ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 10

Mutuality

July 2000

Your comments

We invite your comments on the *proposals and issues for consideration* in this paper.

Comments are due by Friday 21 July 2000 and should be sent to:

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What this policy proposal is about

1 This policy proposal sets out an ASIC model for mutuality based on a comprehensive review of existing mutuality tests. In particular, it sets out:

(a) how we propose to apply the mutuality principles; and

(b) when we will treat a company as having a mutual structure.

2 In formulating the proposal, we have taken into account:

(a) the mutuality guidelines set out in ASIC Interim Policy Statement 147;

(b) preliminary industry stakeholder consultation;

(c) current stakeholder approaches to mutuality in each of the industry sectors; and

(d) APRA's views.

3 This policy would apply where:

(a) Part 5 of Schedule 4 of the Corporations Law (Law) applies and a company is seeking an exemption under Clause 30 (ASIC use); or

(b) Section 63 of the Banking Act 1959 (Banking Act) applies to an Approved Deposit-taking Institution (ADI) incorporated after 30 June 1999 (ASIC use under delegation from the Treasurer); or

(c) ASIC has been consulted on a Transfer of Business application submitted to APRA, where one of the parties is a mutual organisation, and where the proposed transfer may result in a demutualisation.

4 APRA is considering use of the same mutuality framework to determine applications under Section 66(1) of the Banking Act where a company is seeking to use the restricted words or expressions "credit union" or "credit society".

5 This policy is not intended as a guide as to what constitutes mutuality outside these contexts, eg for tax.

Contents

Our policy proposal — issues for consideration

Policy proposal	Issues for consideration
How we propose to apply the mutuality principles	
1 We propose to apply the mutuality principles in exercising our discretion to grant an exemption under Clause 30.	
Exemption under Clause 30(1)	
2 Where an applicant company does not substantially satisfy the mutuality principles, we will generally grant an exemption under Clause 30(1). In borderline cases, for example where a company does not fully satisfy the principles of mutuality but through history or circumstances continues to operate as if it were a mutual organisation, we will treat the application as an application for an exemption from Part 5 made under Clause 30(2).	**2A** Should ASIC always grant an exemption from Part 5's demutualisation disclosure requirements if the company does not substantially satisfy the mutuality principles before effecting the proposed constitutional amendment or share issue?
Exemption under Clause 30(2)	
3 In determining an application for exemption under Clause 30(2), we will consider each of the principles of mutuality to establish the impact of the proposal on the mutual structure of the company.	
4 We will grant relief if we consider the proposal will in fact enhance mutuality in a company. For example, a proposal may strengthen existing mutuality arrangements, or introduce additional mutuality safeguards. Likewise, if a proposal lessens existing mutuality arrangements in only a very minor way, we will grant an exemption.	**4A** Are there any circumstances in which Part 5's disclosure requirements should be fully met and consequently no exemption should be provided where a mutual company is proposing to enhance mutuality?
5 We may impose conditions on an exemption. This will be done where we are concerned about the	

Policy proposal	Issues for consideration
possible future effect of the proposal on mutuality. For example, where a company wants to amend its constitution to enable it to issue shares, a condition may be imposed requiring member approval before further shares are issued. In borderline cases, we may provide relief from some but not all of the disclosure requirements of Part 5 eg relief from the expert's report requirement (Clause 33).	
6 Where a proposal will materially diminish mutuality, we will not grant an exemption.	**7A** Should ASIC refrain from granting an exemption if any diminution of mutuality will flow from a proposed constitutional amendment or share issue?
Implications of Clause 30(4)	
7 If we receive an application for exemption under Clause 30(2), in accordance with Clause 30(4), we will pay particular regard to whether the issue of shares or constitutional modification results in a diversion of surplus to non member investor shareholders to the extent that the dominant purpose of the company alters to that of one being run for the purpose of yielding a return to shareholders. We will not grant an exemption in these circumstances.	

Policy proposal	Issues for consideration
When we will treat a company as having a mutual structure	
8 To be a mutual, the dominant purpose of a company must not be to provide returns to shareholders (Clause 30(4)).	**8A** Does the proposed focus adequately reflect the essence of mutuality?
9 A key purpose of a mutual should be to provide services to members and this should be reflected in the company's constitution.	
10 To decide whether policy proposals 8 and 9 are satisfied, we will use two tests: (a) the economic relationship test; and (b) the governance relationship test. To be a mutual a company must satisfy each element of both tests.	**10A** Are there aspects outside the economic and governance relationships of mutuals that should be considered?
Economic relationship test	
11 Only current members (in their capacity as members by guarantee or as holders of a member share), a like institution or a charity are entitled to share in the undistributed surplus of the financial institution on a winding up.	**11A** Should this restriction apply only to a winding up or should it apply to any distribution of the mutual's undistributed surplus, eg distribution while the mutual remains a going concern? **11B** Is it consistent with the notion of mutuality for a company which has membership/voting qualifications (see Issues 16A–D) to also use those membership qualifications to affect participation in any distribution on wind up?
12 Investor shareholders must not participate in or otherwise accrue rights to surpluses other than by the receipt of dividends.	**12A** Are there any other means by which an investor shareholder could be entitled to share in the mutual's undistributed surplus, consistently with the notion of mutuality?

