EQUITY CROWDFUNDING

RESPONSE TO THE TREASURY CONSULTATION PAPER

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Australian Association of Angel Investors
The Home & The Voice Of Early-stage Investors

ABN: 44 127 412 515 | www.aaai.net.au | info@aaai.net.au

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This paper builds on the previous submissions by the Australian Association of Angel Investors, Equity Crowdfunding Discussion Paper, December 2014 and Equity Crowdfunding Response to the Treasury Discussion Paper, February 2015. Recommendations in this paper have been changed and evolved through further consultation within the community and as a result of participating in the consultation process conducted by the Minister for Small Business and by Treasury.

This paper comprises three sections, a general statement of position addressing an high level view of CSEF and strategic issues; a section providing specific comments against the paragraphs of the Consultation Paper; and a section providing responses to the consultation questions in the Paper.

POSITION

Australia has been patient to migrate into the new age of Internet enabled crowdsourced equity funding. In enacting legislation to regulate this new transaction model it behoves us to implement a solution that facilitates the future rather than frustrating the opportunity.

The country needs a system that evades the perverse risk aversion that has become common practice and returns to our roots as an entrepreneurial community breaking new frontiers. In the 21st century regulation needs to avoid paternalism without completely abandoning prudent protection of interests. In the context of CSEF this means that the government should not be forcing artificial limits on investors any more than it limits investors' decisions on investing in property, listed shares, or any other asset. Similarly, limits placed on companies as issuers under CSEF need to be broadly consistent with the context and not fashioned through a narrow policy lens that fails to consider the consequences.

It is logical that the primary burden of regulatory compliance be focused on the service providers, the platforms. In this way there is no substantial change or increased cost imposed on the companies raising capital or the investors providing the capital. This approach will tend to initially create increased barriers to competition in the platform space which serves the self-interest of current platforms which are eager to encourage this policy. However, in the long run appropriate regulation will be no more of a barrier to entry than it has been for any other form of financial service or product regulated under ASIC and the Australian Financial Services Licensing regime.

Australia must reclaim its position as a global leader not languish as an 'also ran'. Equity crowdfunding is an important and vital step in the evolution of the Australian economy to drive more diverse and more, more successful commercial enterprises. CSEF is about connecting people within the business sector and minimising the structural and regulatory barriers without leaving the participants devoid of reasonable standards of conduct and recourse.

Comments

The following are specific comments against the paragraphs of the Consultation Paper.

Paragraph	Comment
20	Since CSEF is inherently a portfolio based approach for investors seeking to access risky investments and at the same time spread their risk, regulation must not make it impractical for investors to realise an adequate spread of investments. Existing experience of early-stage investors is that a concurrent portfolio of 6-10 investments is the minimum required to have a reasonable chance of seeing a positive return on the portfolio. Similarly, experience has taught that typically it takes less than two years for unsuccessful early-stage companies to fail and more than six years to realise an exit from those that are successful. Thus, to build an effective portfolio of ten concurrent investments investors must be able to realise that goal within four years for a credible expectation of a portfolio return within ten years.

Taking these concerns into consideration and embracing the popular view that CSEF is to provide ordinary Australians with access to this asset class (‘democratisation’) then the regulations should mandate minimum investment amounts that ensure CSEF is accessible to all. Issuers and intermediaries that elect to use CSEF should be bound to provide undifferentiated access to investors for amounts starting at $200.

For sophisticated investors, such as Angel investors operating in Angel groups, the normal guidance is that the high risk early-stage investments typical of this asset class should not exceed 10% of one’s total investment portfolio. It is consistent with the popular democratisation approach to CSEF to assume that many CSEF investors will have no investments other than their CSEF investments so we will model the CSEF investor on net annual income rather than investment portfolio.

A minimum investment of $200 per offer would allow an investor with an after-tax income of $40,000/yr to invest in ten CSEF opportunities and still contain the risk to within 5% of her annual net income. In practice, it is reasonable to assume that investors will not invest at that rate so it could take two to four years to realise a concurrent portfolio of ten investments. At that rate the average investment would rise to $800. However, raising the minimum would still unfairly disadvantage many prospective investors.

