



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 210

# Demutualisation approval procedure rules: Minimum member participation requirement

June 2013

## About this paper

This consultation paper sets out our proposals on the approach ASIC should take when considering requests by credit unions to cease the effect of the 25% minimum member participation requirement in the 'demutualisation approval procedure rules' contained in their constitutions.

We seek feedback from credit unions, their members and legal advisers, relevant industry associations and other interested parties.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This paper was issued on 11 June 2013 and is based on the Corporations Act as at the date of issue.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

You are invited to comment on the issues in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific issues and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on the circumstances in which ASIC should be prepared to give a written notice to the effect that the demutualisation approval procedure rules cease to operate in relation to a specified proposed transaction. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

### Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by Friday 5 July 2013 to:

Fleur Grey  
Senior Specialist  
Deposit Takers, Credit and Insurers  
Australian Securities and Investments Commission  
Level 2, 70 Collins Street  
HOBART TAS 7000  
facsimile: 03 6235 6811  
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## What will happen next?

<b>Stage 1</b>	11 June 2013	ASIC consultation paper released
<b>Stage 2</b>	5 July 2013	Comments due on the consultation paper
	July / August 2013	Decision by ASIC on our approach to dealing with requests to cease the effect of the 25% minimum member participation requirement
<b>Stage 3</b>	July / August 2013	Release of ASIC report on responses to the consultation paper, including our decision on our approach to dealing with requests to cease the effect of the 25% minimum member participation requirement

## A Background to our proposals

### Key points

The constitutions of about 40% of credit unions registered with the Australian Prudential Regulation Authority (APRA) contain special 'demutualisation approval procedure rules', which apply in certain circumstances in addition to the *Corporations Act 2001* (Corporations Act) requirements for approving modifications to constitutions of companies.

The demutualisation approval procedure rules are designed to ensure that proposed transactions that have an impact on the company's future direction are approved by a sufficient and appropriate number of members of the credit union. The rules provide that particular types of transactions can only proceed if approved by a postal ballot before a general meeting is convened to vote on the proposed transaction. The rules include a minimum member participation requirement for the postal ballot.

The demutualisation approval procedure rules contained in the constitutions of some credit unions give ASIC the ability to publish a notice to the effect that the demutualisation approval procedure rules cease to have effect.

We are consulting publicly on the approach we should take when considering requests from credit unions to cease the effect of the 25% minimum member participation requirement in the demutualisation approval procedure rules.

### Demutualisation approval procedure rules

- 1 Under the Corporations Act, the general procedural requirements for modifying the constitution of a company that has a mutual structure are set out in:
  - (a) Pt 2B.4; and
  - (b) if the modification will vary or cancel members' rights (such as voting rights and rights to the company's reserves and assets on a winding up), Pt 5 of Sch 4.
- 2 In addition to these general procedural requirements, about 40% of APRA-registered credit unions, and those previously operating as credit unions but now registered by APRA as banks (collectively referred to in this consultation paper as 'credit unions'), have included in their constitutions additional procedures for approving certain types of transactions that will affect the mutuality of the credit union. These additional rules are generally referred to as 'demutualisation approval procedure rules'.

- 3 Broadly, the demutualisation approval procedure rules are triggered by the following types of events, where the event (the proposed transaction) may be inconsistent with the principles of mutuality:
- (a) modification or repeal of the company's constitution where it would affect the issue of shares and the rights attaching to those shares, variation of membership rights and obligations or the admission of members;
  - (b) issue of shares or admission of members;
  - (c) corporate restructure; and
  - (d) modification or repeal of the demutualisation approval procedure rules in the company's constitution.
- 4 The demutualisation approval procedure rules prescribe the following mandatory procedures before the credit union may convene a meeting of members to vote on a special resolution to approve the proposed transaction:
- (a) at least 25% of all members must participate in a postal ballot, at least 75% of whom must vote in favour of the proposed transaction (for each separate class of members); and
  - (b) the credit union must send to each member with the ballot paper a disclosure statement, a director's statement from each director and an independent expert's report.

### **Establishment of the demutualisation approval procedure rules**

- 5 In 1999, when credit unions became regulated as registered companies under the Corporations Act, there was concern among industry that small groups of members could pass potentially significant resolutions to sell, wind up, demutualise or otherwise restructure a credit union. To address this concern, industry representatives recommended that a minimum participation requirement be developed for proposed transactions of particular significance to the future direction of the credit union. The demutualisation approval procedure rules were developed by the then industry association, Credit Union Services Corporation (Australia) Limited (CUSCAL), to ensure that proposed transactions that have an impact on the credit union's future direction are approved by a sufficient and appropriate number of members of the credit union.
- 6 In October 2000, ASIC issued Class Order [CO 00/2079] *Credit Union Services Corporation (Australia) Ltd: Partial relief from Pt 5 of Sch 4*, which facilitated the voluntary adoption by individual credit unions of the demutualisation approval procedure rules without the need to comply with the provisions in Pt 5 of Sch 4 to the Corporations Act. [CO 00/2079] contained a sunset clause, under which a credit union relying on the class

order was required to include in the constitution a provision that the demutualisation approval procedure rules would cease to operate at the end of the credit union's 2001 annual general meeting.

