with the arrangements for public companies using CSEF, this cap could also be set at \$5 million per 12-month period for proprietary companies. An alternative approach would be to impose a lower cap for proprietary companies, such as \$1 million, in recognition of their lower corporate governance and disclosure obligations. A lower fundraising cap would also be consistent with the amount of funds a proprietary company could feasibly raise from CSEF if they were subject to both a cap on the number of non-employee shareholders and to the investment cap for retail investors of \$10,000 per issuer per 12-month period.
84. For example, if the non-employee shareholder cap were raised to 100, the most a proprietary company could raise in a single CSEF campaign would be \$1 million. Raising funds from sophisticated investors would increase the amount a company could raise, but as noted

at paragraph 82, any funds raised from investors that do not need a disclosure document, including sophisticated investors, would not count towards the CSEF fundraising cap.

85. The diagram below provides an example of how a company could access CSEF if the shareholder limit was increased for all proprietary companies and the proposals to impose additional transparency obligations on companies using CSEF were implemented.

Diagram 1: How companies could access CSEF



Consultation questions — crowd-sourced equity funding

- 9 Should proprietary companies be able to access CSEF? What are the implications for the corporate law framework of permitting proprietary companies to do so?
Yes, they could be allowed to access CSEF but there must be some other requirements and conditions added for investor protection such as what ASSOBS has been using for proprietary companies wanting to raise less than \$500,000:
- From ASSOBS to potential CSEF seeker: The **Corporate Framework Policy is attached** for your completion and return to us once your Pty Ltd company has been registered.
- Condition 1
ASSOBS requires that at least one (1) Director has or has had either: previous experience in a management position of a substantial company and/or has been educated or proficient in corporate governance and/or can demonstrate having had prior experience as an officeholder of at least two (2) companies (listed or unlisted) that are still operating.
- A) Previous Experience in a management position of a substantial company.
- Evidence that a Director has been employed in a Management Position of a substantial company.
 - Evidence that the company is a substantial company.
- To be deemed a substantial company, the company must have a minimum of two (2) traits as listed below:
Public Company
Profitable Company
Five employees or more
Recipient of a Commercialisation Australia Grant
Has received investment from an Angel Investor
Has been in operation longer than 2 years
Has received an R & D grant
OR
- B) Course qualification:
- Evidence that a Director has taken a course at Chartered Secretaries Australia (CSA); or
 - Evidence that a Director has taken a course at Australian Institution of Company Directors (AICD); or
 - Evidence that a Director has taken an equivalent training session or completed a course in company secretarial and/ or corporate governance.
- OR
- C) Practical qualification:
- Evidence that a Director has been an Officeholder of at least two (2) companies (listed or unlisted) that are still operating.
To be deemed as still operating, the Company must still be submitting BAS returns. Please supply last BAS return submitted.
- Who is the Officeholder who satisfies either A, B or C?
Please provide evidence to satisfy this condition.

Consultation questions — crowd-sourced equity funding	
	<p>Condition 2 ASSOB requires that a Pty Ltd entity has a minimum of two (2) directors who are not immediate or related family members. Are the current directors independent from each other?</p> <p>Condition 3 Lastly, the Corporate Governance Framework Policy (as attached for you now) must be signed by this company.</p>
10	<p>If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF? No, because in the post GFC economy, the 20 investor limit is too restrictive so it would be a waste of time just to increase the shareholder limit but not the investor limit.</p> <p>If so, should the shareholder limit be changed specifically for proprietary companies using CSEF? What are the benefits and risks of this approach? Would the benefits outweigh the additional complexity of increasing the shareholder limit for a subset of proprietary companies? Refer to my answer to 9 above.</p> <p>If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap? Yes.</p>

Consultation questions — crowd-sourced equity funding	
11	<p>Should any increase in the shareholder limit solely for proprietary companies using CSEF be temporary, based on time and size limits? What are the benefits and risks of this approach? No. Should be same for both proprietary and public.</p> <p>If the increased shareholder limit is temporary, what arrangements should apply when a company is no longer eligible for the higher shareholder limit (owing either to the expiry of the time limit or exceeding the caps on company size)? Should it be required to convert to a public company? Or should it have the option to conform with the general proprietary company obligations, including the non-employee shareholder limit? At 100 shareholders, should be required to convert to public.</p>
12	<p>If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF? See my answer to 9 above.</p> <p>Do you agree with the proposals for annual reporting and audit? Should these be implemented by requiring proprietary companies that have used CSEF to comply with the obligations of large proprietary companies? Should any other obligations apply? No, not if they have used CSEF to raise less than \$500,000. Only if they are raising more than \$500,000 should they need to appoint an auditor.</p> <p>Given the Government has committed to introducing a CSEF framework for public companies that will include certain reporting exemptions, what are the benefits of permitting proprietary companies to use CSEF when they would be subject to additional transparency obligations? See my answer to 9 above.</p> <p>Do you agree that these obligations should be permanent? Yes.</p>
13	<p>Do you consider that an annual fundraising cap of \$5 million, and eligibility caps of \$5 million in annual turnover and gross assets, are appropriate for proprietary companies using CSEF? If not, what do you consider would be appropriate fundraising caps and eligibility criteria? \$2 million fundraising cap with no eligibility requirement.</p>
14	<p>Are there any other elements of the CSEF framework for public companies that should be amended if proprietary companies were permitted to use CSEF? No. Both should be able to raise either \$2 million or \$5 million but be able to get 40 retail investors in 12 months. So this means the 20/12 rule under Sec. 708 needs amending to 40/12. Let's keep it simple guys!!</p>

