

EXPLANATORY STATEMENT

Issued by authority of the Treasurer

Corporations Act 2001

Corporations Amendment (Crowd-sourced Funding) Regulations 2017

Section 1364 of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The *Corporations Amendment (Crowd-sourced Funding) Regulations 2017* (the CSF Regulations) complement the *Corporations Amendment (Crowd-sourced Funding) Act 2017* (the CSF Act) which implements a regulatory framework to facilitate crowd-sourced funding (CSF) in Australia.

The CSF Regulations prescribe:

- the class of securities that may be offered under CSF;
- the minimum content requirements for the CSF offer document that must be prepared for each CSF offer;
- the content requirements of the general CSF risk warning and retail investor risk acknowledgement;
- the checks that a CSF intermediary must conduct in relation to each CSF offer and what constitutes a reasonable standard in relation to checks; and
- when conduct of a company or CSF intermediary relating to a CSF offer will not constitute providing financial product advice.

Public consultation on the CSF Regulations was conducted between 22 December 2015 and 29 January 2016. 18 Submissions were received from potential CSF intermediaries, venture capitalists and industry bodies as part of the consultation process and the Regulations were adapted in response to the feedback received.

The CSF Regulations commence at the later of the commencement of schedule 1 of the CSF Act (which commences on the earlier of 29 September 2017 or on Proclamation) or the day after the instrument is registered.

The regulatory costs associated with the CSF Regulations were included in the Regulation Impact Statement in the Explanatory Memorandum to the *Corporations Amendment (Crowd-sourced Funding) Bill 2016*.

The CSF Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment (Crowd-sourced Funding) Regulations 2017

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The CSF Regulations prescribe:

- the class of securities that may be offered under the CSF regime;
- the minimum content requirements for the CSF offer document that must be prepared for each CSF offer;
- the content requirements of the general CSF risk warning and retail investor risk acknowledgement;
- the checks that a CSF intermediary must conduct in relation to each CSF offer and what constitutes a reasonable standard in relation to checks; and
- when conduct of a company or CSF intermediary relating to a CSF offer will not constitute providing financial product advice.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

Section 1 – Name of the Regulations

This section provides that the title of the CSF Regulations is the *Corporations Amendment (Crowd-sourced Funding) Regulations 2017*.

Section 2 – Commencement

This section provides that the CSF Regulations commence at the later of the commencement of Schedule 1 of the CSF Act (which commences on the earlier of 29 September 2017 or on Proclamation) or the day after the instrument is registered.

Section 3 – Authority

This section provides that the CSF Regulation is made under the *Corporations Act 2001*.

Section 4 – Schedules

This section provides that each instrument that is specified in a Schedule to the CSF Regulations is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to the CSF Regulations has effect according to its terms.

Schedule 1 – Amendments

Item 1 of Schedule 1 of the CSF Regulations provides for a new ‘Part 6D.3A – Crowd-sourced funding’ to be created in the *Corporations Regulations 2001* (‘the regulations’) after existing Part 6D.2.

Regulation 6D.3A.01 – Types of eligible CSF offers

Sub-regulation 6D.3A.01(1) prescribes that only fully-paid ordinary shares are eligible for CSF. Restricting the CSF regime to fully-paid ordinary shares will ensure that investors have a very clear understanding of the securities they are acquiring and will help build confidence in the CSF regime as it develops.

Sub-regulation 6D.3A.01(2) prescribes that the CSF regime cannot be used in circumstances where a company making a CSF offer intends to use the funds raised to provide a loan (the issue of credit) to any of its related parties. This requirement has been included to ensure that the CSF regime is used only in cases where CSF investors have the ability to invest directly in a company and benefit from the development of the business and its assets.

Without this provision, it would be possible for a company to raise funds through CSF and loan the funds raised to a related party where all the assets and value of the business is held. If this were to occur the CSF investors would not benefit from any growth from the value of the business beyond the repayment of the loan and any interest.