Policy proposal

13 The return on investor shares must be:

(a) limited by reference to an appropriate external benchmark or mechanism, eg BBSW or the All Ordinaries index; or

(b) in total, a fixed percentage (maximum 50%) of the company's current year profit after tax.

The way a company gives returns on investor shares must be approved by the members in general meeting prior to the share issue. The actual dividend payment declared by directors must not exceed this rate of return approved by members.

14 In addition to the issue of investor shares which pay dividends, we will pay particular regard to:

(a) any proposed issue of shares where the effect is analogous to a dividend payment (eg issues of redeemable preference shares where a percentage of the shares are redeemed each year); and

(b) any other proposal which will result in a diversion of reserves or surplus to the detriment of existing mutual members.

Issues for consideration

12B Is there any other mechanism by which a company is able to raise capital (other than by issues to investor shareholders) and still remain a mutual?

12C Should share issues be limited to members? Why? Why not?

12D If non member investor shareholders are permitted, should there be a limit placed on the percentage of shares held by non member investors?

13A If a 50% limit is placed on dividend returns, is this likely to hinder capital raising by mutuals?

13B Should a company also be required to obtain member approval for the amount of the dividend declared, if member's have already approved the method by which returns will be calculated in accordance with Proposal 13(a) or (b)?

Policy proposal

Governance relationship test

15 Only members can participate in the governance of a mutual company. This does not prevent the appointment or election of non-member directors.

16 All members must have the right to participate in governance of the company on an equal footing with all other members. This means:

(a) all fully qualified members each have one vote

(b) if there are membership and voting qualifications based on time periods and minimal balances these must be reasonable. For example, minimal balances should not exceed a reasonable dollar amount taking into account the balances of the majority of customer members and the qualification periods should not be excessive having regard to customer member turnaround. We will view membership qualifications which have the overall effect of disenfranchising more than a small percentage, eg 10%, of the membership as affecting member sovereignty and consequently consider these qualifications to diminish mutuality. Demutualisation protection rules that contain provisions which have the effect of crippling member sovereignty will also be seen as diminishing mutuality; or

(c) if the company has a form of representative governance that substitutes for a direct general meeting, each member has only one vote either in electing the representative or electing those who nominate the representative.

Issues for consideration

15A If non member investor shareholders are compatible with the notion of mutuality, should these investor shareholders be permitted voting rights in the general governance of the company? Can this be done consistently with mutuality principles? How?

16A Do membership qualifications enhance or detract from mutuality? If so, how?

16B Is it appropriate to allow membership qualifications referable to a minimum balance ie potentially prejudicing less wealthy members?

16C Should voting qualifications not apply on certain strategic questions eg where alteration of members rights will result?

16D Suggestions as to what constitutes a reasonable qualifying period and minimum balance (if considered appropriate) are welcomed.

16E Does sub-principle 16(d) fit with existing collegiate voting structures?

16F If a delegate in a collegiate voting structure is not required to vote in accordance with the members' majority instructions, does this undermine the concept that members must govern the company?

Policy proposal	Issues for consideration
Provision (c) is specifically inserted to grandfather existing collegiate voting structures and entities that don't currently use a collegiate voting structure will only be able to utilise this provision in specific circumstances, eg to facilitate a merger, and for a transitional period only of a maximum five years from 1 July 1999. (d) no member has more than one vote, regardless of whether a member holds membership in different capacities; and (e) no class of members (ie investor shareholders, members, redeemable preference share shareholders) has any veto or special voting rights over decisions made by the members generally, unless provided for in Part 2F.2.	
Transfer of business **17** Where a mutual company proposes a transfer of business to a company which does not substantially meet the mutuality principles, we will propose to APRA that it should approve the transfer of business conditional upon the transferring company complying with Division 5 as if it applied.	**17A** Do the members of a transferring mutual company require this additional protection?
Banking Act demutualisation **18** This policy will apply equally where an Authorised Deposit Taking Institution (ADI) is subject to Section 63 of the Banking Act, by virtue of being incorporated after 30 June 1999. Section 63 and the related guidelines have a similar effect to Part 5, and we will apply them, as far as possible, in the same manner.	

Regulatory and financial impact

For a discussion of the regulatory and financial impact of this policy proposal, see separate section, "Regulatory and financial impact."