6. REDUCING COMPLIANCE COSTS FOR SMALL PROPRIETARY COMPANIES

86. This section outlines the regulatory requirements imposed by the Corporations Act on small proprietary companies and considers the following areas of the Corporations Act which may be imposing an unnecessary burden on small proprietary companies.

- the requirement to make an annual solvency resolution;
- the requirement to maintain a share register;
- ways to facilitate the execution of documents;
- completing and lodging forms with ASIC.

87. It seeks views on these and other ways to reduce the regulatory burden on small proprietary companies.

6.1 REGULATORY REQUIREMENTS: WHAT ARE THE REGULATORY BURDENS ON SMALL PROPRIETARY COMPANIES?

88. The key existing obligations on proprietary companies under the Corporations Act are outlined below.¹¹

- Company directors have statutory duties which apply to how they operate their company, such as a duty to act honestly, in good faith and in the best interests of the company, a duty to exercise care and diligence, a duty to avoid conflicts of interest, and so forth. They also have a duty to prevent insolvent trading by the company, breach of which can lead to a director being personally liable for the debts of the company.
- A company needs to maintain financial records which are capable of being used to prepare financial reports. Small proprietary companies are only required to prepare a financial report and a directors' report in very limited circumstances.
- A company is required to make an annual solvency resolution unless it has lodged a financial report with ASIC. This requirement is considered in Section 6.2 of this consultation paper. The solvency resolution is a resolution that the company can pay its debts as and when they fall due. The resolution is made either by all directors signing a written resolution or having a directors' meeting and minuting the resolution. The company must retain a record of the resolution, and the payment of the annual review fee is a representation to ASIC that a positive solvency declaration has been made.
- A proprietary company needs to maintain a register of members and a register of option holders if applicable. The requirement to maintain a register of members is discussed in Section 6.3 of this consultation paper.

11 Part 1.5 of the Corporations Act is a small business guide which summarises the main rules in the Corporations Act which apply to proprietary companies. ASIC also has various resources to assist companies in understanding their obligations under the Corporations Act. For example, see ASIC's guide *Compliance for small business — Small business — knowing your legal requirements — companies*, available at www.asic.gov.au/for-business/your-business/.

- A company needs to notify ASIC of certain changes or events within specified timeframes. This is usually performed by lodging a form which in some cases can be done online. For example, a company must notify ASIC, generally within 28 days, if details about the company change. This notification can be given online. Forms are considered in Section 6.5 of this consultation paper.
- A company needs to review the Extract of Particulars (a summary of the details of the company held on ASIC's register) provided annually by ASIC for accuracy and advise ASIC if changes are required.
- A company needs to pay an annual review fee to ASIC.¹²

89. Other requirements include: the requirement to have a registered office in Australia and to inform ASIC of the location of the registered office and the place where the company operates if different from the registered office; the requirement to disclose the personal details of directors and the company secretary if one is appointed; and the requirement to pay necessary fees when lodging documents.

90. As noted at paragraph 25, the law recognises that the governance, reporting and disclosure obligations on proprietary companies should be commensurate with their status as closely held small business enterprises and therefore less onerous than the obligations on public companies. For example:

- Public companies are required to have at least three directors, while proprietary companies are only required to have one.
- Only public companies are required to hold an AGM.¹³ If a proprietary company is asked to hold an AGM, it may pass resolutions without meeting if all the members entitled to vote on the resolution sign a document containing a statement that they are in favour of the resolution.¹⁴
- Proprietary companies are not subject to requirements for shareholder approval for related party transactions which apply to public companies.¹⁵
- Proprietary companies may choose whether or not to appoint a person as company secretary.¹⁶

91. The law also provides additional relief for small proprietary companies from certain obligations.

- Only large proprietary and public companies are required to prepare and lodge financial reports (including audited financial statements and a directors' report) with ASIC. Small proprietary companies are only required to provide a financial report to members in response to a direction from ASIC or from shareholders with at least five per cent of the votes in the company, and are only required to have it audited if the direction asks for it.¹⁷
- Small proprietary companies are not required to appoint an auditor.