Regulation 6D.3A.02 - Minimum content requirements for a CSF offer document

Sub-regulations 6D.3A.02(1) and 6D.3A.02(3) prescribe the minimum content requirements for a CSF offer document for the purposes of subsection 738J(2) of the Act and the order in which this information must be presented. Under these provisions, a CSF offer document must contain the following information:

- Section 1 - the prescribed risk warning (regulation 6D.3A.03);
- Section 2 - details of the offering company (regulation 6D.3A.04);
- Section 3 - details of the offer (regulation 6D.3A.05); and
- Section 4 - information on the applicable investor protections (regulation 6D.3A.06).

Under sub-regulation 6D.3A.02(2), the CSF offer documents can contain any other information the offering company wishes to include (in addition to the prescribed minimum requirements). Any additional information included will, however, also be subject to section 738U of the Act, resulting in the offer document being defective if any of the additional information included is misleading or deceptive.

Regulation 6D.3A.03 - section 1: the prescribed risk warning statement

This regulation prescribes the wording of a risk warning statement that must be included in all CSF offer documents. By prescribing a standard risk warning that will appear at the start of all CSF offer documents, all investors will be presented with the same clear description of the risks associated with CSF, enabling them to decide if investing in CSF offers is suitable for their circumstances.

Regulation 6D.3A.04 – section 2: details of the offering company

This regulation prescribes the details of the offering company and its key personnel that must be included in all CSF offer documents.

Information identifying the company

Paragraphs 6D.3A.04(1)(a) – (c) prescribe the details about a company that should be part of a CSF offer. Under these provisions, section 2 of a CSF offer document must set out the offering company's name, type, Australian Company Number, registered office address and the address of its principal place of business.

Information on key individuals

Section 2 of a CSF offer document must also contain information on the key individuals within the offering company. Under Paragraphs 6D.3A.04(1)(d) and 6D3A.04(3)(a) – (g) and (i), section 2 of the CSF offer document must include the following information about the existing and proposed directors and senior managers of an offering company:

- their names;
- a description of their respective skills and experience relevant to the management of the offering company; and
- where any of the individuals:

- were convicted of criminal offences or had civil penalties under the Act;
- were disqualified from managing a corporation under Part 2D.6 of the Act;
- were subject to a banning order under section 920A of the Act;
- had a court order imposed on them under paragraph 921A(2)(a) of the Act;
- had been the director, secretary or senior manager of a company when it became insolvent;
- had given an undertaking accepted by ASIC under subsection 93AA(1) of the Act; or
- were convicted of any offence (other than under the Act) or had a penalty imposed under any law (other than under the Act) within the preceding 10 years in their capacity of a director or senior manager of a company:

the details of and circumstances giving rise to each of the relevant offences, penalties, disqualifications, banning orders, court orders and insolvencies (as applicable).

Information on the company

Paragraphs 6D.3A.04(3)(a), (g) and (h) also prescribes that section 2 of the CSF offer document should provide the details of and circumstances giving rise to any:

- convictions against the offering company for criminal offences and civil penalties under the Act;
- undertaking given by the offering company that are accepted by ASIC under subsection 93AA(1) of the Act;
- convictions against the offering company for offences (other than under the Act) within the previous 10 years; and
- penalties imposed on the offering company (other than under the Act) within the previous 10 years.

Information on the company's business and financials

CSF offer documents must also include prescribed information about the offering company and its financials. Under sub-regulation 6D.3A.04(2) and paragraphs 6D.3A.04(1)(e) – (g), section 2 of a CSF offer document must include a description of:

- the offering company's financial statements;
- the offering company's business and organisational structure;
- details of the company's debt and equity capital structure, including of all classes of issued securities and associated rights; and
- details of the key risks of the offering company's business;

The financial statements used for CSF offer documents must be for the offering company's most recent financial year and must comply with the relevant accounting standards. However, as CSF is intended to be a source of finance for start-ups, it is anticipated that some companies accessing the regime may be registered in the financial year in which a CSF offer is made (possibly just a few months before making a CSF offer). In such cases, financial statements are only required to cover so much of the offering company's financial year that ends one month before the CSF offer is made. If required under the accounting standards, the company's financial statements used in the offer document will have to be consolidated.