Of course, if all investors only participate at this low level then an issuer would require 5,000 investors to raise $1m. It is for this reason that pre-purchase or reward crowd funding, e.g. Kickstarter, uses tiered offerings. Within the extant investment community it is not unusual for issuers to provide incentives to encourage investors to commit higher quantum of money by offering bonus shares or options/warrants. The challenge of using these mechanisms in CSEF is that it drives up the complexity of the offer and thus increases concerns about disclosure and risk. Still, given that every consumer is familiar with basic discount pricing it would seem quite acceptable to permit simple bonus structures to be used to incentivise investors to make larger commitments.

Platform operators will not like the idea of the minimum investment because they will struggle to extract sufficient fees from the transaction. However, this is only an issue for that specific fee model which is very much the old investment banking approach. As newer intermediaries enter the platform space with share-economy and other models we can expect a more suitable structure and quantum of fees. The long-term success of CSEF for Australia is based on a

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volume strategy ('long tail') so the foundational legislation and regulation should not be unduly distorted by the short-term interests of the early incumbents that come from the traditional funds management and investment banking context.

A key tenet of early-stage investing (if not all company investing) is that the quantum of the commitment by the investor should be small enough within the scope of their net wealth to be a relatively easy decision, i.e. that the risk of losing the investment will not substantially affect the viability of their livelihood. One has to assume that this is, at least in part, the sort of thinking behind the paternalistic policy of caps. If the government is going to provide protection to its citizens it should also provide enablement – minimum investment to guarantee access.

Investors

The proposal in the Paper is silent on the definition of investors. The language is all framed with the underlying assumption that investors are private individuals but, many investors may wish to use SMSF, trustees of family trusts, private companies, or other vehicles for investment.

This further complicates the rationale for and the application of caps and other constraints. Wherever possible the recommendations in this paper seek to take into account the varied nature of the investors that might participate in CSEF.

Caps

It is simply inappropriate to be applying caps. Issuers and intermediaries should be free to specify any limit on total participation in an offer by any investor.

No Cap: Investors should be free to invest in equity crowdfunded offers according to their own judgement without any regulatory limit.

If caps must be applied then there should only be a cap based on total investment in CSEF opportunities per year not per offer. If this approach is followed then the investor could be required to report CSEF investments as part of the tax return which would then provide a direct measure for a reliable metric such as a cap based on 5% of net annual income after tax.

To close the loop on this approach ASIC and ATO can compare data from tax returns with data reported by intermediaries about investors' activity on their platforms. It has to be the intermediaries as relying on the company reports to ASIC will not disclose the relevant data since some platforms will aggregate their investors and thus the individual investors will not appear in the company reported data on shareholdings.

Policing compliance with caps as proposed in the Paper will become ever more complex and burdensome as investors learn to use obvious mechanisms to evade the caps, e.g. different investment vehicles, using friends or family as trusted substitutes, seduced into a variety of funds established for the purpose (these funds are already being marketed). If there must be caps it is essential there is a clear rationale, a clear metric and a simple compliance reporting and monitoring regime.

Safety Net: It might be advisable to levy a small tax on every investment transaction to achieve a user-pays funding of a counselling and social welfare service to support investors who overextend their financial commitment to equity crowdfunding. This could be supplemented by a small, marginal levy on the license fees paid by intermediaries. This is similar to the

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approach for gamblers and the charges made on the operators of gambling facilities.

AFSL

This simple statement is insufficient. The government should have provided in this paper clear guidance on the characteristics of the AFSL and the requirements for successfully applying and continuing to comply with the AFSL, e.g. the difference between a platform that operates as a fund versus one that is purely a transaction platform will require some significantly different elements of an AFSL.

It is clear that each platform will inherently and necessarily be providing financial advice to the issuers as guidance through the regulatory compliance as well as advice on the best formulation of the offer. The advice on promotion of the offer is about providing a financial product to the retail investors so while one might be tempted to class it as marketing advice and thus not covered under the AFSL, since it relates to the conduct with the retail investors it should be considered as being regulated under the AFSL as advice regarding a financial product.

Pooling: an intermediary that does not provide full, complete (less any previously notified fees) and transparent transfer of funds from investor to issuer should be categorised as a Managed Investment Scheme and regulated accordingly.

