


ASIC
Australian Securities &
Investments Commission

# Treasury Laws Amendment (Mutual Entities) Bill 2018

# Submission by the Australian Securities and Investments Commission

November 2018

## About this submission

1 This submission sets out ASIC's response to the exposure draft of the Treasury Laws Amendment (Mutual Entities) Bill 2018.

2 We support efforts to clarify and simplify the operation of the enhanced disclosure regime in Pt 5 of Sch 4 to the *Corporations Act 2001* (Corporations Act). We also note that the Government may need to consider the extent to which a single-limb definition of 'mutual entity' adequately captures the essential features of mutuality to ensure that it does not apply more broadly or restrictively than intended.

## Historical context and our regulatory role

3 In 1999, as part of financial sector reforms, the 'demutualisation' regime was introduced in Pt 5 of Sch 4 to the then Corporations Law. The regime applies additional disclosure requirements to any unlisted 'transferring financial institution' proposing to modify its constitution or issue shares with one or more specified effects on existing membership rights.

> Note 1: Clause 29 in Pt 5 of Sch 4 to the Corporations Act specifies circumstances in which a modification or share issue will trigger the additional disclosure requirements.
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> Note 2: Paragraphs 6.82 to 6.113 of the explanatory memorandum to the Financial Sector Reform (Amendments and Transitional Provisions) Bill (No. 1) 1999 provide a useful historical overview as to how and why the provisions in Pt 5 of Sch 4 to the Corporations Act came to be, including the reasons for the particular 'trigger' scenarios in cl 29 and ASIC's discretionary exemption power in cl 30.

4 The additional disclosure requirements apply on top of the disclosure requirements that ordinarily apply for transactions requiring member approval, under other parts of the Corporations Act, such as Chs 2F and 2G. The purpose of the additional disclosure requirements is to ensure that members are fully informed—so they can make a sound judgement about whether a proposal is in their best interests.

5 If triggered, the provisions require the notice of the company's meeting of members (at which the proposed transaction is to be considered) to be accompanied by an ASIC-registered disclosure statement containing prescribed information and an independent expert's report on whether the proposal is in the best interests of members of the company as a whole. ASIC must register the disclosure statement if we are satisfied that the statement adequately sets out or explains the specified matters.

> Note: Clause 32 in Pt 5 of Sch 4 to the Corporations Act specifies the matters that must be set out or explained.

6 ASIC has a discretionary power to exempt a company from Pt 5 of Sch 4 if we are satisfied that either:

(a) the company does not have a mutual structure; or

(b) the proposed transaction will not modify the company's mutual structure.

7 Part 5 does not define 'mutual structure', but does provide details of what we may take into account in determining whether a company has a mutual structure, and what we must take into account in determining whether a proposed transaction will result in or allow a modification of the mutual structure. These are:

(a) the particular structure, circumstances and history of the company;

(b) whether each customer is required to be a member or each member has only one vote, and any other relevant matter in relation to the company or its members; and

(c) whether a proposal would have the effect of converting the company into a company run for the purpose of yielding a return to shareholders (cls 30(3) and (4)).

8 Due to the lack of legislative definition, we saw a need to determine how we will exercise our discretionary exemption powers under Pt 5 of Sch 4. Our guidance is in Regulatory Guide 147 *Mutuality: Financial institutions* (RG 147). RG 147 sets out two tests that we will apply when determining whether a company has a mutual structure when considering whether to exercise our discretionary exemption powers in Pt 5 of Sch 4:

(a) the economic relationship test; and

(b) the governance relationship test.

9 We will determine that a company has a mutual structure only if both tests are satisfied.

## Economic relationship test

10 The economic relationship test requires that:

(a) If the company is wound up, the only people or entities who are allowed to share in any undistributed surplus are current members (in their capacity as members by guarantee or as holders of a member share), a like institution or a charity.

(b) If there are investor shareholders, they must not participate in or otherwise accrue rights to surpluses in that capacity except by receiving dividends.