- 7 In August 2002, following further discussion between CUSCAL and ASIC, we issued Instrument [02/0957]. Instrument [02/0957] provided similar relief to that provided by [CO 00/2079], but it did not contain a sunset clause. The relief in Instrument [02/0957] is available only for credit unions that adopt demutualisation approval procedure rules that are identical to, or have substantially the same effect as, a standard set of rules prepared by CUSCAL in 2002 (standard form rules). A number of credit unions have subsequently relied on the relief in Instrument [02/0957] to include the demutualisation approval procedure rules in their constitutions.

### **Disapplication of the demutualisation approval procedure rules**

- 8 In order to rely on the relief in Instrument [02/0957], it was required that the credit union's constitution provide that the demutualisation approval procedure rules shall cease to have effect if and when ASIC has published a written notice to that effect and delivered a copy of that notice to the credit union. This condition was included because there may be situations in which it may be in the public interest to facilitate approval of a particular proposed transaction.
- 9 Under the standard form rules, the terms of the constitution provide for those rules to cease to have effect immediately when ASIC:
- (a) publishes a written notice that the demutualisation approval procedure rules cease to have effect in relation to the credit union; and
  - (b) delivers a copy of the notice to the credit union.

This is subject to any terms and conditions in the written notice.

- 10 The publication and delivery of a written notice by ASIC does not remove the demutualisation approval procedure rules from the constitution of the credit union. Under the standard form rules, the demutualisation approval procedure rules will again come into effect by a board resolution when ASIC withdraws our written notice, makes an order or exemption, or otherwise permits the credit union to adopt or recommence the operation of the rules.
- 11 As the written notice given by ASIC may be subject to terms and conditions specified in the notice, we think that, in general:
- (a) the notice may state that all or specified parts of the demutualisation approval procedure rules cease to have effect only in relation to a proposed transaction specified in the notice; and



- (b) conditions may be imposed on the notice that, in effect, require the credit union to comply with the procedures specified in the condition before the notice will take effect to 'switch off' the demutualisation approval procedure rules.

12 However, it is a matter for the individual credit union to satisfy itself of the legal effect of any written notice which it may ask ASIC to publish and deliver.

#### **When we will issue a notice**

13 Neither Instrument [02/0957] nor the terms of the standard form rules specifies the circumstances in which we can or should publish and deliver a written notice to the effect that the demutualisation approval procedure rules cease to have effect.

14 To date, we have taken the view that we should only issue a notice where the credit union's circumstances raise potential prudential concerns and APRA considers it necessary for a particular transaction to occur expeditiously. APRA may make a compulsory transfer determination under Pt 4 of the *Financial Sector (Business Transfer and Group Restructure) Act 1999* only in limited circumstances. In cases in which the legislative preconditions for a compulsory transfer determination are not satisfied, the demutualisation approval procedure rules may present an obstacle to a proposed transaction aimed at improving the credit union's ability to satisfy prudential requirements.

15 We have received a small number of requests from individual credit unions to publish and deliver a written notice to cease the effect of the demutualisation approval procedure rules contained in their constitutions, or specific requirements under those rules. To date, we have not issued a notice as requested because:

- (a) We have not been satisfied that the circumstances of the credit union making the request have shown that it would be necessary for prudential reasons that the proposed transaction be approved.
- (b) In the absence of such circumstances, we have not been satisfied that it would be appropriate for ASIC to intervene in the application of the terms of the credit union's constitution. We consider that members are entitled to expect that the demutualisation approval procedure rules will have effect in accordance with their terms.
- (c) We have not been satisfied that arguments relating to the costs of compliance with the procedures under the demutualisation approval procedure rules, or the application of these rules to a particular transaction, justify relaxation of the effect of these rules.

## Level of adoption of the demutualisation rules

- 16 As at the date of publication of this consultation paper, our records indicate that the constitutions of about 20% of credit unions contain demutualisation approval procedure rules that are identical to, or have substantially the same effect as, the standard form rules prepared by CUSCAL.
- 17 Approximately 20% of credit unions have included in their constitutions different demutualisation approval procedure rules. For example, some have not included the power for ASIC to give a written notice to cease the operation of the rules or have instead included a sunset clause.