An intermediary that assumes a representative role in holding equity on behalf of the crowd investors should be treated as a Managed Investment Scheme.

An intermediary that actually receives and holds crowd funds then makes investment where the investment decisions are not made directly by the members of the crowd is clearly operating as a managed fund and should be regulated accordingly.

Relief & Eligibility

What is “newly” and why does it matter?

Surely the only concern is whether the company has previously raised capital under an arrangement that would be incompatible with CSEF and thus allowing that company to participate in CSEF would unfairly disadvantage the existing shareholders. Otherwise why does it matter if a public company converts to a proprietary company?

Eligibility for CSEF should be open to companies with up to $10m in annual revenue and up to $5m in gross tangible and cash assets. The asset test should exclude any intangible asset value attributed to assets such as intellectual property, brands, trademarks, goodwill, etc.

Audit exemption should apply without a separate cap, i.e. remove the $1m cap and allow the exemption to stand for the 5 year/$5m limits. At $1m an audit is likely to cost the company in excess of 2% of funds raised in combination of external and internal costs with even greater impact on lost productivity at a time when operational performance is the critical key to future success. At $5m the audit exercise will represent less than 0.5% of funds raised with far less negative impact on productivity.

Checks

A detailed list of checks could have been provided in this paper to help us all understand the efficacy, value and cost of those checks. One has to assume that they will include bankruptcy, criminal, debt and health checks on all principals and major shareholders of the issuer. In

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addition to those fairly procedural checks there should be a requirement for reference checks on all the founders, executives and directors of the issuer. Other validation should address financial assets, financial statements, intellectual property protection claims (registration of patents, trademarks, designs, etc.) and any material contractual relationships.

These checks stop far short of any thorough due diligence or forming the grounds for any sort of investment recommendation/endorsement but, they provide simple verification of factual information all of which can be ascertained relatively quickly and inexpensively.

$5m in 12 months

Given this constraint would a company that had just completed a $5m raise then inherently trigger the lapse of exemptions since it would have gross assets over $5m?

This cap is problematic when considering capital intensive companies such as product-based companies. The approach to CSEF should not be considered only within the context of the low cost, capital efficient sort of businesses that can be built in software. A company developing a medical device, a manufacturing technology, a clean technology, a communications technology, a space technology, or even a retail consumer product is likely to require more substantial funding even at a very early stage. Why is it that these companies are intentionally excluded from access to CSEF by design?

There is no obvious reason why the per year cap need be any different to the cumulative cap. Why does it matter if the company raises all its money in one round, or in five rounds (maximum possible assuming the five year exemption expiry)?

Even if the $5m per year cap remains (it shouldn't) the cumulative asset cap that preserves exemptions should be at least $10m and probably better at $20m. In practice, as described elsewhere in the Paper and in this Response the combination of caps on investors and numbers of shareholders mean that it will be impossible for a company to raise $5m through CSEF in one year as that would require a minimum of 500 investors each contributing the maximum of $10,000, or 200 investors each contributing the maximum of $25,000 across three separate CSEF offers by the same company within 12 months.

Unconditional Right to Withdraw

Why is this five days when the Class Order 02/273 has already supported the well-established ten day period?

If the decision is to stay with five days then it would be prudent to specify five business days.

Securities

The statement here is unclear as it nominates ordinary shares but, allows for those shares to be a new class and to have terms and conditions that vary from other classes of ordinary shares. Does this thus mean that those shares could in fact be preference shares?

The intent that all shares in a CSEF offer must be the same is entirely reasonable and appropriate. The description as 'ordinary shares' seems superfluous and unnecessary if the intention is to permit issuers to construct the CSEF offer to best suit the company and its existing shareholders.

Is it intended that the "CSEF offer" includes a private placement by wholesale investors made as part of the same round of capital raising, or will such transactions be excluded from the

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definition of the “CSEF offer”?

To be clear, it is understood that the private placement does not count towards the caps but, the question here is related to the terms of any such offer relative to a contemporaneous CSEF offer. For example, it is common practice among corporate advisers to raise a single funding round with a staggered offering at two or three different share prices and sometimes with other variation in terms. If this were to happen in parallel to the CSEF offer then it is quite possible that the private investors are being offered more advantageous terms than the CSEF investors.