12 Consideration of fees is outside the scope of this paper.

13 Section 250N.

14 Section 249A.

15 See Chapter 2E for the provisions on shareholder approval for related party transactions.

16 Section 204A.

17 Subsection 292(2) and sections 293 and 294.

92. Some of the requirements outlined above need to be kept as they are to maintain the confidence of investors in small proprietary companies, but some requirements may be able to be removed or relaxed.

6.2 MAKING AN ANNUAL SOLVENCY RESOLUTION

Current law

93. The Corporations Act requires the directors of a company to pass a solvency resolution within two months after each review date for the company, unless the company has lodged a financial report with ASIC within the previous 12 months.¹⁸ The purpose of the solvency resolution is to certify that, in the directors' opinion, the company is able to pay its debts as and when they become due and payable.
94. Companies that have lodged a financial report with ASIC recently are not required to pass a solvency resolution because the financial report includes a directors' declaration which among other things states whether there are reasonable grounds to believe the company will be able to pay its debts as and when they become due and payable.¹⁹
95. Small proprietary companies are generally only required to prepare and lodge a financial report and directors' report in limited circumstances including if directed to by ASIC or by shareholders with at least five per cent of the votes in the company. The requirement to pass a solvency resolution therefore applies to most small proprietary companies.
96. A positive solvency resolution means that the directors have reason to believe that the company will be able to pay its debts as and when they become due and payable. The company must keep a copy of the solvency resolution, but does not need to lodge it with ASIC or otherwise notify ASIC. Instead, the payment of the company's annual review fee and the non-lodgement of a form (Form 485 *Statement in relation to company solvency*) indicate to ASIC that the directors have resolved that the company is solvent.
97. A negative solvency resolution means that the directors have reason to believe that the company will not be able to pay its debts as and when they become due and payable. In that case, they must notify ASIC by lodging a Form 485 within seven days after the resolution is passed. There is no fee for lodging Form 485 within the required timeframes, however fees apply for late lodgement.
98. If the directors fail to pass a solvency resolution within two months after the company's review date, they must notify ASIC using Form 485 within two months and seven days after the review date.
99. Failure to pass a solvency resolution as required and failure to notify ASIC as required of a negative solvency resolution are criminal offences.
100. While these requirements focus directors' attention on the company's solvency at least once a year, alongside this requirement sits the directors' duty to prevent insolvent trading by the company.²⁰ This requirement applies at all times to all company directors. Directors are

18 Section 347A.

19 Paragraph 295(4)(c).

20 Section 588G.

generally personally liable for company debts that are incurred while the company is insolvent. Contravention may attract a civil penalty which may include a pecuniary penalty of up to \$200,000 or disqualification. In certain circumstances involving dishonesty, breach of the requirement carries a criminal penalty of up to 2,000 penalty units and/or five years' imprisonment.²¹

Consultation questions — the solvency resolution	
15	Should the requirement to make a solvency resolution be removed or modified? Is there a more effective way to remind directors of their obligations? For example, would aligning the timing of the resolution with tax or other obligations with fixed timing reduce the regulatory burden? No!! Investor protection is paramount, not hiding solvency issues.
16	What is the extent of the burden imposed on small proprietary companies to make the resolution, in terms of time and/or financial cost? Very small. For instance ASSOBS sends the issuer a pre-prepared solvency statement each quarter and if not returned they are removed from the ASSOBS platform.
17	What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations? Good.
18	Would removing the requirement to make a solvency resolution be likely to increase rates of insolvency or business failure among small proprietary companies? Would unsecured creditors be exposed to increased risk? Are there other risks associated with removing the requirement? Investor protection issues. Could the risks be mitigated adequately by ASIC reminding directors periodically (say, annually) of their duty to prevent insolvent trading by the company? Are there other ways to mitigate the risks? If both ASIC and the CSEF platform operator sends reminders would be good.

6.3 MAINTAINING A SHARE REGISTER

Current law

101. Companies are required to establish and maintain certain registers:
- a register of members (shareholders)²² (sometimes referred to as a 'share register');
 - a register of option holders, if the company grants options over unissued shares; and
 - a register of debenture holders, if the company issues debentures.²³
102. To register a company, the application must specify the shareholders and the number of shares each member has agreed to take up. Shares are taken to be issued on registration of the company.²⁴ Shareholders are therefore those persons specified in the registration

²¹ Schedule 3, item 138.

