Capital Partners' Project response to Treasury Laws Amendment (Measures for a later sitting) Bill 2018: Mutual entities (tranche 2)

Introduction

The Business Council for Co-operatives and Mutuals (BCCM) and Customer Owned Banking Association (COBA) welcome the publication of draft legislation that will begin the process of modernising the Federal law for mutual businesses.

New legislation is needed to make the Australian Corporations Act work better for mutually owned businesses, so that they can compete on a level playing field with other types of firms.

We are supportive of this legislation, as the second part of necessary legislation to implement the key Hammond Review recommendations to help mutuals to raise new capital.

Specifically, this legislation provides for mutual entities registered under the Corporations Act to issue mutual capital instruments (MCIs) without risking their mutual structure or status.

Background to this response

We have made the case for an improved business environment for co-operatives and mutuals since 2013. Our calls first gained political support in the Australian Parliament, following publication of the of the Senate Economic References Committee report into Cooperative, Mutual and Member-owned firms.

Over the last nine months, BCCM and COBA have worked with their member businesses to try to positively influence how the Government implements the recommendations of the Hammond Review.

13 leading mutual businesses spanning different sectors – banking, health and community services and motoring - worked together to help shape the sector's positions on new legislation:

Australian Unity
Bank Australia
CUA
Defence Bank
HCF
Heritage Bank
NRMA
People's Choice Credit Union
P & N Bank
Qudos Bank
RAC (WA)
RACQ
Teachers Mutual Bank

In addition, the Friendly Societies of Australia (FSA) worked as a partner in this project.

Specific comments, queries & suggestions on the draft legislation

Status of MCI – not a preference share

The legislation should be clear that the MCIs are not preference shares for the purposes of the Corporations Act, for example in section 254A(2). There are also various other references in Parts 2F.2 (Class Rights) and 2J.1 (Share capital reductions and buy-backs) where it would be helpful to have this clarified. As the Explanatory Memorandum (EM) states, MCIs are '…a new type of bespoke share for the mutual sector'.

While the intent of MCIs being a separate type of share is reasonably clear, it would be helpful to make that position completely clear as MCIs and preference shares could have some similarities, such as non-cumulative dividends and the instrument's participation in surplus assets and profits. MCIs are generally designed to have more in common with an ordinary share. Making the status of MCIs clearer may also assist mutual ADIs and APRA in their consideration of whether the use of MCIs will qualify as Common Equity Tier 1 (CET1) capital instruments and as instruments into which APRA approved Additional Tier 1 capital and Tier 2 capital could convert.

MCIs should be able to be MEIs under the APRA rules

For MCIs to have the maximum impact in assisting mutual ADIs to raise new capital it is important that MCIs are able to be CET1 capital and that Additional Tier 1 capital and Tier 2 capital instruments can convert into MCIs/MEIs on a non-viability event. While this is clearly a mutual ADI specific issue, the Government has been clear that it wants to allow mutual ADIs to raise capital and compete with the big banks in addition to allowing other mutuals to raise capital by issuing MCIs to invest, grow and compete with other investor-owned corporations.

It is necessary for the mutual ADI sector to have clarity on the status of MEIs vis-a-vis MCIs, and for APRA to be comfortable with the MCI provisions. Broadly, our understanding is that an MEI could be a species of MCI. We expect mutual ADIs would want their MCIs to meet the requirements of Attachment K to APS111 (i.e. Definition of MEI). Currently, there is the potential for inconsistency between, for example, section 167AF and Attachment K to APS 111.

Ensuring that MCI dividends are able to be franked

For the avoidance of doubt, there is a need for an additional item in section 15 of the Exposure Draft (Income Tax Assessment Act 1997) which would amend section 202-15 to specify that all MCI mutual entities are Franking Entities.

In particular section 202-15(b) currently specifically excludes a life insurance company that is a mutual life insurance company from being a franking entity.

MCI mutual entities must be able to frank their dividends and utilise accumulated franking credits.

MCI voting rights at a general meeting

We understand that the next version of the *Treasury Laws Amendment (Measures for a later sitting) Bill 2018: Mutual entities* will include clarity that a member of a mutual entity that holds MCIs has only one vote at a general meeting of the mutual entity regardless of the number of MCIs that the member holds.

MCIs as voting shares

We consider that the legislation should prohibit MCIs from being voting shares as defined in section 9 of the Corporations Act. If MCIs are voting shares, it will introduce the application of the takeovers provisions in Chapter 6 of the Corporations Act to companies limited by guarantee.

Alternatively, it should be clearer that voting rights are a matter to be addressed in the mutual entity's constitution, for example in section 167AG which could in addition to its current provisions include a reference to 'rights attached to the share with respect to voting'.

We consider that this should be in addition to the reference in section 167AJ(1)(c) that an MCI amendment resolution to a constitution may '..provide for the rights and obligations attached to the MCIs;'. This approach would allow mutual members initially through approval of amendments to the constitution and then the mutual entity's Board, if given the constitutional power to determine voting rights, to decide if MCIs would be voting shares.