Will an issuer be permitted to offer debt securities rather than equity securities through a CSEF offer?

If not, then are redeemable preference shares considered equity or debt?

Will an issuer be permitted to offer partly paid securities through a CSEF offer?

Disclosure

The “facts about the company” should include:

- Form of incorporation and details of incorporation including constitution and shareholders’ agreement if they exist but, in any case disclosure of any written or verbal commitments related to ownership interests (it might be useful to simply mandate an ASIC Corporate Score Card (Detailed Express Check) which would drive a modest revenue stream for ASIC but, also greatly increase the awareness and understanding of this valuable tool);
- Details of officers, shareholders, shareholdings and capital funds committed;
- Names, titles and description of roles of employees;
- Details of any ESS or ESOP schemes or provisions whether formally structured or informal;
- Last three years financial statements, or for as long as the company has been registered;
- Highlight any and all debts or financial liabilities;
- Highlight any and all legal disputes or legal liabilities;
- Details of remuneration for all officers, directors, senior staff and key staff;
- All material contractual relationships and nature and value of the relationship;
- Disclosure of all insurance coverage;
- Copy of a standard employee agreement;
- Details of any intellectual property protection registered or under application;
- Details of all previous capital raisings, including unsuccessful CSEF or other crowdfunding campaigns;

The “facts about the CSEF raising” should include:

- Start date, duration and end date;
- Funds to be raised including any minimum commitment required to the round and the position on oversubscriptions given that there is an absolute limit of $5m;
- Platform should provide a running total of commitments made through the platform;
- Full disclosure of all subscription terms including minimum subscription and maximum subscription;

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- Full disclosure of all terms of all fees related to the raising;
- Fully diluted equity position pre and post raising;
- Use of funds, detailed to the tens of thousands of dollars;
- Details of any parallel capital raising from exempt investors or via another platform and what impact, if any, that will have on the subscription limit from the CSEF offer;
- Full details of any changes to the company constitution or shareholders' agreement or other company agreements relating to ownership and compliance that will occur as part of the offer;
- Any conditions precedent for the offer;
- Any conditions consequent to the offer;

25 The principle remains sound but, the concept of what constitutes "relatively small and closely held" is in need of revision.

57 Class Order 02/273 has become a foundational mainstay for Angel groups, entrepreneur pitch events, university business plan competitions, accelerator demo days and many other fora created specifically to allow start-up companies to present their investment opportunities to a collection of investors. The AAAI strongly advocates that the provision of this Class Order be made a permanent feature of the regulatory context for the purposes of the above mentioned fora.

It is worth noting that the vast majority of Angel groups, entrepreneur organisations, business plan competitions and the like operate as not-for-profit organisations. Accelerators tend to be one of:

1. fund-based with a pecuniary interest in the companies that pass through the accelerator and thus appropriate for regulation under the relevant AFSL; or
2. raise capital on a per-cohort basis with a pecuniary interest in the companies that pass through the accelerator and thus appropriate for regulation under the relevant AFSL; or
3. source capital from a beneficiary, have no pecuniary interest in the companies that pass through the accelerator and operate as not-for-profit organisations thus being appropriate to include in the same category as Angel groups and other not-for-profit intermediaries that should enjoy a permanent exemption from the requirement for an AFSL.

In considering the sunset of this Class Order on April 1st 2017 the AAAI can see a valid and compelling case for the exemption it provides to be withdrawn from for-profit accelerators, other financial service providers and financial product issuers which will, by then, have had ample opportunity to adapt to the Australian Financial Services Licensing (AFSL) regime. This would be consistent with the principle of a level playing field and the proposed requirement under this Consultation Paper for CSEF intermediaries to have an AFSL and/or Market License issued by ASIC.

74 Imposing requirements for delivery of information in hardcopy form is an inherently reactionary approach when new legislation should take the opportunity to build for a better future. It seems reasonable to assume that any investor that participates in a CSEF fund raising can be expected to be able to receive information in electronic form.

101 It is worth noting that this paper is framed around the context of early-stage companies contemplating rapid growth. In that context and with the improvements being made in the ESS

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regime it seems naïve to ignore the use of options by start-up companies.