²² Section 168.

²³ As most small proprietary companies do not grant options and cannot issue debentures, only the requirement to maintain a register of members is considered in this paper.

²⁴ Section 120.

application and any persons who agree to become shareholders of the company after its registration and whose names are entered in the share register.

103. One purpose of the requirement to maintain registers is to ensure that certain information is held in a way that enables the public (for example, investors and creditors) to examine it to ascertain the status of the company and who is involved in it. Maintaining a share register may also be good business practice because it helps the company manage its own dealings with its shareholders, such as when it pays dividends. A share register evidences ownership and may assist with establishing rights of the shareholder in a dispute with the company.
104. The share register records the names and addresses of the company's shareholders and the date on which each shareholder's name was entered into the register. The register must also show the names and details of people who ceased being a shareholder of the company in the last seven years, and the date of that cessation.²⁵
105. The register contains details of the shares held by each shareholder. The details of individuals' shares include the date of each issue of shares to the shareholder and the number of shares in each issue, the number of shares held, the class of shares, and the amount paid and unpaid on the shares. As indicated above, the entry on the register evidences the existence of a person's membership status.
106. The registers are required to be kept at the registered office or principal place of business of the company, at the place where the work is done in maintaining the register or at a place approved by ASIC, but may be kept electronically.²⁶
107. Anyone has a right to inspect and/or obtain a copy of a company's register of members provided they do not use the information in a manner or for uses prohibited by the law. A shareholder may inspect the register without charge, however the company may charge a fee (up to a maximum amount prescribed in the *Corporations Regulations 2001* (Corporations Regulations)) to allow other people to inspect the register.²⁷ If a person requests a copy of the register stating the purpose for which access is requested and pays the required fee (up to a maximum amount prescribed in the Corporations Regulations) then the company must provide a copy of the register within seven days.²⁸
108. As outlined at paragraph 102, some of the information recorded in a proprietary company's share register is provided to ASIC in the application for registration as a company. Changes to the register must also be lodged with ASIC using particular forms. Proprietary companies must advise ASIC of changes to shareholder details (including resulting from share transfers) and the share structure (including the issue or cancellation of shares) as outlined in the table below. Failure to notify within certain time limits (generally either 14 or 28 days after the event depending on the nature of the event) is a criminal offence.²⁹

25 Section 169.

26 Section 172.

27 Subsections 173(1) and (2). Schedule 4 of the Corporations Regulations prescribes a maximum fee of \$5.00 to inspect a physical share register and a fee of 'a reasonable amount that does not exceed the marginal cost to the company of providing an inspection' to inspect a register kept on a computer.

28 Subsection 173(3). Schedule 4 of the Corporations Regulations prescribes a maximum fee of \$250.00 to obtain a copy of a share register for a company with up to 5,000 shareholders.

29 Sections 178A, 178B, 178C and 178D.

Table 2: Changes to be notified to ASIC

	Notice of change to shareholder details	Notice of change to share structure
Proprietary company with up to 20 shareholders	Yes — in respect of each shareholder.	Yes — if the change to shareholder details causes the information about the shareholder previously held by ASIC to change.
Proprietary company with more than 20 shareholders	Yes — only in relation to persons who are (or as a result of the change will become) one of the ‘top 20’ shareholders of a class of shareholders.	Yes — if the notifiable change to shareholder details causes the information about the shareholder previously held by ASIC to change.

109. The notification requirements under the Corporations Act have enabled ASIC to develop a comprehensive database of company information. This means that there is duplication in the retention of information: on the one hand by the company in its share register and forms lodged with ASIC; and on the other hand by ASIC in its registry. Indeed, as highlighted in Table 2, while all proprietary companies are required to notify ASIC of changes to the ‘top 20’ shareholders of a class, the effect of this for proprietary companies with up to 20 shareholders is that ASIC holds the same information about all of the company’s shareholders as that recorded in the company’s share register. Additionally, members of the public are able to obtain key information on companies from ASIC rather than visiting the registered office of the company (or other location where the register is kept).

Consultation questions — the share register	
19	What is the extent of the burden imposed on small proprietary companies to establish and maintain a share register, in terms of time and/or financial cost? This is one of the costs of raising equity capital. With new apps and software this will become less of a time/burden.
20	What is the value to small proprietary companies of maintaining a share register? Would companies need to maintain similar records even if the law did not require them to? Handy thing to have especially for secondary sales by shareholders.
21	Should the requirement to maintain a share register be removed for small proprietary companies with up to 20 shareholders, given that ASIC’s records duplicate the information in the share register of such companies? Yes, it could be as it’s not imperative for a small company with only up to 20 shareholders to have one. If the issuer uses a CSEF platform to raise their funds there should be plenty of documented records of investors/shareholders.