Regardless of the position taken in relation to the classification of MCIs as voting shares, MCIs should be excluded from the definition of securities in section 92(3) of the Corporations Act recognising that the MCIs will only be issued by mutual entities and that such entities should remain outside of the takeovers provisions, in particular where other members of the mutual entity are not shareholders.

Section 167AF

Delete 'declared' from the heading of the section as the section relates to a dividend which has become a debt owed by the mutual entity in accordance with section 254V regardless of whether the dividend was declared.

Section 167AG – fully paid shares and broad constitutional power to determine the terms of MCIs

We understand that the intent of section 167AG(a) is to ensure that MCIs are issued as fully paid shares and that this obligation is specified in the mutual entity's constitution.
We consider that it is important that the section also provide that the share that is issued is fully paid. Section 167AG(a) should therefore be amended to read:

'A share in mutual entity meets the requirements in this section if the entity's constitution:

(a) provides that the share may only be issued as ~~is~~ a fully paid share; and'

The EM should make it clear that the intention of this section and the reference in section 167AJ(1)(c) that an MCI amendment may '..provide for the rights and obligations attached to the MCIs;' is to allow a mutual entity to include a power in its constitution to issue shares that meet the requirements in section 167AG (see also the discussion above in relation to voting rights) in a similar way to the common practice for constitutions to address section 254A(2) for preference shares, which is to include in the constitution the broad parameters with respect to the issue of preference shares and include a discretion for the Board to set the specific details of that share. So in the case of a MCI the Board of the mutual entity would be empowered to decide to issue MCIs and to decide:

- whether the MCIs will participate in the surplus assets and profits of the mutual entity; and
- what other terms may apply to the MCI, for example, the method that applies to the calculation of a dividend (provided that dividends are non-cumulative).

Section 167AH

Make it clear that the MCI mutual entity could pass a resolution to result in the entity ceasing to be a MCI mutual entity before it has no MCIs on issue but that such resolution cannot take effect before there are no MCIs on issue.

Practically a MCI mutual entity may want to pass the resolution first and then deal with the MCIs, for example, buy them back or undertake a capital return, however, the entity would want the certainty of knowing that it would be ceasing to be a MCI mutual entity before it deals with the MCIs.

Section 167AH should therefore be amended to read:

'A resolution of an MCI mutual entity that would result in the entity ceasing to be an MCI mutual entity can only take ~~has~~ effect ~~only~~ if:'

Section 167AI

Confirmation that mutual entities wishing to alter their constitutions after the end of the special procedure period in section 167AI may do so according to the terms of their constitutions at that time.

Section 167AJ rights and obligations of MCIs

We understand that section 167AJ(b) and (c) allow the constitution of a mutual entity to be amended to include rights and obligations attached to MCIs that go beyond the mandated requirements of an MCI in sections 167AE to 167AG. As such, the constitution would be able to include specific rights and obligations such as the right to receive dividends and how the dividend may be determined, voting rights, and rights on winding up and also a power to allow the Board to determine the rights and obligations attached to particular MCIs.

This point could be made in the EM or a note could be included after section 167AJ in a similar manner to the note after section 167AD(3) which provides that the rights to be attached to MCIs could include, but not be limited to, rights to dividends, voting rights, rights to repayment of capital on winding up and rights to priority of payment in relation to other MCIs or securities etc.

Section 167AK

Make it clear that there must have been no more than 2 previous meetings at which MCI amendment resolutions have been considered rather than there not having been more than 2 MCI amendment resolutions considered.

There could be multiple MCI amendment resolutions to make the necessary changes.

Section 167AK

Make it clear that the MCI amendment resolution meets the class right requirements without further compliance with Part 2F.2. This may be addressed in a similar manner as used in section 167AK(2)(b).

Section 167AK

To make it clear that in addition to the powers in this section, if an MCI amendment resolution is passed, the mutual entity will be deemed to have complied with any further requirements specified in its constitution that may apply by reason of the MCI amendment resolution being proposed or passed. In particular, this is to deal with provisions in constitutions that may mean that merely convening the members meeting to consider the

MCI amendment resolution may trigger a demutualisation – such an outcome needs to be avoided.

Consideration should be given to allowing MCIs to be redeemable

As noted above, MCIs are not preference shares and as such MCIs are not redeemable. Consideration should be given to allowing MCIs to be redeemable in the same manner as preference shares, that is out of profits or the proceeds of a new issue of MCIs (see sections 254J to 254L of the Corporations Act). Whether a particular MCI would be redeemable would be a matter for its terms and following the inclusion of a power in the mutual entity's constitution for the Board to determine if the MCIs would be redeemable, it would be a matter for the Board to determine. The option for MCIs to be redeemable could be addressed as a new sub-section of section 167AG. It is important that MCIs' capacity to be redeemable does not rule them out as CET1 capital.

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20 December 2018