CONSULTATION QUESTIONS		Source 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? 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?	10
	50 is inadequate and overly constraining within the context facing the business community today. The continued migration of generational change that sees ever more multi-generational, family-owned businesses being opened to non-family investors, the rapid rise in entrepreneurial start-ups in the low cost digital sector where a large number of small investors can readily provide the required capital, the complexity, inefficiency and expense of using syndication vehicles like the ESVCLP driving sophisticated investors to return to the direct investment model – all of these are raising the number of investors entering companies without substantially changing the nature of the business to justify the high costs and complexity of public company compliance. Using modern computing systems, the same systems upon which all companies are expected to rely for their routine bookkeeping, accounting and communications; there is no challenge of scale when communicating with a larger number of shareholders, or receiving communication from a larger number of shareholders. The matter of influence cannot be so easily resolved by technology but, in reality it is very rare that more than a handful of individual shareholders hold sufficient equity to be considered shareholders with influence. To be sure, smart companies will work hard to extract the maximum value from the knowledge and networks of their shareholders as recommended by the AAAI in the Guidelines launched by the Minister last week. The permitted number of non-employee shareholders in a proprietary company should be increased to at least 200 but, the sensible approach would be to align the normal limit and the CSEF limit so that there is only one rule. On that basis and using the various caps and limits provided by the government for the proposed CSEF regime, the shareholder limit would rise to 500. That is probably too far for most considerations, although with the ASX specifying 400 as an entry requirement there is an argument for making the proprietary limit 400. Thus, any company reaching the limit is destined to be either a listed or unlisted public company but, at least then all public companies have a common baseline.	

	Consultation Questions	Source Page reference
2	What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection?	10
	In practical terms changing the limit will not make a material difference to the provisions for small shareholders in any company in Australia, large or small, private or public. Shareholder protection is very limited and functionally constrained to those with sufficient shareholdings to exercise their rights.	
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?	10
	The advent of increased uncontrolled informal communication on the Internet has changed the potential for sharing of information. A company must now be mindful of the very real risk that any information shared with a shareholder may become public information. Even of such exposure is a material breach of the shareholders' agreement or punishable under ASIC regulation there is little point once the cat is out of the bag as it is the release of the information that will do the damage. For this reason proprietary companies are struggling to balance the value of sharing information about their performance and operations with their shareholders against the risk to the business if that information finds its way into the public domain where competitors, creditors and everyone else can get access.	
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?	10
	There should be a precedent for this in the situation where a listed company is taken private by new owners such as is common in the private equity sector. Similarly, what is the rule today if a company that is public and unlisted reduces its shareholder base to fewer than 50 and decides to reregister as private? If the new proprietary company regulation is going to be inclusive and permit companies to transfer back from public to proprietary then those companies should simply be treated as all other proprietary companies. The issue of the previously issued shares should be accounted for by the requirement for a special resolution to approve the decision to change status. If that requirement is not in the constitution or shareholders' agreement of the company then perhaps it should be a default requirement under the regulation.	

CONSULTATION QUESTIONS		Source Page reference
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)?	**11**
	The reality of the 'personal offer' is that this behaviour is rarely relevant or borne out by the common practice. The assumptions behind the small scale offerings are obsolete and it would be simpler to remove this as an exemption and bring all small proprietary companies under a single regime. The law should be amended to be consistent across all capital raising mechanisms so, if the CSEF legislation will permit a certain number of investors and a certain quantum of capital then those limits should apply to all companies within that class. The capital raising cap could be indexed but, that would probably create a greater amount of uncertainty and unnecessary granularity. Rather the cap should be set with a view to the next ten years and scheduled for review in 8 years to prepare properly for any change in year 11.	
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?	**11**
	Benefits are increased access to finance for companies, increased access to diversified investments for investors, increased employment for the community and increased tax revenues for the government. Risks are increased exposure to the quantum of financial damage resulting from fraudulent behaviour, trading while insolvent, bad management and failure of businesses due to loss of key personnel. The current definition of Sophisticated Investor is fundamentally flawed and should be substantially reformed. The AAAI has made many submissions on this issue previously. However, if the current definition is to stand it is not clear why a change in the 20/2 limits would have an adverse impact on that definition.	
7	Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended?	**11**