Consultation questions — the share register	
22	<p>If the requirement were removed for small proprietary companies with up to 20 shareholders:</p> <ul style="list-style-type: none"> • how could share ownership be transferred?³⁰ Could transfer take effect via a different mechanism, such as on notification to ASIC or on acknowledgment from the company? Some SME's may choose to issue securities as digital securities (encrypted stock), meaning the securities will be uncertificated securities, the ownership and transfer of which are recorded on a cryptographically-secured distributed ledger system using similar technology used for trading digital Bitcoins. These 'Colored Coins' provide a way for SME's to raise capital using the Bitcoin blockchain. • how would shareholders be able to ascertain the identity of the other shareholders of a company? Would it be reasonable to require shareholders to obtain the information from ASIC (including paying the required fee)? If the issuer or the CSEF platform did not keep records, then they would have to get the information from ASIC. <p>Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register? I think they should, as a sign of respect for their investors, keep a register of members.</p>
23	<p>Alternatively, should the requirement for small proprietary companies to maintain a share register be modified? If so, how? For example, should small proprietary companies with up to 20 shareholders continue to retain a share register but no longer be required to notify ASIC each time shareholder details change? Should be required to keep a share register. This is the trade-off price of being able to source CSEF.</p>
24	<p>Would removing/modifying the requirement to maintain a share register be likely to increase the risk of minority shareholder or property rights disputes for small proprietary companies? Are there other risks associated with removing the requirement? Yes and probably yes.</p>

6.4 FACILITATING THE EXECUTION OF DOCUMENTS

Current law

110. Proper execution of documents can be critical to their enforceability. Businesses need to know that documents are executed in accordance with the law to ensure they are effective. Uncertainty can lead to increased compliance costs as parties attempt to minimise their exposure to risk.

30 The Corporations Act (at sections 1072F and 1072G) provides replaceable rules (which act as a contract and may be modified or overruled by a company's constitution) regarding the registration of transfers of shares between persons. When shares are transferred, the transfer needs to be registered and the new owner's name entered into the register of members before the transfer takes effect. The director/s are not normally required to register the transfer of shares unless certain conditions are met. In addition, the director/s of a proprietary company may retain control over the membership of their company because they may refuse to register a transfer of shares in the company for any reason.

Execution by sole director companies with no company secretary

111. Without limiting the ways in which a company may execute a document (including a deed), the Corporations Act specifies certain acceptable methods of execution.³¹ It states that a company may execute a document without using a common seal if the document is signed by:

- two directors of the company; or
- a director and a company secretary of the company; or
- in the case of a proprietary company that has a sole director who is also the sole company secretary—that director; and

with a common seal if the seal is fixed to the document and the fixing of the seal is witnessed by:

- two directors of the company;
- a director and a company secretary of the company; or
- in the case of a proprietary company that has a sole director who is also the sole company secretary—that director.³²

112. Neither of these methods accommodates the execution of documents by a proprietary company which has a sole director and no company secretary. (As outlined at paragraph 90, a proprietary company must have at least one director and is not required to appoint a company secretary.)

113. A company may alternatively execute documents in accordance with the provisions in the company's constitution, which may specify a method of execution that differs from the requirements under the Corporations Act.

114. Although the legislated methods are not the only acceptable methods of execution, they are the methods most commonly preferred by signatories as they allow counterparties to assume that the document has been duly executed by the relevant officeholders (and that the document is therefore valid and binding), without needing to do further work to verify that this is the case.³³ Such further work might involve conducting a detailed search of a company's constitution, board minutes and delegations to ascertain that the signatories have the authority to sign.

115. Therefore sole director companies without secretaries can still execute documents, but because they cannot do so by means specified in the Corporations Act persons who rely on those documents are unable to assume that a document executed by a sole director of a company without a company secretary has been validly executed.

116. This inability inadvertently creates a compliance burden for both those proprietary companies which do not have a company secretary and their counterparties who must undertake additional steps to ensure a document has been validly executed (for example, by reviewing the company's constitution). Anecdotally, this appears to lead to:

31 Subsection 127(4) states that section 127 does not limit the ways in which a company may execute a document (including a deed). This means that, for example: a deed may be executed by an Australian company in accordance with the method prescribed in its constitution; or a person may act as the company's agent where the person has the authority to execute documents on behalf of the company.

32 Subsections 127(1) to (3).

33 Section 128 and subsections 129(5) and 129(6).

- counterparties being required to search a company's constitution to ensure the director has the authority to execute documents on behalf of the company; and
- counterparties requiring sole director companies to pass resolutions giving the director authority to execute the documents.