We invite your comments on the impact of this policy proposal.

Explanation

Mutuality and the Law

1 The Financial Sector Reform (Amendments and Transitional Provisions) Act No.1 1999 amended the Corporations Law to include, inter alia, a new demutualisation regime in Part 5 Schedule 4 to the Law.

2 Determining a concept of mutuality is necessary because:

(a) there is no statutory definition of mutuality for use in this context;

(b) the scope of the demutualisation regime, and in particular the low triggers set out in Clause 29, will necessitate the determination of numerous exemption applications which requires a uniform approach to mutuality; and

(c) supervising the constitutional amendments required by Clause 24 of Schedule 4 to the Law calls for some guide as to mutuality.

3 The ASIC model for mutuality will be used by ASIC where:

(a) Part 5 of Schedule 4 of the Corporations Law applies and a company is seeking an exemption under Clause 30 (ASIC use); or

(b) Section 63 of the Banking Act 1959 (Banking Act) applies to an Approved Deposit-taking Institution (ADI) incorporated after 30 June 1999 (ASIC use under delegation from the Treasurer).

4 It is intended that financial institutions will use this policy as a guide to aid in determining whether they have a mutual structure.

5 APRA is considering using this model for mutuality to determine applications under Section 66 of the Banking Act where a company is seeking to use the restricted words or expressions “credit union” or “credit society”.

6 The concept of mutuality is also relevant in considering applications to APRA for Transfers of Business where one or both of the parties to the Transfer are mutuals, and where the application may, either intentionally or inadvertently, result in a demutualisation. ASIC plays an advisory role to APRA in approving transfers, eg a transfer involving a mutual entity may be subject to an APRA imposed condition, resulting from consultation with ASIC, that requires disclosure under the demutualisation regime to ensure affected members are appropriately informed.

Part 5 demutualisations

7 The Part 5 demutualisation regime applies when an unlisted company proposes modifications to its constitution that have the effect of varying or cancelling the rights of members, or classes of members:

(a) to vote;

(b) to the reserves of the company;

(c) to the assets of the company on a winding up; or

(d) that invoke the class rights provisions of Part 2F.2 of the Law.

8 In addition, the demutualisation regime is triggered if an unlisted company issues shares with the effect of varying or cancelling rights so that Part 2F.2 applies.

9 A company might trigger the application of Part 5 whether or not demutualisation is the intended result. Building societies, credit unions and friendly societies should take into account the mutuality principles when proposing constitutional change or a share issue. If the company considers that the proposed change or share issue may invoke Part 5 but in light of the principles would not result in any loss of mutuality, they may apply to ASIC under Clause 30 for relief from this Part.

10 Companies should note that even where an exemption from Part 5 has been granted, there is a common law obligation to ensure that the members are informed as to the purpose of a meeting, in a manner that is not misleading. This requires a broad statement of the purposes of the resolution so that members can make a reasonable informed judgement as to whether to attend. Where a special resolution is intended to be passed the substance of the resolution must be indentified in the notice.

11 Companies should also be aware that a company that is not a mutual but calls itself a mutual may be in breach of Section 12DA of the Australian Securities and Investments Commission Act 1989, which prohibits a corporation in trade or commerce, engaging in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.

Section 63 demutualisations

12 Section 63 of the Banking Act and related guidelines are proposed to apply to all ADI's incorporated after 30 June 1999, in the same circumstances under which Part 5 applies to transferring financial institutions.

13 Note that Section 63 does not apply to friendly societies and that there is currently no equivalent legislative provision governing disclosure in the context of demutualisation of friendly societies incorporated after 30 June 1999.

Other applications

14 Issues have been raised as to whether members of mutual organisations should be afforded additional regulatory protection to that provided to shareholders of public companies ie in addition to Part 5

of the Law. It is important for us to note here that ASIC does not propose new law: that is the responsibility of Government on the advice of Treasury. The role and objectives of Treasury in implementing the Corporations Law amendments comprising Schedule 4 to the Corporations Law, including the Part 5 demutualisation disclosure regime, are outlined in the Explanatory Memorandum to the Financial Sector Reform (Amendments and Transitional Provisions) Act (No.1) 1999.

How we propose to apply the mutuality principles

15 Companies should note that the demutualisation regime triggers in Clause 29 are sufficiently low that any variation of members rights or any share issue requiring member approval may invoke Clause 29. In the case of non-demutualisations, where a company does not wish to meet the disclosure regime outlined in Clause 29, an application must be made for an exemption pursuant to Clause 30.

16 An applicant company should be aware that an exemption granted under Clause 30 is an exemption from Part 5 only and that class rights provisions pursuant to Part 2F.2 may still apply.

17 Any exemption granted under Clause 30 applies only to the specific proposal for which it is granted and does not apply as a general exemption for future proposals.

