

31 October 2018

To Financial Innovation & Payment Unit
Treasury
Langton Crescent
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By email: mutualreform@treasury.gov.au

Treasury Laws Amendment (Mutual entities) Bill 2018 – submission to Treasury by King & Wood Mallesons

We refer the exposure draft of the *Treasury Laws Amendment (Mutual entities) Bill 2018* (**Mutual Entities Bill**) and explanatory material which was released by Treasury for consultation on 4 October 2018.

We welcome the opportunity to make a submission to this consultation. We have acted for many mutual entities over the years in relation to a range of matters including capital raising, mergers, constitutional queries and amendments, demutualisation issues and general corporate and governance advice.

We understand the challenges the mutual sector has experienced in raising capital and we are pleased to see the amendments proposed to be made to the *Corporations Act 2001* (Cth) (**Corporations Act**) by the Mutual Entities Bill. We note that those amendments are intended to implement Recommendations 5 and 9 of the inquiry into *Reforms for Cooperatives, Mutuals and Member-owned Firms* (conducted by Greg Hammond OAM, a former partner of our firm) (**Hammond Report**).

Our submission relates to the following matters, on which we have made some comments and raised some queries in sections 1 to 8 below:

- scope of the proposed amendments;
- interrelationship with the *Banking Act 1959* (Cth) (**Banking Act**);
- ASIC Regulatory Guide 147;
- the definition of “mutual entity” and divergence from the existing governance relationship test;
- class rights;
- removal of ASIC’s exemption powers;
- potential for transitional or other relief to facilitate constitutional amendments; and
- references to unlisted companies as mutual entities.

We have also made some brief drafting comments in section 9.

1 Scope of the proposed amendments

Comments / observations

As mentioned above, the proposed amendments address Recommendations 5 and 9 of the Hammond Report. Recommendation 5 was as follows:

“Government consider the continued effectiveness of Part 5 of Schedule 4 of the Corporations Act and the demutualisation guidelines implemented under the Banking Act, and the exercise of ASIC’s directions under them, to determine whether any amendments to legislation or regulation are necessary or desirable”.

We note that the proposed amendments related to Part 5 of Schedule 4 of the Corporations Act, but that they do not seek to address the demutualisation guidelines in the Banking Act.

We also note that Recommendations 5 and 9 were to be considered by Treasury in conjunction with Recommendation 8 (i.e. *“The Corporations Act be amended to expressly permit mutuals registered under the Act to issue capital instruments without risking their mutual structure or status”*).

Query

See section 2 below in relation to the interrelationship with the Banking Act.

Is Treasury looking to propose additional amendments to the Corporations Act which *expressly* permit mutual entities to issue capital instruments, as per Recommendation 8 of the Hammond Report?

2 Interrelationship with the Banking Act

Comments / observations

Under section 63(8) of the Banking Act, the Treasurer has a similar authority to that of ASIC under the Corporations Act to propose guidelines in respect of a potential demutualisation of a mutual authorised deposit-taking institution (**ADI**).

The Treasurer has currently delegated this authority to ASIC.

If ASIC’s exemption power under the Corporations Act is removed, it will be necessary to consider how the Treasurer will exercise powers to approve any demutualisation of an ADI.

Queries

Is Treasury looking to propose similar amendments to the Banking Act regarding demutualisation guidelines?

In light of the proposal to remove ASIC’s exemption power from Part 5 of Schedule 4 of the Corporations Act, will the Treasurer revoke the existing delegated authority to ASIC regarding the Banking Act discretions regarding mutual ADIs?

3 ASIC Regulatory Guide 147

Comments / observations

If the proposed amendments are passed, much of ASIC’s Regulatory Guide 147 (**RG 147**) will become redundant.

Queries

Is Treasury aware of whether ASIC is proposing to revoke, replace or re-write RG 147?

If so, is Treasury aware of whether ASIC intends to provide updated guidance on the duties of directors of mutuals? We note that ASIC has released guidance for directors of mutual entities in INFO 231 in response to Recommendation 10 of the Hammond Report, however, we expect that this will need updating given the proposed amendments and we also note that INFO 231 doesn't address disclosure in relation to capital instruments issued by mutuals which would be helpful for directors.

4 The definition of “mutual entity” and divergence from the existing governance relationship test

Comments / observations

There is a risk that a number of mutual entities will not meet the proposed ‘mutual entity’ definition upon commencement of the amendments due to different formulations in mutual entity constitutions regarding membership entitlements and voting, including in respect of:

- memberships in different capacities;
- joint memberships;
- proxies; and
- body corporate representatives and attorneys.

For example, some mutual constitutions permit a person to be a member in their individual capacity and also in a separate capacity (e.g. as trustee for an unincorporated association) and still be permitted to vote each membership interest.

Similarly, some mutual constitutions permit a person who holds an individual membership and a joint membership with another person to have one vote for each membership (noting that typically joint memberships only have one vote) – this is specifically recognised in ASIC RG 147.40(c).

Again, some mutual constitutions provide that a proxy or body corporate representative who is also a member has one vote on behalf of each body corporate member / appointing member (as applicable) and one vote on their own behalf – this is likely to be less of an issue but the wording in some constitutions is unclear.

