

## Article Information

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## New Regulations for Crowd funding Start-Ups, Investors and Platforms

**On February 10 2016 the Corporations Amendment (Crowd-Sourced Funding) Bill 2015 passed the House of Representatives. Before the Senate votes upon this Bill, the Senate Economics Legislation Committee was due to report on the Bill on 22 February 2016, and will hold a public hearing today, 23 February 2016.**

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*Once that Bill is passed, the Corporations Amendment (Crowd-Sourced Funding) Regulation 2015 (Cth) will likely be registered. **Partner, David Cornwell and Law Clerk, James Lowrey** outline the requirements imposed by the proposed Regulations on crowd funding platforms, investors and companies.*

### Summary

The *Corporations Amendment (Crowd-Sourced Funding) Regulation 2015* (Cth) (**'Regulations'**) set out:

- the "securities" that are eligible for crowd funding
- the minimum content requirements for a Crown-Sourced Funding ('CSF') offer document (including the terms of the general CSF risk warning)
- the Retail Investor's risk acknowledgement, which must be completed before the Retail Investor's application for CSF securities can be accepted by the CSF Intermediary, and
- the details of a CSF Intermediary's "gatekeeper obligations", including what the "reasonable standard" for these are.

The earliest these Regulations may come into force is [this Parliamentary Sitting Week](#) of 22 February 2016. However, the Treasury has yet to report on their Consultation on the Regulations, and the Senate Economics Legislation Committee will only conclude their Inquiry into the Corporations Amendment (Crowd-Sourced Funding) Bill 2015 this week.

Please note, all references are to the proposed sections of the *Corporations Regulations 2001* (Cth) and the *Corporations Act 2001* (Cth) (**'Corporations Act'**).

### Securities that are eligible for crowd funding (reg 6D.3A.01)

Only fully-paid ordinary shares.

### Minimum content requirements for a CSF offer document (reg 6D.3A.02)

The Regulations provides strict guidelines on the contents of a CSF offer document. The document must contain the following four sections.

Section 1: Risk warnings (reg 6D.3A.03). This section must include the following statement:

"Equity crowd funding is risky. Issuers using this facility include new or rapidly growing ventures. Investment in these types of ventures is very speculative and carries high risks.

You may lose your entire investment, and you must be in a position to bear this risk without undue hardship.

Even if the company is successful, the value of your investment and any return on the investment could be reduced if the company issues more shares.

Your investment is unlikely to be liquid. This means you are unlikely to be able to sell your shares quickly or at all if you need the money or decide that this investment is not right for you.

Even though you have remedies for misleading statements in the offer document or misconduct by the company, you may have difficulty recovering your money.

There are rules for handling your money. However, if your money is handled inappropriately or the person operating the platform on which this offer is published becomes insolvent, you may have difficulty recovering your money.

Ask questions, read all information given carefully, and seek independent financial advice before committing yourself to any investment.”

Section 2: Information about the offering company (reg 6D.3A.04). This section must include:

- information to identify the offering company
- information about the directors, officers and managers of the offering company (including skills, experience and legal history), and
- the offering company’s business structure, financial records and legal history.

Disclosure of ‘legal history’ requires that if either the offering company, its directors, officers or managers have been convicted of a criminal offence under the Corporations Act, incurred a civil penalty under the Corporations Act, or been disqualified from managing a corporation under the Corporations Act; a description must be provided of the circumstances which led up to this occurrence. Note however, this only concerns issues regarding the Corporations Act.

Section 3: Information about the offer (reg 6D.3A.05). This section must include:

- a description of the securities and the associated rights on offer
- the minimum and maximum subscription
- the maximum expected duration of the offer
- a description of how the proceeds from the offer are intended to be used, and
- a description of any previous CSF offers undertaken by the company/key personnel/‘related parties’ (see reg 6D.3A.05(4)-(5)).

The amending Act introduces a new definition of ‘related party’ (see sections 9 and 738G(3)). This defines a related party as a ‘related body corporate of the company’, which includes holding companies, subsidiaries and any subsidiary’s holding companies (sister companies) (see section 50). A related party also includes ‘an entity controlled by a person who controls the company; or an associate of that person’. The Explanatory Memorandum explains this extended definition seeks to pick up ‘sister’ entities of the company that are not body corporates (see paragraph [2.46]).