Exemption under Clause 30(1)

18 An exemption will generally be granted under Clause 30(1) where a company does not substantially satisfy the mutuality principles.

19 However, an exemption will not be granted if the company has simply deviated from the mutuality principles prior to making the application, or has ceased to operate as a mutual company in the lead up to the application being made. ASIC will look at the particular structure, circumstances and history of the entity (as detailed in Clause 30(3)) to determine if the company has been operating as it if were a mutual and in this case ASIC may treat the application for relief as an application under Clause 30(2) and may provide relief from some but not all of the disclosure requirements of Part 5.

Exemption under Clause 30(2)

20 Where an application is made for exemption under Clause 30(2), ASIC must consider whether the modification of the applicant's constitution or a proposed share issue will result in a modification of the mutual structure of the company.

21 We will consider both the principles of mutuality and the particular history and circumstances of the company to establish the impact of a proposal on the mutual structure of a company. Reduced compliance with the mutuality principles after the proposal, is likely to result in an exemption not being granted under the terms of Clause 30(2).

22 If the proposal is considered by ASIC to enhance mutuality, or diminish mutuality in a very minor respect, an unconditional exemption will be granted. We will assess this type of modification on a case by case basis. Where a proposal will diminish mutuality, but not materially, only partial relief from Part 5 requirements maybe granted. Conditions of an exemption granted for a specific proposal may include restrictions on future proposals of the same or a similar type, eg on a proposal for a share issue each subsequent issue may require member approval.

Clause 30(2)(b)

23 ASIC acknowledges that there is potential for companies to distribute surplus to members while it is a going concern. Whilst we consider it is possible to do this without affecting the mutual structure of an entity, if the proposal encompasses an issue of shares to either member or non-member investor shareholders, there is potential for the proposal to convert the company to one with a dominant purpose of yielding a return to shareholders. If the proposal has the potential to distribute surplus to non members or to investor members only, at a cost to mutual members, ASIC may determine not to grant an exemption. Of course, this does not mean that the proposal cannot go ahead. It just means that full disclosure must be made when member approval is sought.

24 In some cases where member approval is sought to enable a share issue to proceed, we may impose conditions on the exemption to ensure that a dividend mechanism, or any other mechanism that has the potential to reduce mutuality, does not alter the company's dominant purpose.

Implications of Clause 30(4) — "dominant" purpose

25 Mutuality fundamentally involves a commonality of interest between an entity's owners and customers. The Courts have held that there are two characteristics which are usually found in a mutual organisation: effectively, that every member must have a voice in the administration of the association and any surplus must ultimately come back to the members (see *Faulconbridge v National Employers Mutual General Assurance Association Ltd* [1952] 1 Lloyd's List Law Reports 17 at 27, 35 referred to with approval in *Re: NRMA* 33 ACSR 595 at 631). At its simplest, a mutual company does not have any purely investor shareholders, and so management are not subject to competing claims (eg raising prices to maximise profits versus running a service to members or payment of dividends versus subsidisation of product related expenses).

26 When considering a proposed constitutional modification or share issue, ASIC assesses whether the proposal would result in the company being run for the purpose of yielding a return to shareholders (see clause 30(4)). To this end, ASIC analyses the relationship between the company and its members by reference to the economic relationship test and the governance relationship test, both of which contain a number of limbs.

27 In recognition of the fact that some mutual companies have, or will seek to have, a mixture of ordinary members and investor shareholder members, ASIC will apply this purpose test to mean "dominant" purpose. A company may seek to yield a return to shareholders and remain a mutual, provided that such a return to shareholders does not become the dominant purpose. The principles of mutuality will be considered in arriving at a determination as to what a company's dominant purpose it. For example, if a company substantially meets both the governance and ecomonic

relationship tests, it is likely that the company has a dominant purpose to provide services to members, and not a dominant purpose of yielding a return to investor shareholders.

When we will treat a company as having a mutual structure

28 We consider that the proposed economic relationship test and governance relationship test encapsulate the fundamentals of a mutual structure, but are not inflexible in their application. We consider that flexibility is appropriate to recognise the various types of "mutual" structures that currently exist.

29 Where a company does not meet each of the limbs of the economic relationship test and governance relationship test, we will consider the company's particular structure, circumstances and history to consider whether in the light of these the company should nevertheless be regarded as having a mutual structure.

30 We propose to omit from our final policy the principle from Interim Policy Statement 147 that customers must be members.

31 Given the varying degrees of adherence to this principle in the current mutual environment and the need to maximise flexibility across all transferring financial institution industries, we consider it more appropriate to remove this principle as a fundamental of mutuality.