CONSULTATION QUESTIONS		Source Page reference
	The concept and construct of disclosure documents has been fashioned in a top-down process starting with the most onerous structure of a full public company prospectus then seeking to reduce that burden under specified circumstances. This inherently assumes that the standards and characteristics of a full retail public offering are the right and relevant standards and characteristics for a small proprietary company. That is flawed thinking. It would be far better to address the specific characteristics of a small proprietary company and the investors it is likely to attract then describe the disclosure requirements for that situation. In this way the situation could be reframed from being an exemption from providing disclosure to that of a requirement to provide appropriate disclosure. Companies and investors would then benefit from a clear path to a capital raising using common standards designed to share the relevant information at an appropriate level of detail with necessary forward-looking projections. Better information shared in a more standardised way would speed the process and increase the number of companies engaging in compliant capital raising processes.	
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?	11
	Asked and answered above	
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?	17
	Yes. The legal implications are discussed elsewhere as possible but, the AAAI has not retained legislative legal counsel to review the entire Corporations Act, its Regulations and the multitude of detail implications. Broadly speaking proper adoption of CSEF for proprietary companies will result in simplified corporate law constructs with greater standardisation across all types of companies and improved efficiencies resulting from that harmonisation.	

#	CONSULTATION QUESTIONS	Source Page reference
10	If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF? 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? If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap?	17
	Yes. Even if there is no change to the shareholder limit many companies will be able to benefit from CSEF. The vision of great hordes of retail investors supporting companies through CSEF has not been borne out by the experiences in jurisdictions where CSEF has been legal for years. It has not been borne out by the experience of ASSOB in Australia. If one assumes the caps proposed in this Paper and the current shareholder limit continue to apply then a proprietary company using CSEF with an exemption from the 20/2 conditions could still raise $1.15m (3 campaigns within 12 months accessing 46 investors at the maximum of $25,000 per investor and assuming the company had fewer than five non-employee shareholders initially). No. The limit should not be changed only for CSEF, as the rationale for the limit is not based on the capital raising mechanism. The limit should be established without reference to the capital raising mechanism. 100 non-employee shareholders is too low for a cap that will enable effective use of CSEF. For further discussion see the response above to consultation question 1.	
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? 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?	18

CONSULTATION QUESTIONS		Source Page reference
	As described in response to consultation question 10 and other consultation questions, changes to the shareholder limit should not be dependent on the method of capital raising. Further, they should be standard for the class of company regardless of time or size. The second part of the question is perhaps the most eloquent argument against the proposal. Imagine a company has raised capital through CSEF using a special exemption on shareholder numbers and then reaches the limit of the applicability of that exemption. It is then faced with the choice of converting to a public company or finding some way to shed a number of its shareholders. Conversion to a public company is generally undesirable due to the increased compliance costs unless there is a clear and near term plan to list on an exchange. Shedding shareholders will be problematic to say the least and may encourage some very undesirable behaviour from the outset of the capital raising, such as an emphasis on raising capital as debt which can be very damaging to the company and essentially denies investors the benefits of equity participation. This is important because the latter (benefits of equity participation) is generally held out to be the primary motivation for CSEF in the first place.	
12	If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF? 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? 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? Do you agree that these obligations should be permanent?	**18**
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?	**18**

CONSULTATION QUESTIONS		Source Page reference
	As described above in comment on Paper paragraph 20 the fundraising cap should be higher to be inclusive of capital intensive businesses. This is consistent with a broader government strategy to encourage a more diversified economy with deeper roots in manufacturing and technology development rather than narrowing the economic base of the country to only be services businesses. As discussed in the comment above on Paper paragraph 20 there should be no annual fundraising cap, only a cumulative cap over a five year period and it should be in the order of $20m. Eligibility for CSEF should be open to companies with up to $10m in annual revenue and up to $5m in gross tangible and cash assets. The asset test should exclude any intangible asset value attributed to assets such as intellectual property, brands, trademarks, goodwill, etc.	
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?	18
	In this Response we have proposed substantial changes to the CSEF framework for public companies but, if those were implemented then it is likely that the same framework could be used effectively for proprietary companies.	
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?	22
	The current solvency resolution process is rational, valuable and light weight in terms of compliance. It should be retained. Aligning the timing of the resolution with the financial obligations of the fiscal year and tax return would seem to be a more rational approach. It is reasonable to assume that it is at tax time that the directors are best informed of the financial status of the company. However, this may blur the distinction between ATO compliance and ASIC compliance creating confusion and a failure to comply unless the government takes responsibility for closing the compliance loop between the ATO and ASIC internally, i.e. companies would indicate compliance as part of the tax return and the ATO would inform ASIC without any further action from the company.	
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?	22