Practically, these issues often do not arise as mutual entities traditionally conduct general meetings on a show of hands rather than by conducting a poll. However, ASIC's stated policy position (see ASIC Report 489 at paragraph 252) is that good corporate governance practice is for companies to conduct a poll on all resolutions as a matter of course. This, combined with advancements in technology (which allow for electronic proxy lodgements, direct voting and, potentially in the future, virtual meetings), means that mutual entities will increasingly adopt these measures which will necessitate voting on resolutions via a poll rather than on a show of hands. As the proposed amendments are designed to elevate rather than marginalise the status of mutual entities, we submit that the proposed amendments should not inadvertently cut across these features or discourage mutual entities from adopting contemporary corporate governance practices, where the one membership / one vote principle is preserved.

Query

Is it possible to amend proposed subsection 51M(2) of the Corporations Act to clarify that a person who holds a membership in more than one capacity may have a vote for each membership in accordance with the constitution of the mutual entity? Appreciating that there are alternative drafting approaches which are likely to be suggested to Treasury to address this issue, we would be happy to discuss possible amendments if that would be helpful.

5 Class rights

Comments / observations

Notwithstanding the removal of the existing section 29(1) from Part 5 of Schedule 4 of the Corporations Act, Part 2F.2 of the Corporations Act regarding variations to class rights will continue to apply and be relevant.

There remain differing views, and therefore uncertainty, as to whether constitutions of mutual ADIs may be amended to permit the issue of certain forms of Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital without varying the rights of existing members – in large part, this depends on the provisions of the relevant constitution.

While other classes of ‘members’ or security holders (e.g. investor shareholders, or holders of preference shares or mutual equity interests (**MEIs**)) will generally not have any special or veto voting rights in relation to decisions of members generally (therefore satisfying the ‘no more than one vote at a general meeting of the company’ test), there may be circumstances where those classes of member may be required to vote as a class.

Query

Where holders of investor shares (e.g. preference shares / MEIs) have a class right to vote, is it possible to amend section 51M to clarify that:

- the entity is a ‘mutual entity’ notwithstanding the class right of consent that the holders of those shares have; and
- in determining the consent of that class, holders can vote in accordance with the number of such shares they hold, or other determinant of their economic interest, in that class?

6 Removal of ASIC’s exemption powers

Comments / observations

The proposed amendments contemplate that ASIC will no longer have the power to exempt entities from Part 5 of Schedule 4 in light of the simplified definition of ‘mutual entity’.

Query

While the existing ASIC exemption power needs to be changed in light of the proposed amendments, given the breadth of mutual structures and governance arrangements (i.e. lack of uniformity amongst constitutions), we query whether a form of ASIC exemption power should be retained to cater for the ‘known unknowns’. Ideally, any form of exemption power would be administered by ASIC in accordance with the replacement of RG 147.

7 Potential for transitional or other relief to facilitate constitutional amendments

Comments / observations

The constitutions of many mutual ADIs contain demutualisation approval provisions which substantially reflect the existing Part 5 of Schedule 4 of the Corporations Act or variants thereof.

As noted at paragraph 3.75 of the Hammond Report, consideration should be given to amendments specifically allowing such constitutions to be amended to either remove or modify these provisions to bring them into line with the new Part 5 of Schedule 4 and/or the new definition of 'mutual entity'.

Query

Are further amendments being proposed (either as transitional provisions or otherwise) which specifically clarify that an entity which seeks to amend its constitution to bring it into line with either the new definition of 'mutual entity' or the proposed new Part 5 of Schedule 4 of the Corporations Act, will not:

- trigger with the existing or new demutualisation provisions; or
- be taken to vary the class rights of members under Part 2F.2 of the Corporations Act?

8 References to unlisted companies as mutual entities

Comments / observations

The provisions of Schedule 4 of the Corporations Act apply to mutual entities which are 'unlisted transferring financial institutions', but not other mutual entities.

For that reason, the proposed amendments to Part 5 of Schedule 4 adopt the existing terminology in that part, which includes the definition of 'unlisted company', which is defined as follows:

"unlisted company means a company (registered under clause 3) that does not have voting shares quoted on a prescribed financial market".

It is possible that, over time, mutual entities will seek to issue securities (such as preference shares or MEIs) that may be classified as 'voting shares' and which are quoted on a financial market such as the ASX.

In this case, it is possible than an entity that was originally an 'unlisted transferring financial institution' may cease to be an 'unlisted company' (as used in the proposed amended Part 5 of Schedule 4 of the Corporations Act) and therefore lose the benefit of the simplified framework (as it would arguably cease to meet the new limb in paragraph 29(1)(b)).

Query

Given the primary purpose of the proposed amendments is to provide the mutual sector with greater certainty and confidence to be able to raise capital without the risk of demutualisation, has Treasury considered updating the references to 'unlisted companies' in Schedule 4 to clarify that transferring financial institutions will not lose their mutual status simply because they issue a separate class of quoted security (and hence cease to be an 'unlisted company', as currently defined).

9 Technical drafting issues

We note that the proposed amendments to Part 5 of Schedule 4 do not delete all references to a 'share issue' in those provisions. For example:

- section 29(4)(c)(i) – content of an expert's report;
- section 31 – coverage of disclosure statement; and
- section 32(1) and (3) – registration of a disclosure statement.

These technical amendments may need to be addressed.

We are providing these comments, suggestions and queries on behalf of our firm, and the views expressed are our own and not those of our clients (although we expect that some, if not all, of these issues may have been raised with Treasury by a number of our clients).

We would welcome the opportunity to discuss any aspect of our submission with Treasury. Please contact Jo Dodd (02 9296 2154; jo.dodd@au.kwm.com), Rhys Casey (07 3244 8062; rhys.casey@au.kwm.com) or Ian Paterson (03 9643 4237; ian.paterson@au.kwm.com) if you wish to do so.

Yours faithfully

King & Wood Malesony