Economic relationship test

32 The members of a mutual should have first claim on the company's undistributed surplus in the event of a winding up, as the surpluses were usually built up as a result of business with the members over a number of years. We recognise that the members at the time of a distribution may not be the same members whose business produced the surplus, but we understand that it is consistent with industry practices, the prior regulatory regime and practical considerations (for example, it was almost impossible to track down all previous members) to permit existing members to enjoy a windfall distribution in the event of a winding up. Investor shareholders whose business has not (historically) created the surpluses and who become members or solely investors on a promise of a different kind of return should arguably not benefit at a cost to the truly mutual members.

33 Similar logic should also be applied to the distribution of surplus whilst the company is a going concern.

34 We recognise the need for mutuals to raise capital to compete in the current financial environment, and also recognise the need for capital injection to be rewarded by access to the distributable surplus of a mutual.

35 However, unrestricted returns on dividends may result in a company's dominant purpose changing to that of yielding a return to shareholders, and so result in the company ceasing to have a mutual structure. ASIC recognises that it is possible for a mutual to pay dividends to a limited

number of investor members, provided that the effect of such payment is not to convert the company into one run for the purpose of providing a return to shareholders or running the company in a manner that results in the deliberate distribution of reserves to investor shareholders to the potential detriment of mutual members.

36 To avoid the effect of a company converting to one run for the dominant purpose of providing a return to shareholders, the returns available to shareholders in a mutual company are restricted. Returns on investor shares must be limited by reference to an appropriate external benchmark or mechanism, or total no more than a fixed percentage of the company's current year profit after tax. Members must approve in general meeting the method for determining returns to shareholders, and the return must be restricted in accordance with the limitations set out in the proposal.

37 If the rate of return is not fixed or restricted, the share issue is unlikely to be consistent with mutuality. If dividends are unrestricted and determined and payable at the discretion of directors, the focus of the company turns to one of yielding a return to shareholders. To ensure adequate interest in the market to take up a share issue, and in turn provide a company with capital, directors will be pressed to exercise their discretion to declare dividends over and above those that would be payable under a restricted method of return.

38 Where a share instrument carries a right to a fixed or restricted rate of return only (where that method of return has been approved by members) the instrument is consistent with the notion of mutuality.

39 If the member governance aspect of mutuality is satisfied by members approving the method of return prior to the issue, and the directors are required to declare dividends within the parameters set by the members, there is arguably no role for further member approval of the dividend payment.

40 In recognition that mutuals may need to raise capital through share issues (albeit restricted) we propose to omit from our final policy the principle from Interim Policy Statement 147 which says only customer members can hold investor shares.

Governance relationship test

41 All members should have a say in the governance of the organisation. While one member one vote is the most obvious method of fair member participation, the history of collegiate voting illustrates that a system of proportional representation can co-exist with mutuality or at the least need not detract from mutuality. In this policy, we have taken steps to accommodate collegiate voting as we understand it to operate.

42 Some companies are interested in amending their constitutions to include membership qualifications. Where membership qualifications are imposed by a company's constitution, any person who fails to meet the membership criteria would be unable to vote. In these circumstances classes of members based upon voting rights may be created and the one member one vote principle may not be met. For this reason we have reworded the "one member one vote" appearing in [IPS 147], to read "fully qualified members each have one vote".

43 The treatment of minors, who are excluded from voting for reasons outside of membership qualifications, should be differentiated from disqualified members where the disqualification results from failure to meet the membership qualifications. In particular, minors should not be prejudiced when a company gives consideration to member participation in a distribution of surplus upon a wind-up.

44 Mutuals should exercise caution in setting membership qualifications to make sure that member qualifications do not effectively:

(a) advantage a minority;

(b) frustrate member sovereignty; or

(c) trigger the class rights provisions of the Law.

45 We would expect no more than a small percentage of members to be excluded as a result of membership/voting qualifications.

46 Membership and voting qualifications based on time periods and minimal balances (if allowed) must be reasonable. Minimal balances should not exceed a reasonable dollar amount taking into account the balances of the majority of customer members and the qualification periods should not be excessive having regard to customer member turnaround.

47 A mutual seeking to introduce these requirements into its constitution may trigger Part 5 and may wish to apply for exemption under Clause 30. An application for exemption will not automatically be granted but rather will be considered on its merits. In some cases high-threshold membership qualifications, ie that result in disenfranchisment of a large percentage of members, will diminish mutuality rather than serve to enhance it.

48 If investor shares vest voting rights in the investor shareholder, the shares must not vest any greater control over the governance of the mutual, than a member would have, ie one member one vote must apply and proportional voting rights attaching to the level of shareholding would not be permitted.

49 Members who are members by virtue of purchasing a member share or giving a guarantee, and in addition have purchased investor shares, should still have only one vote.

