



ASIC

Australian Securities & Investments Commission

REPORT 369

Response to submissions on CP 210 Demutualisation approval procedure rules: Minimum member participation requirement

August 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 210 *Demutualisation approval procedure rules: Minimum member participation requirement* (CP 210) and details our responses to those issues.

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.

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- 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.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

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A Overview/Consultation process

- 1 In Consultation Paper 210 *Demutualisation approval procedure rules: Minimum member participation requirement* (CP 210), we consulted on the approach that ASIC should take when considering requests by individual credit unions to cease the effect of the requirement for 25% minimum member participation in postal ballots for proposed transactions affecting mutuality (25% minimum member participation requirement). This requirement is included in the ‘demutualisation approval procedure rules’ contained in some credit unions’ constitutions.

Note: In this report ‘credit unions’ refers to credit unions currently registered by the Australian Prudential Regulation Authority (APRA) and those previously operating as credit unions but now registered by APRA as mutual banks.
- 2 The constitutions of about 40% of credit unions currently contain some form of demutualisation approval procedure rules. About half of the rules are identical to, or substantially the same as, the demutualisation approval procedure rules prepared by the then industry association Credit Union Services Corporation (Australia) Limited. (A smaller number of those constitutions allow ASIC to cease the effect of all or some of the rules by giving a written notice to the relevant credit union.) Our current policy is to give a written notice to cease the effect of all, or any part of, such rules only where a credit union’s circumstances raise potential prudential concerns and APRA considers it necessary for a particular proposed transaction to occur expeditiously.
- 3 In CP 210, we sought feedback on whether we should:
 - (a) change our policy on when we should publish and deliver a written notice to cease the effect of the 25% minimum member participation requirement (where a credit union’s constitution gives us the power to do so); or
 - (b) impose conditions on any written notice requiring the credit union to instead comply with a lower threshold than 25% for this requirement.
- 4 This report highlights the key issues that arose out of the submissions received to CP 210 and our responses to those issues.
- 5 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 210. We have limited this report to the key issues.
- 6 Copies of non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 210.

Responses to consultation

- 7 We received four responses to CP 210: one non-confidential submission from the mutual banking industry body—the Customer Owned Banking Association—and confidential submissions from three representatives of individual credit unions. We are grateful to respondents for taking the time to send us their comments.
- 8 The main issues raised by respondents related to:
- the appropriateness of our current policy and other circumstances in which it might be appropriate to extend this policy;
 - the practical impact of the demutualisation approval procedure rules on a credit union’s ability to explore, with certainty, particular projects and initiatives that would be in the best interests of the company and its members;
 - the achievability of the 25% threshold; and
 - whether it would be appropriate to lower the 25% threshold.
- 9 Respondents were generally supportive of the requirements for member voting in the demutualisation approval procedure rules and of our existing policy. It was generally acknowledged that the rules were democratically adopted by credit union members in accordance with the terms of their constitutions and the *Corporations Act 2001* (Corporations Act) and that, therefore, any publication and delivery by ASIC of a written notice should be done cautiously and in accordance with the intended purpose of the rules.
- 10 Respondents held divergent views on the situations in which the rules were intended to apply. One response (which was made on behalf of several credit unions) considered that the rules were not intended to apply to transactions that do not in substance amount to a ‘demutualisation’ or affect the mutuality of the credit union. Other responses considered that the rules specifically apply, and were intended to apply, to a broader range of circumstances.
- 11 These responses also raised divergent views about disadvantages that would be likely to result from ASIC changing our policy to consider switching off the 25% minimum member participation requirement in these circumstances.
- 12 Respondents also held divergent views about the achievability of the 25% threshold. None of the responses supported lowering the 25% threshold (instead of switching it off entirely).

B Response to submissions on CP 210

Key points

This section outlines the key issues raised in the submissions on CP 210 and our responses to those issues. It covers feedback on whether we should:

- change our approach to publishing and delivering a written notice to cease the effect of the 25% minimum member participation requirement; or
- impose conditions on a written notice requiring a credit union to instead comply with a lower threshold.

When ASIC should change the 25% member participation requirement

- 13 In CP 210, we noted that some credit unions have suggested to ASIC that the 25% threshold for member participation for postal ballots under the demutualisation approval procedure rules is too high due to disengagement of members in the voting process. We asked for feedback on the circumstances in which we should consider giving a notice to switch off this requirement.
- 14 The responses identified three kinds of circumstances in which the respondents considered it may be appropriate for ASIC to take this action:
- (a) transactions that do not in substance amount to a demutualisation of the credit union;
 - (b) transactions that do not significantly change the identity, character, nature and business of the credit union; and
 - (c) transactions where the rules are triggered due to a credit union having adopted ‘mutual bank’ status.

Transactions that do not in substance amount to a ‘demutualisation’

- 15 One response supported ASIC giving a notice to switch off the 25% minimum member participation requirement for a proposed transaction that would not in substance amount to a demutualisation, based on whether the company would continue to meet the ‘governance relationship’ and ‘economic relationship’ tests in Regulatory Guide 147 *Mutuality: Financial institutions* (RG 147).
- 16 Other respondents opposed ASIC taking any action to switch off the requirement in these circumstances. These respondents noted the following:
- (a) Credit unions and their members have previously adopted their own interpretation of ‘mutuality’, and elements that are important to that

concept. For ASIC to cease the effect of any part of the demutualisation approval procedure rules in such circumstances would involve ASIC imposing its own interpretation of mutuality and deciding what factors are important to mutuality in place of those approved by members.

- (b) The rules were intended to include a relatively comprehensive list of triggers that extend to various forms of corporate restructures, and not only demutualisations.