The description of the company's business should give investors information so that they can judge the company's prospects and make an informed choice before deciding to invest. Including the company's organisation structure will give investors an overview of the division of responsibilities and accountabilities within the company giving them an indication of the company's prospects of executing its business plans.

The requirement to provide details of the company's capital structure applies in relation to its debt and equity. The offer document will need to indicate the number of shares on issue and outline the amounts that are fully paid and amounts that are still to be paid. Where a CSF offering company has different classes of securities it will need to indicate this and provide details on the different rights that apply to each of the classes of securities. As the disclosure obligation applies in relation to the rights associated with each class of securities in the company, the CSF offer document must also provide details on any:

- options that have been granted or expected to be granted;
- shareholders agreements that provide for any rights or obligations to some or all of the company's shareholders;
- terms in the company's constitution relating to rights, restrictions or obligations on any of the shareholders; and
- tag-along or drag along rights that may apply.

The disclosure requirements apply similarly in relation to the offering company's liabilities. As such, the CSF offer document will have to provide details on all of the company's debts including the key obligations relating to each debt. For example, if an offering company has an outstanding loan, the CSF offer document will have to include details on the amount of the loan, its tenure, the amount still outstanding, the relevant interest rate, details of any security provided as part of the loan and any other key information that may be relevant.

Lastly, section 2 of the CSF offer document must provide details on the key risks to an offering company's business. The objective of this requirement is for CSF offer documents to provide investors with information on the risks to a particular business that could cause the venture to fail. It is not intended to cover general risks to all businesses or risks arising from general economic conditions.

For example, if a company making a CSF offer is in the process of applying for a patent over its invention and the company's business plans depend on obtaining the patent, the CSF offer document must identify the risk of the patent not being approved as one of the company's key risks. Similarly, if a company needs a safety certification before its products can be sold, its CSF offer document must include the risk that certification is not granted as one of the key risks to the company's business.

A CSF offer document will not generally have to list an economic downturn as one of its key risks as this is a general risk that applies to all businesses. A CSF offer document would also not have to generally outline a change to interest rates as part of its key risks. However, where such changes directly impact the business then disclosure will be required.

Regulation 6D.3A.05 - section 3: information about the CSF offer

This regulation prescribes that section 3 of a CSF offer document must include details about the CSF offer, what the proceeds of a CSF offer will be used for and information on previous CSF offers by a company and its key individuals.

Sub-regulation 6D.3A.05(1) provides that a CSF offer document must:

- describe the securities that are being offered for issue, and the rights associated with the securities;
- specify the maximum expected duration of the offer, although the offer may be open for less than the time specified (if, for example, the maximum subscription amount is reached); and
- specify the minimum and maximum amount of funds sought under the offer, and describe how the funds raised are intended to be used.

The description of how the funds raised will be used must include a description of how funds in excess of the minimum subscription amount will be used by the offering company.

Sub-regulations 6D.3A.05(2) and (3) provide that section 3 of a CSF offer document must also explicitly indicate if any of the funds being raised as part of the CSF offer will be paid (whether directly or via an interposed entity) to:

- a current or proposed director or senior manager of the offering company;
- the CSF intermediary that will publish the offer or any of its related parties;
- anyone promoting or marketing the offer;
- anyone who holds securities giving them more than 20 per cent of voting rights in the offering company; and
- any related parties (as defined in sub-section 738G(3) Act) of the offering company.

Sub-regulations 6D.3A.05(4) and (5) require section 3 of a CSF offer document to include information on previous CSF offers (including on the outcome) undertaken by:

- the offering company;
- the offering company's current and proposed directors and senior managers;
- a person who controls the offering company; and
- the related parties of the offering company.