Section 4: Information about investor rights (reg 6D.3A.06). This section must describe:

- the ‘cooling off period’ rights (s 738ZD)
- the waiver of financial accounts auditing (s 201(5)). This provides financial accounts of the offering company do not need to be audited for up to five years
- the waiver of Annual General Meeting obligations (s 250N(5)-(6)). This provides the offering company is not required to hold an Annual General Meeting for up to five years
- the waiver of reporting requirements (ss 314(1AF), (2A)). This provides the offering company is not required to meet certain Corporations Act requirements on publishing annual financial reports, directors’ reports and auditor’s reports for up to five years, and
- the responsibility upon the intermediary to provide a facility for communications between the offering companies and their investors (s 738ZA(5)).

### **Risk Acknowledgement (reg 6D.3A.10)**

The following risk statement must be set out in every agreement accepted by every Retail Investor making an application pursuant to any CSF offer (s 738ZA(3)(b)):

“I have read the CSF offer document. I understand this document is not a prospectus and contains less information than a prospectus.

I have read the risk warning and I understand that it contains some of the important information for making a decision about investing. However:

- I understand that equity crowd funding is risky and that I may lose my entire investment, and
- I confirm that I could bear that loss without suffering undue hardship, and
- I understand that I may never be able to sell my shares and the value of my investment may be diluted over time.

I am aware that I can use the communication facility to ask questions and that there is a 5 business day cooling off period in relation to this investment.”

### **Gatekeeper Obligations - Due Diligence Review Obligations of CSF Intermediaries (reg 6D.3A.11)**

A CSF intermediary, as a “gatekeeper”, must conduct a number of checks on each offering company (s 738Q(1)). These include checks on:

- identity: including name, ACN, registered office, and principal place of business (reg 6D.3A.11(2))
- eligibility to crowd fund: including whether the offering company (reg 6D.3A.11(3)(a); s 738H(1)):
  - is a public company limited by shares;
  - has its principal place of business in Australia
  - has a majority of directors who ordinarily reside in Australia
  - has less than \$5 million in gross assets, consolidated with related parties
  - has less than \$5 million in annual revenue, consolidated with related parties
  - is not a listed company and none of its related parties is a listed company, and
  - does not have a substantial purpose of investing in securities or interests in other entities or schemes, and none of its related parties have such a purpose.

In determining whether the offering company or a related party has a, substantial purpose of investing in securities or interests in other entities or schemes, the Explanatory Memorandum explains,

‘It would be inappropriate for an investment company, which will itself be investing in other unspecified entities, to undertake such activities in the lower disclosure environment provided by the CSF regime.’ (see paragraphs [2.29-2.30])

- the skills, experience and legal history of directors, officers and managers (regs 6D.3A.11(4)(a), 6D.3A.04(1)(d))
- legal history of the offering company (reg 6D.3A.11(4)(b)), and
- minimum content requirements of the CSF offer document (reg 6D.3A.11(4)(a); s 738K(1)).

The above checks must meet a ‘reasonable standard’ requirement. This requires that the checks are based on reliable and independent documentation (which can include electronic data) relevant to the check (reg 6D.3A.12; s 738Q(2)).

The information will not be regarded as ‘independent’ if it is sourced from an entity associated with the offering company, an intermediary or any related parties (reg 6D.3A.12(4)). Specifically, this means the information cannot be sourced from documentation ‘under the control of’:

- the offering company
- directors, officers, or managers of the offering company
- any person who ‘controls’ (undefined) the offering company, or
- any related party of the company.

In determining whether the documentation relied upon is ‘reliable’, the CSF intermediary must take into account (reg 6D.3A.12(5)):

- the accuracy of the documentation
- the degree to which the documentation is secure from unauthorised modification
- the method by which the documentation is kept up-to-date
- the degree of comprehensiveness of the documentation
- whether the documentation is maintained by:
  - the Commonwealth, a State or a Territory, or
  - an authority of the Commonwealth or of a State or a Territory;
- whether there is an obligation under an Australian law to maintain the documentation.

### **Documents not constituting financial product advice**

Finally, the amendments introduce exemptions to the provisions regulating ‘financial product advice’. The following

documents are exempt, so long as they do not contain 'personal advice' (reg 7.1.08(3A)):

- CSF offer documents
- information about a CSF offer posted on a CSF intermediary's platform, and
- advertisements or publication in relation to a CSF offer.

'Personal advice' is currently defined under Ch 7 of the Corporations Act (ss 761A, 766B(3)). Personal advice is:

...financial product advice that is given or directed to a person (including by electronic means) in circumstances where:

- the provider of the advice has considered one or more of the person's objectives, financial situation and needs...; or
- a reasonable person might expect the provider to have considered one or more of those matters.

*Further information about the Senate Economics Legislation Committee Report and Hearing is available at the Committee Inquiry website [here](#). Further information about the Treasury Consultation is available at the Treasury Consultation website [here](#).*