CONSULTATION QUESTIONS		Source Page reference
	Insignificant if one assumes a well-run company, i.e. a company in which the directors are routinely aware of the financial status of the company requires no more than ten minutes to draft and approve the resolution. A company that is not well-run may face higher demands on its time and resources but, that demand will serve to alert the company to its failure in management and governance, as it seems would be the appropriate intent of the regulation.	
17	What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations?	**22**
	Given the very high liability risks faced by directors and particularly by non-executive directors, this simple, low-cost action of approving a resolution serves as a timely and useful reminder of their obligations. This is one argument for keeping the resolution out of cycle from the tax return to ensure it has an higher visibility than being subsumed into the noise of the tax return process.	
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? 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?	**22**
	While removing the requirement for the insolvency resolution is likely to in-and-of-itself increase the rates of insolvency and business failure it would provide poorly run companies with a further excuse for their failure to comply with the obligations to avoid trading while insolvent. Similarly, it would remove another piece of the foundation upon which unsecured creditors might rely to seek recompense from directors of a company that has failed. For a requirement that is so minimal in effort and trivial in execution there seems little reason to remove the requirement.	
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?	**24**
	Insignificant if one assumes a well-run company, i.e. a company in which the directors are routinely aware of the ownership status of the company requires no more than fifteen minutes to update a share register with a change and submit the requisite form to ASIC. A company that is not well-run may face higher demands on its time and resources but, that demand will serve to alert the company to its failure in management and governance, as it seems would be the appropriate intent of the regulation.	

<table>
<tr><th colspan="2">CONSULTATION QUESTIONS</th><th>Source Page reference</th></tr>
<tr><td rowspan="2">20</td><td>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?</td><td rowspan="2">24</td></tr>
<tr><td>Single shareholder companies should be exempt from maintaining a share register independent of the information held by ASIC.

Companies with more than one shareholder should always maintain a current share register for the benefit of the shareholders. This is required to provide the appropriate information to address votes by the members at a general meeting, exercise of any other shareholder rights and to ensure that shareholders have access to the share register information without the cost and burden of purchasing a report from ASIC (or service provider).</td></tr>
<tr><td rowspan="2">21</td><td>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?</td><td rowspan="2">24</td></tr>
<tr><td>No.</td></tr>
<tr><td rowspan="2">22</td><td>If the requirement were removed for small proprietary companies with up to 20 shareholders:
• 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?
• 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)?
Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register?</td><td rowspan="2">25</td></tr>
<tr><td>The lack of a register does not substantially change the process or mechanism for transfer of share ownership. The change need only be by recognition being shifted to properly executed transfer documents, or payment/consideration, or registration with ASIC. In practice, today, where a company fails to enter a change in share ownership into the internal register and/or fails to provide timely notification to ASIC the shares are still considered to have been transferred as of the date upon which all parties complete execution of the transfer documentation. This is appropriate as the internal matters of share ownership of a proprietary company should not be dependent on public records.</td></tr>
</table>

CONSULTATION QUESTIONS		Source Page reference
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?	25
	No modification seems to be required	
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? Are there other risks associated with removing the requirement?	25
	Removing or substantially weakening the requirement for a share register and for timely registration with ASIC of the details of any changes is very likely to increase uncertainty, encourage abuse and thus raise the incidence of shareholder or property rights disputes. This is particularly likely when there is property of significant value involved such as real assets and/or intellectual property with substantial commercial value.	
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?	28
	It definitely causes problems as many sole director companies are unaware of the impact this distinction has their operation. At the same time they are typically the companies with the least resources available to recognise and address their failures in compliance. This puts them at a distinct disadvantage in business transactions where counterparties may well be aware of and taking advantage of the circumstances to execute agreements that they, the counterparties, know are unenforceable. Execution of documents should be common sense and consistent with contract law generally. So, a company with a single director should be able to have that single director execute any document without any other requirement. A company with two or more directors should continue to require at least two directors to sign.	
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?	28