Regulation 6D.3A.06 - section 4: Information about investor rights

Section 4 of CSF offer documents must provide details on protections and rights applying to CSF investors. This includes advising retail investors of their right to the 5 business day cooling off period that applies to investments in CSF offers under section 738ZD of the Act. To comply with the disclosure requirements, the CSF offer document will also need to indicate how retail investors can make use of the cooling-off period.

This section of the CSF offer document must also outline the effect of any of the corporate governance concessions that may apply to a company. For example, if a new public company is making a CSF offer, section 4 of the CSF offer document will have to indicate that the company will be exempt from needing audited financial statements for up to five years (unless they raise more than \$1 million from CSF offers) and that for a period of up to five years, the company will not have to hold an annual general meeting.

Lastly, section 4 of the CSF offer document must also provide investors with information about the communication facility the CSF intermediary is required to operate under section 738ZA of the Act.

Regulation 6D.3A.07 - Risk acknowledgment

Regulation 6D.3A.07 prescribes the wording of the risk acknowledgement that a retail investor must complete before their application for CSF securities can be accepted by the CSF intermediary as per paragraph 738ZA(3)(b) of the Act.

Regulation 6D.3A.08- Prescribed checks relating to gate-keeper obligations

Under section 738Q of the Act, a CSF intermediary is required to conduct certain prescribed checks to a reasonable standard. This requirement is part of a CSF intermediary's gatekeeper obligations (which detail when a CSF intermediary cannot publish or continue to publish a CSF offer document, replacement or supplementary CSF offer document).

Regulation 6D.3A.08 prescribes that a CSF intermediary must check the identity of an offering company, its eligibility to crowd fund and the details of the offering company's directors and senior managers before publishing a CSF offer.

The offering company's identity

Sub-regulation 6D.3A.08(2) requires a CSF intermediary to check an offering company's Australian Company Number, its company type, its registered office and address of its principal place of business. A CSF intermediary will be able to easily verify these details to a reasonable standard by checking it against the Australian Securities and Investments Commissions' (ASIC) registers where all of the required information is readily available.

If there is a discrepancy between the information in the CSF offer document and on ASIC's registers then the CSF intermediary knows there is a problem with the information and should not publish the CSF offer document. Where the discrepancy in information arises because the offering company has used more recent information in the offer document but has not given ASIC the updated information, the offering company will have to provide ASIC with the updates and the CSF intermediary should conduct the checks again to fully verify the required information.

The offering company's eligibility to crowd fund

Sub-regulation 6D.3A.08 (3) requires a CSF intermediary to ensure that an offering company satisfies the eligibility requirements under the Act before publishing the CSF offer document on its platform. To meet this obligation, a CSF intermediary must check to a reasonable standard that a company making a CSF offer:

- is a public company limited by shares;
- has its principal place of business in Australia;
- has a majority of directors who are ordinarily resident in Australia;
- has less than \$25 million in gross assets, consolidated with its related parties;
- has less than \$25 million in annual revenue, consolidated with its related parties;
- is not a listed corporation and none of its related parties are listed corporations; 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.

Making a CSF intermediary check to a reasonable standard the eligibility of companies before publishing an offer document will help ensure the limited disclosure CSF regime is only used by intended companies. The level of checking required to meet the reasonable standard requirement will vary depending on the circumstances for each offering company.

Where a CSF intermediary is able to confirm the eligibility requirements against information in the ASIC register then this will in most cases mean that they have undertaken the required check to a reasonable standard. For example, a CSF intermediary will be able to check the ASIC registers to confirm whether the company is an Australian company rather than a foreign company, satisfying the need to check that the company's principal place of business is in Australia.

In some circumstances, a CSF intermediary may not be able to independently verify the eligibility requirements. For example, it would not be possible for the CSF intermediary to independently verify that none of the company's related parties is a listed entity as there may not be information available listing all of the company's related parties. In such cases, the CSF intermediary would be able to satisfy the check to a reasonable standard by explaining to offering companies (in writing) the types of entities that would be a related party to the company and obtaining the required information from the offering company in accordance with a reasonable process developed, documented and implemented by the CSF intermediary (as per regulations 6D.3A.09).