50 We acknowledge that there will be members who are members in their own right, but who are also part of a joint membership and/or are a representative of another member or hold a proxy. In this circumstance the member will be entitled to one vote attributable to their own membership plus one vote for each of the joint membership and/or as a representative.

Regulatory and financial impact

1. PROBLEM

The Financial Sector Reform (Amendments and Transitional Provisions) Act No.1 1999 amended the Corporations Law to include, inter alia, a new demutualisation regime. The thresholds that trigger this demutualisation regime are quite low and in many cases a company will trigger Part 5, with no intention to demutualise. In these cases it is necessary for a company to apply for an exemption, under Clause 30 of the Law, from the Part 5 demutualisation regime. In order to grant an exemption from Part 5, ASIC must have regard to whether a company is a mutual, and if so whether a proposal under Part 5 would affect the company's mutual structure. Clause 30(3) and (4) of Part 5 of the Law are indicators as to what constitutes mutuality, but are not determinative.

In addition, determining a concept of mutuality is necessary because:

(a) there is no statutory definition of mutuality for use in this context;

(b) the scope of the demutualisation regime will require determination of numerous exemption applications which requires a uniform approach to mutuality; and

(c) supervising the mandatory constitutional amendments requires some guide as to mutuality; and

(d) Transfer of Business applications submitted by mutual organisations, where the application may, either intentionally or inadvertently, result in a demutualisation will require guidance as to mutuality. Here, ASIC plays an advisory role to APRA in approving the transfer, eg appropriate disclosure to affected members. ASIC may suggest that a transfer should require disclosure under the demutualisation regime, or other actions by way of a Section 20 statement under the Financial Sector (Transfer of Business) Act 1999.

2. REGULATORY OBJECTIVE

ASIC is seeking to ensure that there is in place a mutuality policy which enables a uniform approach to be taken by ASIC in assessing applications:

1. for exemption under Clause 30 of the Law from the demutualisation regime set out in Part 5 of the Law. Clause 30 provides for exemption to be given where a company's proposed modification of its constitution or a share issue will not result in a modification of the company's mutual status. ASIC interprets this to mean a modification which results in a lessening of the company's mutual status;

2. under Section 63 of the Banking Act, which is proposed to mirror, as far as possible, the Part 5 demutualisation regime, but which will cover only authorised deposit taking institution demutualisations, where the ADI was incorporated after 30 June 1999;

3. for Transfers of Business involving at least one mutual.

APRA may also use this policy in determining applications pursuant to Section 66 of the Banking Act. Section 66 of the Banking Act requires a company to apply to APRA for consent to use a restricted name, including "credit union" and "credit society". APRA's guidelines state that a company will only be permitted to use the words "credit union" and "credit society" where the company is a mutual.

3. OPTIONS

1. Not to develop a mutuality policy and rely on past practices.

2. To develop a framework built around principles of mutuality (that represent the key characteristics of mutuality) to guide potential applicants and ASIC operational staff in the exercise of discretionary powers to grant exemptions.

It is proposed that there will be some flexibility attaching to these principles, and consequently we do not believe that any further options need be considered.

4. COST/BENEFIT OF EACH OPTION

Impact Group Identification

A. Financial Institutions

B. ASIC (and possibly APRA)

C. Members

D. Professional Advisers

E. Industry Associations

Option 1 - Doing Nothing

A. Financial Institutions

Benefit

- Companies are not tied to any principles, which allows maximum flexibility and innovation
- Companies have the ability to retain a claimed "mutual" status in the policy vacuum ie companies which exhibit a non-mutual structure (having regard to the broad notion of mutuality) may still call themselves mutuals
- Companies are not fettered in making an application for exemption from Part 5 to ASIC

Cost

- This option would create additional expense for industry given the uncertain application of the regulatory regime (ie having to cover all bases)
- Lack of awareness of issues
- Industry has no indication as to ASIC's line of thinking
- Industry may be tempted to rely on past regulatory or industry association policy, which may not prove accurate in the current environment
- Industry runs the risk of incurring penalties or sanctions if the choices they make are seen by ASIC as contravening the Law

B. ASIC (and possibly APRA)

Benefit

- Maximum flexibility in exercising discretionary powers

- Initial resource saving in not developing a policy
- Avoidance of criticism from industry resulting from an unpopular policy

Cost

- Non-uniform application of the exemption provision in Clause 30 which may result in similar institutions being subject to different decisions and potential prejudice to members
- No certainty in operational applications
- Potential inconsistent determination of applications between ASIC and APRA.
- ASIC/APRA criticism and possibly AAT Appeals
- Additional ASIC resources would be required for case by case determinations, from scratch

C. Members

Benefit

- Provides the company with greater flexibility which may result in greater reward to the member with expanded services
- Cost saving to society (indirectly to member) by potentially not having to meet an increased disclosure regime