117. There are currently approximately 167,540 Australian companies which have a sole director and no company secretary.³⁴ Amending the law to facilitate the execution of documents by such companies may deliver significant compliance cost savings for this population.

'Split execution' of documents by companies

118. As outlined above, the Corporations Act specifies certain acceptable ways of executing a document. Where execution requires two officeholders to sign the document, the law is silent on whether the officeholders may sign separate (identical) copies of the document (split execution) or whether the signatures need to be on the same document. This creates uncertainty and leads to differing interpretations of the law.

119. Companies are often required to sign documents when the officeholders are in different locations. Uncertainty about split executions can therefore have a day-to-day impact on the conduct of business. An inability to rely on split execution may lead to unnecessary costs, delays or disruptions to business.

120. The law provides for separate identical copies of a document to be treated as one in relation to internal governance matters such as passing resolutions without holding a directors' meeting or general meeting, as the case may be.³⁵ Recognising split execution of documents may be consistent with these provisions.

Execution of deeds by foreign companies

121. The ways in which a company may execute a deed outlined at paragraph 111 apply only to Australian companies. As a result, the assumptions that can be made as to a deed's valid execution do not apply to a deed executed by a foreign company.

122. There is a degree of uncertainty amongst the business and legal communities about how a foreign company can execute a deed so as to be valid and enforceable as a deed under Australian law when transacting in Australia. In some overseas jurisdictions there is no concept of a common seal or even of a deed, nor a distinction between agreements and deeds. Accordingly, ascertaining that a deed has been duly executed can be difficult and time consuming where a counterparty from a foreign jurisdiction is involved.

123. This is becoming more of an issue as commerce becomes increasingly globalised. Small Australian businesses (as well as larger businesses) frequently enter into deeds with foreign companies. Unless sufficient additional steps are taken, businesses are exposed to a risk that those deeds are not enforceable as deeds because they are not executed in accordance with Australian requirements.

³⁴ ASIC data as at January 2015.

³⁵ Subsections 248A(2) and 249A(3) respectively. See also subsections 249D(3), 249N(3), 249P(4), 252B(4), 252L(3) and 252N(4) for other examples.

124. The United Kingdom (UK) recognised similar issues for its businesses. In the *Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009*, the UK deems that 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 UK law (rather than requiring the foreign company to execute in accordance with UK law).³⁶

Consultation questions — execution of documents	
25	Does the current law cause problems and/or increase compliance costs for sole director/no secretary companies and their counterparties in executing documents? What is the extent of the burden imposed on sole director/no secretary small proprietary companies in terms of time and/or financial cost? No – leave as is.
26	Is it appropriate to amend the law to specify that a company with a sole director and no company secretary may execute a document without using a common seal if the document is signed by the director or with a company seal if the fixing of the seal is witnessed by the director? Maybe? Are there any risks associated with this approach? Are there any alternative approaches? Not sure.
27	Is there an issue regarding split execution? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? What are the benefits and risks of specifying in the law that split execution is acceptable? I think leave execution of documents by officers as is.
28	Is there an issue regarding the execution of deeds by foreign companies? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? Not sure. Should the UK approach be adopted in the Corporations Act? Should a similar approach be taken to other bodies corporate? What are the benefits and risks? Not sure.

6.5 COMPLETING AND LODGING PRESCRIBED FORMS WITH THE REGULATOR

Current law

125. The Corporations Act requires companies to provide certain information to ASIC. Companies must submit forms to ASIC to register and deregister and they must notify ASIC when certain changes occur to the company. For example, a company must notify ASIC if it issues shares, if it changes the location of a register that it is required to keep, if it changes address, if its directors or company secretary change and if a director or secretary changes their name or address.

126. The requirement to lodge information with ASIC which may be unnecessary or redundant may be a source of regulatory burden for small proprietary companies. Indeed, the law should not require a company to lodge such information with ASIC.

³⁶ Sections 44 and 46 of the *Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009*.

127. ASIC undertook a review of its forms in late 2013 to identify those which could be removed, consolidated or streamlined based on whether they contained information or data that was not required, or not substantially used, by ASIC or the public. ASIC has been progressively removing and amending certain forms since its 2013 review. However the removal or amendment of some forms may require amendments to the Corporations Act, limiting ASIC's ability to effect these changes.
128. ASIC has also been working to require more forms to be lodged online. From 1 October 2014, ASIC Registered Agents have been required to lodge four key company forms online, including Form 484 *Change to company details*. This has benefits for small proprietary companies with updates not subject to postal delays and manual processing, and the added convenience for those who wish to lodge after standard business hours.

Consultation questions — ASIC forms	
29	Could any forms which are used by small proprietary companies and prescribed by the Corporations Act or Corporations Regulations be removed, amended or streamlined to reduce the compliance burden? How much time/money would it save you? Not sure.

