

Crowd sourced equity funding - riding the wave of change

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A recent Corporations and Markets Advisory Committee (**CAMAC**) report proposes a detailed regulatory blueprint to facilitate crowd sourced equity funding (CSEF) in Australia. CSEF is a world-wide phenomenon and has the potential to promote the start-up and small-scale enterprise sector in Australia.

The key recommendations of the report which was released on 5 June 2014 include:

- Implementing a separate regulatory structure to facilitate CSEF;
- Establishing a new category of “exempt public company”;
- Allowing issuers to raise up to \$2 million during any 12-month period; and
- Allowing investors to invest up to \$2,500 per company and \$10,000 in aggregate during any 12-month period.

In this article, [Michael Hansel](#) and [Richard Hanel](#) explore the current obstacles to CSEF and CAMAC’s proposed regulatory framework which attempts to balance the interests of investors as well as issuers.

Purpose of the review

Crowd sourced funding (crowdfunding) involves an entity raising money by way of small contributions from a large number of participants, typically sourced through an online crowdfunding platform and promoted via social media. Although crowdfunding has typically focused on social or artistic projects seeking donation funding or reward funding (funding in return for a finished product or membership scheme), crowdfunding may well emerge as a method for start-up and small-scale companies to raise capital through the issue of shares. CAMAC’s review focuses only on CSEF.

Current regulatory obstacles

The current regulatory obstacles to raising money this way include:

- A general prohibition on proprietary companies making public offers (outside of exemptions such as the small-scale exemption and professional/sophisticated investor exemption), as well as a cap of 50 non-employee shareholders;
- The disclosure and compliance requirements of public companies, including restrictions on advertising and the requirement to issue a prospectus, plus the listing requirements for those companies wanting to raise money from the public via the ASX; and
- The licensing requirements for operators of crowdfunding websites.

CAMAC’s recommendations

CAMAC recognises that CSEF has a role in Australia as a means of encouraging the entrepreneurial start-up sector. The competition from other countries that have already instigated or implemented appropriate regulations should be adopted in Australia to support the facilitation of CSEF.

The report considers in detail the regulations which should apply to achieve the appropriate balance between support for this form of fund raising and investor protection. CAMAC’s key recommendations

include:

1. **A new category of “exempt public company”** – Recognising that offers to the public should be made via a public company, a new category of “exempt public company” would be established which would be exempt from specified compliance requirements until reaching a certain size (\$5 million in capital suggested) or a specified time has elapsed (three years suggested). It would then convert to a “normal” public company. Some existing small proprietary companies may be eligible to convert to an “exempt public company” to gain access to the crowdfunding regulations and some non-exempt public companies would also have access, subject to separate disqualifying criteria.
2. **Start-up and small-scale enterprises only** – Supporting the objective of facilitating assistance to start-up and small-scale enterprises, a range of public companies would be excluded from participating, such as “cash box” arrangements, listed entities, entities that have already made a regulated public offer and companies with substantial capital (more than \$10 million suggested).
3. **A limit on capital raising** – Offers made via crowdfunding could not exceed a specified limit (\$2 million suggested) during any 12-month period.
4. **Limits on other fund raising** – An exempt public company would not be permitted to raise money under the prospectus/offer document provisions in the Corporations Act, but could raise additional funds via the exemptions.
5. **Specific offer disclosure requirements** – Specific and standardised disclosure requirements would apply. This disclosure would include information to enable a comparison or contrast of the rights attaching to crowdfunded shares and the rights attaching to other shares issued by the company. Issuers would also have an obligation to notify the intermediary of any material adverse change to the offer to enable updating of the information on its portal.
6. **Offer only made online through a single intermediary** – Offers could only be made through a single intermediary and only made online.
7. **Intermediaries to play a central role and be licensed** – Intermediaries would play a central role in the crowdfunding processing and require specific licensing via ASIC. Under the license, the intermediary would need to comply with specified requirements (e.g. the conduct of limited but standardised due diligence on issuers) and specified prohibited conduct (e.g. no investment advice and no soliciting the acceptance of offers). CAMAC envisages a range of standardised template documents to be available for use by intermediaries during the offer process.
8. **Investor-investor and investor-issuer communication facilitated via intermediary** – Reflecting the social media inter-action at the centre of crowdfunding, the intermediary would facilitate a means of communication between registered investors and with the issuer.
9. **Limits on investor contributions** – An investor would be limited during any 12-month period to a maximum investment per vehicle (\$2,500 suggested) and a maximum aggregate of investments (\$10,000 suggested). An intermediary may have a limited role to monitor these limits for contributions made under a single offer or otherwise through its portal, but otherwise reliance can be placed on self-certification.
10. **A risk warning and acknowledgement process** – Intermediaries would need to provide a clear and direct risk warning to participants before each investment via a standardised template. Intermediaries would then obtain a standardised acknowledgement of risk from each investor prior to an issue of shares.
11. **Availability of cooling-off and withdrawal rights for investors** – An investor would have a cooling-off period (proposed at five clear working days), which could not be waived. Following acceptance, the investor would also have opt-out rights within a specified time period once notified by the intermediary of any material adverse change to an offer.
12. **No restrictions on secondary sale** – Investors would be able to sell their shares immediately without restrictions. Intermediaries who propose to facilitate secondary trading will need to be

appropriately licensed.

13. **Restrictions on share sale by directors/promoters** – To reduce the potential for investors being subjected to a “pump and dump” exercise, directors and associated shareholders would be restricted from selling a significant portion of their holding (10% or more of its holdings suggested) for a specified period (12 months from any offer suggested).

A recurring theme is the use of standardised template documents throughout the process to reduce costs and complexity and to ensure that crowdfunding investors receive the same form of information for all offers.

Other jurisdictions

CAMAC reviewed initiatives implemented or proposed in the USA, Canada, United Kingdom and New Zealand. Whilst expressing a view that there is value in having a degree of regulatory consistency with other jurisdictions, CAMAC recognises that each country needs to forge its own path in the context of its existing approach to corporate regulation. CAMAC has noted that its recommendations are generally consistent with the proposals implemented or being pursued in the USA, Canada and New Zealand, but with some key differences.

Next steps

A timeframe has not been set for implementation. However, it is anticipated that the report will be considered as part of the Federal Government’s on-going development of the National Industry Investment and Competitiveness Agenda.

Until new regulations are implemented, companies wanting to take advantage of crowdfunding need to continue to operate within the existing corporate regulatory structure or utilise one of the other methods of crowdfunding available.

Hopgood Ganim Lawyers' [Corporate Advisory and Governance](#) team can provide detailed advice on crowdfunding options and regulatory issues.

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