Cost

- There is no assurance to members that applications for exemption will be treated uniformly, which may result in an exemption form Part 5 being granted in one circumstance (resulting in lesser disclosure to members) and not in a similar circumstance. This in turn could result in prejudice to members interests where disclosure in accordance with Part 5 would have been more appropriate
- May result in a lost opportunity to control the company's decision
- May result in expensive sanctions against the company for inappropriate choices eg member complaint, loss of the company's ability to call itself a "credit union"
- Potential loss of member protection afforded by increased disclosure

D. Professional Advisers

Benefit

- There is no loss of flexibility in advising clients on mutuality and developing applications
- Potential increase in work opportunities and thereby remuneration

Cost

- Uncertainty regarding the application of ASIC's discretionary powers under Clause 30 and consequently uncertainty regarding the success of applications
- More extensive research required to address issues
- Drafting relief applications may be difficult because there are no set guidelines.

Option 2- Implementing a Mutuality Policy

A. Financial Institutions

Benefit

- Enhanced member protection. The demutualisation regime seeks to protect member interest and consistent assessment of applications for relief from having to meet this regime against a pre-determined concept of mutuality, will ensure this protection is continued
- Increase in awareness of issues
- Increase in certainty about the ASIC approach to proposals
- Reduced cost of applications for exemption
- Reduction in the likelihood of a proposal contravening the Law and attracting ASIC sanctions

Cost

- Cost of compliance with requirements of the new regulatory regime will arguably impose hardship on smaller institutions
- Loss of flexibility in determining whether a company is a mutual or not which may result in loss of ability to use the name “credit union”, and loss of the company’s mutual “status”
- Possible increase in costs by having to meet an increased disclosure regime
- Some fettering in making a case to ASIC for exemption

B. APRA/ASIC

Benefit

- Increased certainty in operations
- Reduced risk of inadvertent disparity between APRA and ASIC (if Policy adopted by APRA) decisions and consequential potential conflict between regulators
- Reduced risk of similar institutions being subject to different determinations
- Reduced possibility of members interests being prejudiced
- Less resources will need to be utilised if a systematic, uniform approach to these applications is adopted

Cost

- It may be argued that there is scope for worthy cases for exemption to fall outside the policy, but we believe that there is enough flexibility in the policy to counter this risk
- The policy is less flexible than having no guidelines at all

- Initial cost of resources to develop policy and train staff in application

C. Members

Benefit

- Protection of members' interests ie ASIC will not grant an exemption from the disclosure regime in inappropriate circumstances. The members benefit from the company having to meet a more rigorous disclosure regime
- Increased awareness of issues
- Less likelihood of the company suffering repercussions for inappropriate choices eg member complaint, penalties imposed by regulator

Cost

- Potentially higher costs to a company in complying with stricter disclosure, which means less money in members' reserves

D. Professional Advisers

Benefit

- Advisers are better able to offer guidance to clients on how to meet statutory requirements ie awareness of issues
- Increase in certainty regarding the success of an application
- Application for relief will be easier to develop
- Decreased possibility of error resulting in sanctions on client society

Cost

- Potentially less need for advisers if companies consider they are capable of making applications for exemptions themselves, using the policy as guidance
- Loss of flexibility in advising on and developing applications

E. Industry Associations

Benefit

- Increase in awareness of ASIC approach to applications
- Ability to provide more certain advice to members
- Less possibility of member complaints
- Less chance of incurring financial costs and loss of public profile from non-compliance

Cost

- Possible decrease in member dependence
- Possible loss of control over the "mutuality" concept where the ASIC approach varies from the industry association approach

Full consultation with industry and key stakeholders will give us insight into the complete cost/ benefit analysis of the proposal. ASIC would be interested to receive specific information from industry on the costs of compliance with Part 5 and in particular whether there are considered to be more efficient and less costly models for implementing a mutuality regime, than that proposed in this policy paper.

5. PREFERRED OPTION

Option 2 (and specifically the policy proposals set out in this paper) has been preferred because:

(a) After research and consultation, we believe the concept of mutuality focuses on the economic and governance aspects of the mutual arrangement.

(b) There is little (if any) additional cost to companies associated with implementing the mutuality principles. The additional costs that will be incurred by a company in meeting Part 5, are imposed by legislation and are not associated with meeting the requirements of ASIC's mutuality policy.

(c) The principles have been considered both on an industry by industry basis and in terms of the concept of mutuality as a whole, and are flexible enough to accommodate variations of the mutual structure. The principles are not considered to hinder an company's potential for growth.

(d) Companies that find the mutuality principles too restrictive to proceed with certain proposals may need to consider demutualisation in order to advance in a particular direction. Failure to meet the proposed principles indicates that the company has a non-mutual structure, or is pursuing activities that do not fit within the mutual concept.