## Overview of our proposals

- 18 Generally, requests by credit unions for ASIC to publish a notice to cease the effect of the demutualisation approval procedure rules are concerned with the 25% minimum member participation requirement for the postal ballot. These requests have suggested that the 25% minimum member participation requirement is too high due to disengagement of members in the voting process.
- 19 In light of these requests and the time that has passed since we issued Instrument [02/0957], we now consider it timely to consider the appropriateness of the 25% minimum member participation requirement for postal ballots under the standard form rules and the circumstances in which we should consider approving requests by credit unions to cease the effect of the rules. We are consulting on whether we should:
- (a) change our current approach to circumstances in which we will publish and deliver a written notice that ceases the effect of the 25% minimum member participation requirement; and
  - (b) consider imposing conditions on any written notice to require the credit union to instead comply with a lower threshold for member participation in a postal ballot.
- 20 We are not consulting at this time on any other procedural requirements under the standard form rules, or on the application of any demutualisation approval procedure rules to the extent that they are not standard form rules. We are also not consulting on circumstances in which we should withdraw a written notice or otherwise permit the board of a credit union to resolve that the rules, which have previously ceased to have effect, again come into effect.

## B The 25% minimum participation requirement

### Key points

We seek feedback on whether we should change our approach to when we should publish and deliver a written notice to cease the effect of the 25% minimum member participation requirement.

We also seek feedback on whether we should impose conditions on any written notice to require the credit union to instead comply with a lower threshold for member participation in a postal ballot.

### Our approach to requests to cease the effect of the 25% minimum member participation requirement

#### Issue

**B1** We are considering whether we should change our current approach to circumstances in which we will publish and deliver a written notice to cease the effect of the 25% minimum member participation requirement.

#### *Your feedback*

- B1Q1 Should ASIC consider giving a notice to switch off the 25% threshold? If not, why not? If yes, in what circumstances do you think we should do so?
- B1Q2 What benefits do you consider will result from switching off the 25% threshold?
- B1Q3 What disadvantages do you consider will result from switching off the 25% threshold?
- B1Q4 What impact, if any, would switching off the 25% threshold have on your business costs? How would you manage potential changes?
- B1Q5 Are there any practical problems with the implementation of this proposal? Please give details.

#### Discussion

- 21 To date, we have taken the view that the issue of a notice to cease the effect of the standard form rules would be justified only where there are current prudential concerns that make the proposed transaction necessary. We have considered that potential prudential concerns in the medium to long term (rather than current concerns) are not sufficient to justify the exercise of this power.
- 22 However, we note that there may be a broader range of circumstances in which it is appropriate to switch off the 25% member participation threshold

for postal ballots under the demutualisation approval procedure rules (rather than ceasing the effect of the standard form rules in their entirety).

- 23 In the requests that we have received from credit unions it has been submitted that:
- (a) the 25% threshold is difficult or impossible to reach due to low levels of member participation in resolutions on the general business of those credit unions; and
  - (b) given the uncertainty of achieving the minimum level of member participation at the postal ballot stage, there is a disincentive for management of credit unions to propose transactions to their members and incur the costs of conducting the postal ballot and preparing the required disclosure documents (including the commissioning of an independent expert's report).
- 24 On the basis of information provided by Abacus Australian Mutuals Limited, we understand that levels of member participation in voting on resolutions to undertake corporate restructures or mergers of credit unions (not necessarily limited to cases in which the demutualisation approval procedure rules applied) has varied in recent years, with member participation rates exceeding 25% in some instances and not in others.
- 25 We understand that the industry representatives responsible for developing the standard form rules were conscious of the need to set any participation requirements at low enough thresholds to avoid making governance decisions by interested members impossible.
- 26 If the minimum participation requirement ceased to have effect (but all other parts of the standard form rules continued to apply), members would continue to have the protection of a two-step approval process that would afford members:
- (a) the opportunity to exercise the right to vote on a proposed transaction in a convenient form (the postal ballot) and so participate in decisions of considerable importance for the future direction of the company; and
  - (b) a second opportunity to vote on a proposed transaction at a general meeting of members for the purpose of making a special resolution.
- 27 However, removal of the 25% threshold for member participation in the postal ballot may significantly increase the risk of enabling transactions that will impact the future direction of a credit union to be approved by a small number of members participating in both the postal ballot and the special resolution at a general meeting.

## Conditions to effectively impose a lower participation threshold

### Issue

- B2** We are considering whether we should impose conditions that require the credit union to instead comply with a lower threshold for member participation in the postal ballot.