(c) The dividend that can be paid to investor shareholders must be limited by reference to an independent and objectively verifiable external benchmark or mechanism, or not be more than a fixed percentage of the company's annual profit after tax in any year, and be payable only out of that year's profits.

(d) Members must approve the way the company calculates dividends on investor shares at a general meeting before the company issues any investor shares. Directors must make sure that actual dividend payments are not more than the limits set by the general meeting.

### Governance relationship test

11 The governance relationship test requires that:

(a) Only members can participate in the governance of a mutual company.

(b) Members must have the right to participate in the governance of the company on an equal footing with other members.

(c) Membership must only allow the person who holds the membership to have one vote.

(d) No class of member (e.g. investor shareholders in contrast to members) has any veto or special voting rights in relation to decisions made by the members generally, unless the law requires it (e.g. Pt 2F.2 of the Corporations Act dealing with class rights).

## Our support for clarifying and simplifying the regime

12 We support changes to clarify and simplify the operation of Pt 5 of Sch 4 to the Corporations Act.

13 Under the current provisions, the 'triggers' for application of the additional disclosure requirements are determined by whether a modification or share issue has certain kinds of effect on existing membership rights. Companies may need to undertake relatively complex legal analysis to reach a view as to whether the proposed transaction will have one or more of these effects. This may require a detailed comparison of the present rights under the company's constitution and what the situation will be, or may be, following implementation of the proposed transaction.

14 In undertaking this analysis, companies must also consider the operation of the 'class rights' provisions in Pt 2F.2 of the Corporations Act, and how the courts have applied those provisions.

15 Even if a company forms a legal view that the provisions do not apply to a particular proposal, we acknowledge that there may be a degree of uncertainty and a risk that ASIC or a court may ultimately form a different view.

16 We also acknowledge apparent industry concern that, if a company complies fully with the additional disclosure requirements in Pt 5 of Sch 4, the disclosure material may raise a perception that the company will be demutualised as a result of the proposal, even if that is not the intent or broader effect of the proposal. For example, while a proposed constitutional

modification or share issue may have particular effects on members' rights as specified in cl 29, the company might continue operating on the basis of 'principles of mutuality' following implementation of the proposal.

17 While our ability to provide exemptions from Pt 5 of Sch 4 is designed to address this scenario, we acknowledge that if we determine that we cannot exercise the exemption power (and the company must therefore give additional disclosure material) there may be a perception that the company will be demutualised as a result of the proposed transaction, even if such a conclusion does not align with the company's intent or view on the effect of the transaction.

## The definition of 'mutual entity'

18 The proposed amendments replace the existing cl 29 'triggers' with a new single trigger event—that the company is no longer a 'mutual entity'. This is determined by whether the company meets the single-limb 'one member, no more than one vote' test.

19 The result of this change is that mutual members will no longer be entitled to receive enhanced disclosure for a proposed transaction that may have a significant effect on members' economic relationship with, and rights in relation to, their company, but that does not affect their voting rights.

20 We consider that a definition of 'mutual entity' should be capable of achieving each of the following objectives:

(a) It should adequately describe the fundamental corporate structure of those companies that market or promote themselves as customer or member owned, while excluding all other companies.

(b) It should operate in all scenarios, in isolation (e.g. for the definition in the exposure draft, without a complementary economic relationship component).

21 We note that there may be some mutual companies and members that have strong views on the traditional principles of mutuality, which may be broader than consideration simply of members' voting rights. We suggest that consultation on the exposure draft legislation should take any such views into account.

22 We also query whether it needs to be clarified that the test for 'mutual entity' will allow for a member to vote in different capacities (as ordinarily allowed for under the Corporations Act). For example, what would be the situation if an individual (who is a member of the company in their individual capacity) is also acting as a representative exercising voting rights for another member (e.g. a corporate member) who is legally or practically unable to exercise their voting rights themselves, or is acting as a proxy for another member?