6.6 OTHER WAYS TO REDUCE COMPLIANCE COSTS

129. Some areas of the Corporations Act which may be able to be amended to reduce the regulatory burden on small proprietary companies have been considered in the previous sections. This is not exhaustive, and the Government is interested in views regarding other ways to reduce compliance costs.

Consultation questions — other ways to reduce compliance costs	
30	Are there any other requirements under the Corporations Act which impose unnecessary compliance burdens on small proprietary companies? What is the extent of the burden in terms of time and/or financial cost? How could the burden be reduced? Not sure.

APPENDIX: SUMMARY OF CONSULTATION QUESTIONS

Consultation questions		Page reference
Appropriateness of the shareholder limit		
1	Should the law be amended to increase the permitted number of non-employee shareholders in a proprietary company and what would be an appropriate limit? Don't believe that would be of any particular benefit. Or do companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base with limited access to information or ability to influence the affairs of the company to justify the greater governance requirements currently placed on them? Yes, justified.	10
2	What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection? I think it could.	10
3	Have there been changes to market practice or the broader operating environment such that shareholders and investors now have greater access to management or information about a company's performance? What are the ways by which management now remains accountable to shareholders or shareholders otherwise have access to information about a company? The internet and company website.	10
4	If the shareholder limit were increased, how should the law treat public companies which become eligible to be registered as proprietary companies but have issued shares under a disclosure document? The law should still hold the company's officers accountable to make good any statements or obligations made to investors under a previous disclosure document whilst a public company.	10
Small scale offerings and other exceptions to the disclosure requirements		
5	Should the law be amended to increase the 20 investor limit and/or the \$2 million cap? Absolutely!! 40 would be good. What would be an appropriate limit? Should the \$2 million cap be linked to increase in line with the consumer price index (CPI)? It could be.	11
6	What are the benefits and risks of increasing the 20 investor limit and/or the \$2 million cap? Benefit would be less exposure per retail investor. Who would benefit or bear the risk? The investors. Could there be unintended consequences from altering these limits, for example in terms of the definition of a sophisticated investor? Can't see how.	11
7	Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended? No, just make them go to disclosure if they want to raise more than the \$ cap or the 40/12.	11

Consultation questions		Page reference
Increasing flexibility in capital raising		
8	Would increasing the shareholder limit for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements provide small proprietary companies with sufficient additional flexibility to raise capital? Definitely expanding the small scale offerings exception would.	11
Crowd-sourced equity funding		
9	Should proprietary companies be able to access CSEF? Of course. What are the implications for the corporate law framework of permitting proprietary companies to do so? Very little if you simply change the "20" to "40" in the 20/12 rule of Section 708 of the Corporations Act 2001.	17
10	If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF? Yes. If so, should the shareholder limit be changed specifically for proprietary companies using CSEF? No, not necessarily. What are the benefits and risks of this approach? Would the benefits outweigh the additional complexity of increasing the shareholder limit for a subset of proprietary companies? If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap? It could be, but this approach would be far more complicated than merely changing the 20/12 to 40/12.	17
11	Should any increase in the shareholder limit solely for proprietary companies using CSEF be temporary, based on time and size limits? What are the benefits and risks of this approach? Not sure. If the increased shareholder limit is temporary, what arrangements should apply when a company is no longer eligible for the higher shareholder limit (owing either to the expiry of the time limit or exceeding the caps on company size)? Should it be required to convert to a public company? Or should it have the option to conform with the general proprietary company obligations, including the non-employee shareholder limit? Getting unnecessarily complicated.	18
12	If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF? See my answer to 9 above. Do you agree with the proposals for annual reporting and audit? Should these be implemented by requiring proprietary companies that have used CSEF to comply with the obligations of large proprietary companies? Should any other obligations apply? No. Until they become a public company they should adopt a financial reporting regime something like this: Financial reporting: During the period in which the Company is raising capital and at all times	18

Consultation questions	Page reference
<p>following, the Directors and Company Secretary must ensure that the company produces an annual financial report and directors report and provide such reports to all shareholders within five (5) months of the end of the financial year.</p> <p>The financial report must be produced by a member of CPA Australia or the Institute of Chartered Accountants in Australia.</p> <p>So long as the company remains a small proprietary company and has not been requested to produce a financial report and directors report by ASIC or shareholders in accordance with the Corporations Act the financial report will be a general purpose report.</p> <p>Given the Government has committed to introducing a CSEF framework for public companies that will include certain reporting exemptions, what are the benefits of permitting proprietary companies to use CSEF when they would be subject to additional transparency obligations? Investor protection, disclosure and transparency.</p> <p>Do you agree that these obligations should be permanent? Until and unless they transition to public.</p>	