CONSULTATION QUESTIONS		Source Page reference
	Yes, the law should be amended so that the single director company can execute documents with only the signature of the single director. In the case where the company is a single director, single shareholder company this is sufficient. In the case where the company is a single director, multiple shareholder company it might be prudent to modify the replaceable rules and/or impose a requirement on the company constitution that all shareholders are bound to accept and authorise the sole director as signatory simply by becoming shareholders, i.e. this is the norm and does not need and further, specific resolution of members. The company seal is an archaic and obsolete form of identification. A modern equivalent could be realised by making an electronic certificate such as those issued by Verisign and similar vendors an acceptable form of executing a document. However, the use of a seal (dating as it does from a time when literacy was a rarity) seems superfluous and irrelevant to the context of a modern proprietary company. The best solution would be to repeal the use of a seal entirely. Similarly, witnessing signatures is a very weak validation as the standard form requires only a signature from the witness and anybody can be the witness. This makes verification of the witness who is supposed to be providing the verification of the signatory a difficult and often fruitless exercise. Again, introducing electronic standards which would inherently provide identification and traceability of the witness as well as verification of the time and place of the signatures would renew the value and efficacy of the witness process.	
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?	28
	Split execution would be a simple and sensible change. Since it is already acceptable when executing Board records many companies assume that it is already legal for other documents. It should be! Benefits are increased flexibility, reduced compliance costs, reduced incidence of companies inadvertently being in breach of the law and thus leaving the option for legal evasion of agreements on a technicality which in turn should reduce the incidence of frivolous legal actions being brought before our courts. The primary risk of split execution is the level of confidence that each signatory and any other parties can have in the legitimacy of execution when compared to requiring the signatories to be in the same room at the time of execution. This can only be reliably addressed using electronic measures, otherwise it will essentially remain a matter entirely reliant upon trust.	

CONSULTATION QUESTIONS		Source Page reference
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? 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?	28
	Small proprietary companies in Australia routinely engage in international commerce but, frequently lack the internal knowledge and access to external expert advice to ensure proper legal process is followed, or even to understand the risks of agreements signed with foreign entities. As such the burden is best characterised as unrecognised, unmeasured and uncapped liability. With proper rationalisation of the Australian standard for companies executing documents it should be entirely reasonable to impose those same standards on foreign companies entering into agreements with Australian counterparties. This would be even stronger if the authentication processes were electronic as discussed above (26 & 27). Given the likelihood of many of these foreign companies coming from the emerging economies of Asia there is an additional rationale for imposing our own standards. Not only will these provide greater security for Australian companies but, it will foster a common standard within our trading zone that will better facilitate the growth of the regional economy. On the other hand we could adopt the UK approach which requires no significant change in Australia. It seems more courteous to trading partners and lower friction to business but, it does nothing to enhance the security of those commercial agreements as it inherently requires Australian companies to seek legal action in foreign jurisdictions when attempting to address a dispute. This substantially raises the burden in terms of costs and time, largely making such redress an impractical option for most Australian small proprietary companies.	
Completing and lodging forms with the regulator		
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?	29

Consultation Questions		Source Page reference
	At this time the only recommendation we have on this question is that the ASIC online system be migrated to one that automatically prepopulates forms with existing data to reduce the data entry burden, ensure lower error rates in submitted information (rework) and increase the likelihood that companies recognise and correct any incorrect data. So a more holistic dashboard presentation of company data would be required rather than an online system that simply mimics the very fragmented and cumbersome approach of paper forms. This was appropriate as we migrated onto online systems but, it is now a glaring inefficiency that costs ASIC and threatens the reliability and timeliness of the data. This change may require changes to the way the legislation describes reporting obligations and almost certainly will require changes to the way regulation prescribes reporting.	
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?	**29**