Initiatives to Improve Fundraising in the Australian Capital Market

This article describes reforms to the fundraising provisions of the Corporations Law that are proposed as part of the Government's Corporate Law Economic Reform Program.

INTRODUCTION

This paper sets out proposals for reforms designed to significantly reduce the cost of fundraising by Australian companies.

Fundraising is regulated by the Corporations Law, which generally applies to offers of shares, options, debentures and interests in managed investment schemes. In particular, the current rules require the preparation of a disclosure document (or prospectus) and its distribution to potential investors.

The reforms focus on improving the environment for fundraising by lowering the transaction costs associated with preparing a disclosure document and raising capital. Facilitating investment in new and existing enterprises in a way that is cost-effective and underpins confidence in the integrity of our equity markets will improve the growth potential of the Australian economy.

THE GENERAL DISCLOSURE OBLIGATION

The reforms will retain the current mandatory general disclosure obligation. This places the onus on the person raising capital to provide the information reasonably required by investors and their advisers in deciding whether to apply for securities.

Disclosure of material information in an effective way places investors in a position to make more confident assessments about securities without undertaking their own costly enquiries. It is generally more practicable and cost-effective for the fundraiser, rather than numerous investors, to undertake enquiries and disclose details about its own business. A general disclosure requirement is preferred to a 'checklist' of specific disclosure requirements because of its flexibility and effectiveness in ensuring issuers take responsibility for prospectus content.

IMPROVING THE QUALITY OF DISCLOSURE

The reforms will address criticisms that the current disclosure rules result in disclosure documents which are too long and complicated, or obscure information of interest to investors.

The reforms will achieve this in two ways. First, fundraisers will be able to issue substantially shorter prospectuses for retail investors by omitting information which is primarily of interest to professional analysts and advisers.

Prospectus length and complexity is a particular concern for retail investors, who may not be experienced in reading and comprehending technical information. The reforms facilitate the presentation of information to retail investors in a manner best suited to their needs, while more technical information would be available to investors, professional analysts and advisers on request. There will not be a requirement to summarise the information, provided it is sufficiently identified in the prospectus and it is made clear that it is of a type primarily of interest to professional advisers and analysts.

Secondly, given the possible advantages to investors in receiving short and manageable profile statements, the reforms will give the Australian Securities and Investments Commission a discretion to allow certain industries to issue short profile statements to investors, rather than a prospectus. Profile statements will contain key information and will enable investors to make comparisons between similar products. The full prospectus will be available to investors on request.

FACILITATING VENTURE CAPITAL

Small to medium-sized fundraisers are less able to fund the cost of complying with the fundraising disclosure obligations, particularly in their start-up phase. The disproportionate cost of fundraising for small enterprises may increase the cost of capital raising beyond attractive levels. The value of small business to the economy warrants a reduction in current disclosure requirements to a level within the means of the fundraiser, subject to appropriate safeguards on investor protection.

In particular, sophisticated high-worth investors do not have the same need as others for regulatory protection. Capital raising from such persons should not be inhibited by disclosure rules designed to protect typical retail investors. Mandatory rules for disclosure should not extend to such persons, who can safeguard their own interests in a cost-effective manner (which may or may not involve requiring full disclosure by the fundraiser).

The reforms will facilitate fundraising by small and medium-sized enterprises in three significant ways:

- A disclosure document will not be required if a person makes an unlimited number of personal offers that result in securities being issued to 20 or fewer persons in a rolling one year period with no more than $2 million being raised. This will reduce the costs for small business when making small scale offerings and will free them from constraints in fundraising without exposing investors to unnecessary risks.
- A disclosure document will not be required for offers made to 'sophisticated' investors. Sophisticated investors will include:
  - persons who make an investment of at least $500 000;
  - persons who invest less than $500 000, provided the offer is made through a licensed dealer and the dealer is satisfied on reasonable grounds that the investor has previous experience in investing in securities which allows them to assess the investment; and
  - persons who invest less than $500 000, provided a qualified accountant certifies that the investor has a gross income over the previous two financial years of at least $250 000 or has net assets of at least $2.5 million.
- The reforms introduce the Offer Information Statement (OIS) as a new fundraising mechanism for small enterprises. An issuer will be able to raise several tranches of capital under an OIS, instead of using a prospectus, provided the total raised during its life does not exceed $5 million. Issuers seeking to raise larger amounts of capital are expected to bear the costs of prospectus preparation.

  Disclosure obligations under the OIS will be limited to the disclosure of specified information known to the corporation. It is anticipated that this will significantly reduce the cost of disclosure. However, an OIS will include prominent warnings that it has a lower disclosure requirement than a prospectus and that investors should obtain professional advice before accepting the offer. An OIS will also be required to include financial reports prepared in accordance with the Corporations Law.

REFORMING THE LIABILITY PROVISIONS

The fundraising liability provisions should ensure that due diligence enquiries occur where appropriate and that material information is disclosed. However, the current rules have been criticised on the basis that they increase due diligence and disclosure costs beyond affordable levels (and thereby deter fundraising).

Unlike other commercial transactions entered into by a corporation, in the case of a prospectus the directors, professional advisers and others are made liable to investors for misleading statements whether or not they have acted

fraudulently. This results in costly due diligence as those persons seek to avoid any mistakes. It may also encourage the inclusion of unnecessary details in a prospectus out of an abundance of caution to ensure that all disclosures are made and all potential liability avoided.

The fundraising liability rules will be reformed in three significant areas, with the aim of improving their operation and reducing unnecessary transaction costs associated with complying with the fundraising rules.

First, the fundraising rules will be reformed to ensure that the liability of each category of person is commensurate to their proper role in preparing the disclosure document. For example, where a corporation engages professional advisers (such as lawyers and accountants) to assist in preparing a disclosure document, it is currently unclear whether those advisers are liable for all parts of the document which they have assisted on. This may result in professional advisers adopting an overly cautious approach, contributing to the cost of preparing the document and the length of the document. The reforms will clarify that professional advisers are only liable for specific statements in the prospectus for which they accept responsibility.

Secondly, the reforms will remove the current set of confusing and complicated defences which are available to each category of person involved in preparing a disclosure document. Instead, a uniform due diligence defence will be available to all participants where they prove that they made such enquiries (if any) as were reasonable, took reasonable care and it was reasonable for them to have believed that the prospectus was not misleading. This will reduce compliance costs, in particular the legal costs of advising on due diligence responsibilities.

Finally, the reforms will remove the overlapping application of the strict liability provisions of the Australian Securities and Investments Commission Act, the State and Territory Fair Trading Acts and section 995 of the Corporations Law. One of the main effects of this change will be to provide a self-contained liability regime in the law for dealings in securities.

FACILITATING ELECTRONIC COMMERCE

The use of electronic technology has the potential to reduce fundraising costs as well as improve the pace with which up-to-date information is provided to investors. However, the current law contains a number of impediments to electronic commerce.

The reforms will facilitate electronic commerce by:

- removing the requirement for paper disclosure documents and the requirement that all directors sign the disclosure;

- reforming the restrictions on sharehawking, which generally prohibit sending a disclosure document to investors in different places by electronic means; and
- removing the current requirement that an application form be 'attached to' the disclosure document and instead allowing an application form to be 'included in, or accompanied by,' the disclosure document.

CONCLUSION

The proposed reforms to the fundraising provisions will reduce the transaction costs associated with capital raising in Australia and facilitate investment. As part of the Corporate Law Economic Reform Program, the reforms are consistent with the Program's broader aims of modernising the Corporations Law and giving it an economic focus by introducing world best practice in business regulation.