Consultation questions		Page reference
13	Do you consider that an annual fundraising cap of \$5 million, and eligibility caps of \$5 million in annual turnover and gross assets, are appropriate for proprietary companies using CSEF? If not, what do you consider would be appropriate fundraising caps and eligibility criteria? \$5 million good, but really \$2 million would do the job for small scale fundraising until they need to go to disclosure.	18
14	Are there any other elements of the CSEF framework for public companies that should be amended if proprietary companies were permitted to use CSEF? No – both class of incorporation should be able to use the 40/12 rule. Then after that go to disclosure.	18
Making an annual solvency resolution		
15	Should the requirement to make a solvency resolution be removed or modified? Is there a more effective way to remind directors of their obligations? For example, would aligning the timing of the resolution with tax or other obligations with fixed timing reduce the regulatory burden? No.	22
16	What is the extent of the burden imposed on small proprietary companies to make the resolution, in terms of time and/or financial cost? Small.	22
17	What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations? Good.	22
18	Would removing the requirement to make a solvency resolution be likely to increase rates of insolvency or business failure among small proprietary companies? Could do. Would unsecured creditors be exposed to increased risk? Probably. Are there other risks associated with removing the requirement? Probably. Could the risks be mitigated adequately by ASIC reminding directors periodically (say, annually) of their duty to prevent insolvent trading by the company? Probably. Are there other ways to mitigate the risks? If they are using a CSEF platform to raise the funds, then the platform operator should also require solvency statements for the issuer to remain listed on the platform.	22
Maintaining a share register		
19	What is the extent of the burden imposed on small proprietary companies to establish and maintain a share register, in terms of time and/or financial cost? Not too much and there are apps and software to simplify and lessen the time involved.	24
20	What is the value to small proprietary companies of maintaining a share register? It provides a level of comfort to potential investors to know that the company respects the investors and the investment given by making an effort to provide proper register of member records. Would companies need to maintain similar records even if the law did not require them to? I think they should.	24

Consultation questions		Page reference
21	Should the requirement to maintain a share register be removed for small proprietary companies with up to 20 shareholders, given that ASIC's records duplicate the information in the share register of such companies? It should be not mandatory.	24
22	If the requirement were removed for small proprietary companies with up to 20 shareholders: <ul style="list-style-type: none"> • how could share ownership be transferred? Could transfer take effect via a different mechanism, such as on notification to ASIC or on acknowledgment from the company? Could be electronically. • how would shareholders be able to ascertain the identity of the other shareholders of a company? Would it be reasonable to require shareholders to obtain the information from ASIC (including paying the required fee)? Yes. Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register? There could be so best keep updated registry.	25
23	Alternatively, should the requirement for small proprietary companies to maintain a share register be modified? If so, how? For example, should small proprietary companies with up to 20 shareholders continue to retain a share register but no longer be required to notify ASIC each time shareholder details change? No and no.	25
24	Would removing/modifying the requirement to maintain a share register be likely to increase the risk of minority shareholder or property rights disputes for small proprietary companies? Absolutely. Are there other risks associated with removing the requirement? Probably.	25
Facilitating the execution of documents		
25	Does the current law cause problems and/or increase compliance costs for sole director/no secretary companies and their counterparties in executing documents? What is the extent of the burden imposed on sole director/no secretary small proprietary companies in terms of time and/or financial cost? Leave as is.	28
26	Is it appropriate to amend the law to specify that a company with a sole director and no company secretary may execute a document without using a common seal if the document is signed by the director or with a company seal if the fixing of the seal is witnessed by the director? Are there any risks associated with this approach? Are there any alternative approaches? Not sure.	28
27	Is there an issue regarding split execution? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? Not sure. What are the benefits and risks of specifying in the law that split execution is acceptable? Not sure.	28

Consultation questions		Page reference
28	<p>Is there an issue regarding the execution of deeds by foreign companies? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? Not sure.</p> <p>Should the UK approach be adopted in the Corporations Act? Should a similar approach be taken to other bodies corporate? What are the benefits and risks? Not sure.</p>	28
Completing and lodging forms with the regulator		
29	<p>Could any forms which are used by small proprietary companies and prescribed by the Corporations Act or Corporations Regulations be removed, amended or streamlined to reduce the compliance burden? How much time/money would it save you? Not sure.</p>	29
Other ways to reduce compliance costs		
30	<p>Are there any other requirements under the Corporations Act which impose unnecessary compliance burdens on small proprietary companies? Not sure. What is the extent of the burden in terms of time and/or financial cost? How could the burden be reduced? Not sure.</p>	29