Checking the CSF offer document is clear and concise and effective

Paragraph 6D.3A.08(3)(b) requires that the CSF intermediary also check that a CSF offer document is clear and concise before publishing it on its platform. The purpose of this requirement is to ensure that CSF intermediaries have a process in place for ensuring that CSF offer documents consist of full sentences, are not overly complex and do not obscure the meaning of any of the prescribed content.

Check offer document satisfies content requirements

Paragraph 6D.3A.08(3)(b) also provides that a CSF intermediary must check CSF offer documents to ensure they contain the minimum content requirements specified in regulations 6D.3A.02, 6D.3A.03, 6D.3A.04, 6D.3A.05 and 6D.3A.06. Under this requirement, a CSF intermediary is only required to check that all of the prescribed minimum contents are included in a CSF offer document but does not need to verify the accuracy of the information.

Check information relating to key personnel

Paragraph 6D.3A.08(4)(a) requires an CSF intermediary to check the names and addresses of the current and proposed directors and senior managers of an offering company before publishing the CSF offer on its website. The CSF intermediary can verify this information using normally accepted forms of identification such as a driver's licence or through the records held on the ASIC registers.

Paragraph 6D.3A.08(4)(b) provides that a CSF intermediary must also check that the offer document contains the information required under paragraph 6D.3A.04(3) (details of criminal offences, civil penalties, disqualifications etc) for the offering company and each current or proposed director and senior manager.

Regulation 6D.3A.09 – Standard of checks to be undertaken by CSF intermediaries

Regulation 6D.3A.09 prescribes the standard to which the intermediary must conduct the checks under Regulation 6D.3A.08.

Sub-regulation 6D.3A.09(2) provides that where possible, an intermediary should check registers maintained by ASIC and the ASIC website to verify information in a CSF offer document as required. Intermediaries will comply with this standard even if they obtain the information on ASIC's registers through information brokers.

If there is a discrepancy between the information in the CSF offer document and on ASIC's registers then the CSF intermediary knows there is a problem with the information and should not publish the CSF offer document. Where the discrepancy in information arises because the offering company has used more recent information in the offer but has not given ASIC the updated information, the offering company will have to provide ASIC with the updates and the CSF intermediary will have to conduct the checks again until it is able to fully verify the required information.

Sub-regulation 6D.3A.09(3) provides that in cases information cannot be verified through a register maintained by ASIC, the intermediary will perform the required checks to a reasonable standard by explaining in writing to the offering company what information is required (including the level of detail required) and requiring the offering company to provide the required information in accordance with a reasonable process the intermediary has developed, documented and implemented.

Finally, sub-regulation 6D.3A.09(4) provides that an intermediary satisfies its obligation to check that an offer document is clear, concise and effective by checking the offer document in accordance with a reasonable process the intermediary has developed, documented and implemented.

Regulation 6D.3A.10 - General risk warning

Regulation 6D.3A.10 prescribes the wording of the risk warning that an intermediary must display prominently on its offer platform as required under sub-section 738ZA(2) of the Act.

Regulation 7.1.08 - Documents not constituting financial product advice

Sub-regulation 7.1.08(3A) prescribes that CSF offer documents, and any information drawn from a CSF offer document that is published elsewhere on a CSF intermediary's website or in advertisements and publications of a CSF offer do not constitute the provision of financial product advice, as long as the content is drawn from or contained in the CSF offer document and does constitute the provision of personal advice.

The effect of this provision is that a CSF intermediary will be able to publish a CSF offer document and material drawn from or contained in a CSF document on its platform without needing an authorisation to provide financial product advice (as long as doing so would not constitute the provision of personal advice). A CSF intermediary would also be able to use information drawn from or contained in a CSF offer document to advertise a CSF offer without needing an authorisation to provide financial product advice as long as the advertisement does not provide personal advice and does not breach the advertising restrictions in section 738ZG of the Act.