6. CONSULTATION

Limited consultation was carried out with industry associations on the existing Interim Mutuality Policy Statement [IPS147], which was issued as an interim stop-gap pending development of a permanent policy. The Interim Mutuality Policy Statement was based on the previous AFIC Prudential Standard on Credit Union Mutuality.

When [IPS 147] was implemented, both ASIC and industry acknowledged that this would be an interim policy only and that after further consideration and research on mutuality, and full consultation with industry, a permanent mutuality policy would be issued. Some of the accepted interim mutuality principles in [IPS147] have been preserved in this policy proposal.

So that we can more accurately assess the regulatory and financial impact of the policy proposals contained in this paper, we are issuing this paper and inviting comments from interested parties on any aspects of it.

We would be interested in any comments on:

(a) the likely financial impacts of our proposal as whole

(b) whether the proposed principles adequately represent the fundamentals of mutuality.

In particular we seek comment and industry views on:

- the issues for consideration highlighted alongside the policy proposals; and
- the workability of these proposed principles of mutuality in the current industry environments.

Development of policy proposal

On 1 July 1999 responsibility for the supervision of building societies, credit unions and friendly societies was transferred from the State and Territory regulators to the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). Some of ASIC and APRA's new responsibilities require them to determine when a company has a mutual structure.

In particular, ASIC must determine if a transferred financial institution has a "mutual structure" when considering whether to grant an exemption from the demutualisation provisions set out in Part 5 of Schedule 4 of the Corporations Law. There is no existing legal definition of mutuality.

Our Interim Policy Statement 147 [IPS 147], issued on 9 December 1999, introduced a concept of mutuality for interim use so that we could meet our new responsibilities.

This concept of mutuality was also adopted by APRA. As the prudential regulator of transferring financial institutions, APRA has implemented a guideline restricting the use of the words "credit union", "credit society" and "credit co-operative" to institutions with a mutual structure. To determine which companies are entitled to use these restricted words under Section 66 of the Banking Act, APRA must first determine whether a company has a mutual structure.

Both ASIC and APRA appreciate the need for consistent interpretation as to what constitutes mutuality and for this reason the mutuality guidelines in [IPS147] have also been implemented by APRA. APRA is also considering adopting the final ASIC Policy Statement on mutuality as an APRA standard, with necessary additions/modifications.

To date, we have determined a number of applications for exemption from Part 5 pursuant to Clause 30 of Schedule 4 using the mutuality framework in [IPS 147]. This has enabled us to identify the differing circumstances under whichapplications for exemptions may arise.

Key terms

In this policy proposal:

"APRA" means the Australian Prudential Regulation Authority

"ASIC" means the Australian Securities and Investments Commission

"Banking Act" means the Banking Act 1959

"company" means a financial institution as defined below

"demutualisation provisions" or "demutualisation regime" means Part 5 of Schedule 4 of the Law, specifically Clauses 29 and 31-33, and Section 63 of the Banking Act and related guidelines.

"financial institution" means a company that is:

(a) for the purposes of Part 5, an unlisted transferring financial institution (registered under Clause 3 of Schedule 4 of the Law) applying for an exemption pursuant to Clause 30 (ASIC application); or

(b) for the purposes of Section 63 of the Banking Act, an ADI incorporated after 30 June 1999 (ASIC application by delegation of the Treasurer)

"investor share" is a share in a mutual company that provides a dividend return to the investor shareholder

"investor shareholder" is either a member or non-member who holds investor shares with the company, that pay a dividend in return.

"Law" means the Corporations Law

"member" means a member for mutual purposes (but not necessarily a "member" for all purposes of the Law), ie a person who is admitted to membership under the company constitution (either by member share or guarantee) to receive benefits or services, and who has met any other membership qualifications, if relevant.

"surplus" means that part of the income of the company that is available for reinvestment into the company or for payment by way of limited dividend to investor shareholders (after operating expenses have been deducted).

"transferring financial institution" has the meaning given to it in Clause 1 of Schedule 4 to the Corporations Law.

"undistributed surplus" means that part of the income of the company that has been retained in reserve to provide for the continued operation of the company in providing services to members and meeting operational expenses.

What will happen next?

Stage 1

19 June 2000	ASIC policy proposal paper released for comment by industry and IndustryAssociations.

Stage 2

21 July 2000	Comments due on the policy proposal

Stage 3

Early August 2000	Collate comments and finalise drafting of policy statement

Stage 4

August 2000	Policy released and published

Your comments

We invite your comments on the proposals and issues for consideration in this paper.

Comments are due by Friday 21 July 2000 and should be sent to:

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Australian Securities and Investments Commission
GPO Box 5719AA
Melbourne VIC 3001
facsimile (03) 9280 3306
phone (03) 9280 3340

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

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