#### *Your feedback*

- B2Q1** Do you think that 25% is an appropriate threshold for the minimum member participation requirement in the postal ballot? Why or why not? If not, what do you think would be an appropriate level? Why?
- B2Q2** What benefits do you consider will result from altering the 25% threshold for the minimum member participation requirement in the postal ballot?
- B2Q3** What disadvantages do you consider will result from altering the 25% threshold for the minimum member participation requirement in the postal ballot?
- B2Q4** What impact, if any, would altering the 25% threshold have on your business costs? How would you manage potential changes?
- B2Q5** Are there any practical problems with the implementation of this proposal? Please give details.
- B2Q6** If possible, please provide any available data relating to voting participation levels in support of your answers.

### Discussion

- 28 We consider that the level of member participation in a ballot on a particular transaction is likely to be affected by a variety of factors, including the subject matter of the proposed transaction, marketing conducted by management to encourage member participation and the potential impact on individual members of the transaction (e.g. whether members may receive a benefit as a result of the transaction being approved).
- 29 Accordingly, we consider that it is difficult to determine an appropriate lower participation threshold that would be considered achievable but continue to ensure that there is an appropriate level of participation of members in important decisions about the future direction of a credit union.

## C Regulatory and financial impact

- 30 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. We are seeking to strike an appropriate balance between:
- (a) ensuring members of credit unions continue to have the opportunity to participate in a postal ballot to register disapproval of a proposed transaction, and, in the event that the approval is given by 75% of members who respond to the ballot, the further opportunity to participate in the formal vote on the special resolution; and
  - (b) ensuring that the requirements placed on relevant credit unions by the standard form rules remain appropriate in today's market conditions.
- 31 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:
- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
  - (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
  - (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).
- 32 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 33 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:
- (a) the likely compliance costs;
  - (b) the likely effect on competition; and
  - (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

## Key terms

Term	Meaning in this document
Abacus Australian Mutuals Limited	The industry association representing the Australian mutual sector, including credit unions, mutual building societies and friendly societies
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
[CO 00/2079]	ASIC Class Order [CO 00/2079] <i>Credit Union Services Corporation (Australia) Ltd: Partial relief from Pt 5 of Sch 4</i>
Corporations Act	<i>Corporations Act 2001</i> , and regulations made for the purposes of that Act
credit union	APRA-regulated credit union
CUSCAL	Credit Union Services Corporation (Australia) Limited
demutualisation approval procedure rules	Rules contained in some credit unions' constitutions that apply when the credit union is seeking member approval of certain types of transactions that will affect the mutuality of the credit union.
Instrument [02/0957]	Instrument [02/0957], issued by ASIC on 23 August 2002
principles of mutuality	A largely standard set of mutual principles, on which many credit unions' constitutions are based
proposed transaction	A proposal by a credit union to modify the credit union's constitution that would trigger the application of the demutualisation approval procedure rules
standard from rules	A standard set of demutualisation approval procedure rules prepared by CUSCAL in 2002

## List of issues and questions

Issue	Your feedback
<p>B1 We are considering whether we should change our current approach to circumstances in which we will publish and deliver a written notice to cease the effect of the 25% minimum member participation requirement.</p>	<p>B1Q1 Should ASIC consider giving a notice to switch off the 25% threshold? If not, why not? If yes, in what circumstances do you think we should do so?</p> <p>B1Q2 What benefits do you consider will result from switching off the 25% threshold?</p> <p>B1Q3 What disadvantages do you consider will result from switching off the 25% threshold?</p> <p>B1Q4 What impact, if any, would switching off the 25% threshold have on your business costs? How would you manage potential changes?</p> <p>B1Q5 Are there any practical problems with the implementation of this proposal? Please give details.</p>
<p>B2 We are considering whether we should impose conditions that require the credit union to instead comply with a lower threshold for member participation in the postal ballot.</p>	<p>B2Q1 Do you think that 25% is an appropriate threshold for the minimum member participation requirement in the postal ballot? Why or why not? If not, what do you think would be an appropriate level? Why?</p> <p>B2Q2 What benefits do you consider will result from altering the 25% threshold for the minimum member participation requirement in the postal ballot?</p> <p>B2Q3 What disadvantages do you consider will result from altering the 25% threshold for the minimum member participation requirement in the postal ballot?</p> <p>B2Q4 What impact, if any, would altering the 25% threshold have on your business costs? How would you manage potential changes?</p> <p>B2Q5 Are there any practical problems with the implementation of this proposal? Please give details.</p> <p>B2Q6 If possible, please provide any available data relating to voting participation levels in support of your answers.</p>