- 17 The responses noted that the demutualisation approval procedure rules impose additional and supplementary procedures to the obligations in the Corporations Act that apply to demutualisation proposals. While one respondent suggested disclosure sent to members when the rules were adopted may not have sufficiently explained that they would apply beyond transactions that were in substance demutualisations, another submitted that the disclosure sufficiently highlighted the prescriptive nature of the rules.

Transactions that do not involve a significant change to the credit union

- 18 One response noted that the 25% minimum member participation requirement is an appropriate threshold for restructure proposals that involve fundamental changes to the credit union. However, the respondent supported ASIC consideration to switch off this requirement where a proposed transaction will not significantly change the identity, character, nature or business of the credit union.
- 19 Examples of circumstances provided by this respondent included where there would be a clear benefit to the company's members and where there would not be any impact on members' rights (such as access to reserves and voting entitlements). It was noted that ASIC would need to consult with the mutual banking industry body when determining whether a proposal would significantly change the identity, character, nature or business of the credit union.
- 20 In these circumstances, the respondent considered that it may be appropriate for ASIC to consider giving a notice to switch off the 25% minimum member participation requirement in the interest of members (i.e. to avoid unnecessary expenditure of member funds).

Transactions where the rules are triggered due to a credit union having adopted 'mutual bank' status

- 21 Two responses noted that the demutualisation approval procedure rules may apply to transactions that involve credit unions that have received consent from APRA under the *Banking Act 1959* to adopt 'mutual bank' status. These responses submit that the application of the rules in these circumstances was neither foreseen nor intended.

- 22 The demutualisation approval procedure rules may apply in these circumstances because a condition imposed by APRA on the adoption of mutual bank status is that the credit union is no longer permitted to use the term ‘credit union’ in its name. The demutualisation approval procedure rules may be triggered for a proposed restructure where the successor to the credit union’s business is not entitled to use the words ‘credit union’ in its name, and so may apply where the restructure involves a mutual bank.
- 23 The responses noted that APRA’s policy on the adoption of mutual bank status was implemented after the rules currently in place in many constitutions were drafted, and accordingly this situation was not contemplated at the time those provisions were approved by members.

Achievability of the 25% threshold

- 24 In CP 210, we noted that a small number of credit unions had on previous occasions suggested to ASIC that the 25% minimum member participation requirement may be difficult to achieve due to low levels of member participation in resolutions on the general business of credit unions and that this may give rise to uncertainty and disincentives for credit union management to incur the costs of proposing transactions to their members.
- 25 However, we also noted that the industry representatives responsible for developing the demutualisation approval procedure rules were conscious of the need to set participation requirements at low enough levels to avoid making governance decisions by interested members impossible.
- 26 One response (made on behalf of several credit unions) provided examples indicating typically low member participation in decisions by members of those credit unions on matters such as mergers with other credit unions and director elections.
- 27 Two responses submitted that caution should be taken in comparing levels of member participation in the general business of credit unions with decisions that would fundamentally change the nature of the credit union. These respondents considered that the 25% threshold is demonstrably achievable, and referred to a number of matters in which this level of participation had been achieved.
- 28 One of the responses also noted that it is the responsibility of the board of the credit union to explain to members the nature of a proposed transaction, and its effect. This respondent raised a concern that if the 25% minimum member participation requirement is switched off by ASIC, it may suggest that the proposal does not warrant member engagement.

Certainty and flexibility for credit unions

- 29 In CP 210, we asked for feedback on the benefits that would result from switching off the 25% minimum member participation requirement.
- 30 One response noted that compliance with the demutualisation approval procedure rules involves considerable costs in conducting the postal ballot, public relations campaign and the commissioning of an independent expert's report. It noted that the board of a credit union may be less prepared to incur these costs where there is significant uncertainty about whether there will be sufficient member participation in the postal ballot. This respondent submitted that switching off the 25% minimum member participation requirement would reduce this uncertainty.
- 31 This respondent also submitted that public interest requires a balance to be struck between the rights of companies to democratically impose restrictions on their own operation (through the demutualisation approval procedure rules) and the general standards of corporate governance. The respondent observed that flexibility in decision-making is becoming increasingly important, noting that the mutual industry has recently seen significant consolidation and pursuit of alternative strategies and opportunities. It submitted that such alternatives are generally aimed at enriching and preserving the mutual business model, and that application of the 25% minimum member participation requirement may prevent projects and initiatives that benefit the company and its members.
- 32 Another respondent noted that switching off the 25% minimum member participation requirement would result in an easier path for credit unions with the demutualisation approval procedure rules to introduce beneficial changes to their branding, structure or alliances within the mutual authorised deposit-taking institution (ADI) sector.

Risks for members

- 33 In CP 210, we expressed our concerns about intervening in the application of the terms of a credit union's constitution where members have previously agreed to those terms. While members would still have the protection of a two-step approval process for decisions of considerable importance to the credit union, we noted that there may be an increased risk of enabling significant transactions to be approved by a small number of members. We asked for feedback on disadvantages that may result in switching off the 25% minimum member participation requirement.
- 34 Some respondents agreed that this is exactly the risk that credit unions have sought to diminish by adopting the demutualisation approval procedure rules. These respondents submitted that interfering with the application of these rules could undermine and devalue the members' decision to adopt them.

35 As in feedback on the achievability of the 25% threshold, one response raised a concern that intervention by ASIC to switch off this requirement could contribute to lower levels of member participation, by suggesting that a proposed transaction is not sufficiently important to warrant member engagement and enabling the board to not make the same effort to fully inform members about the proposal and its effects.

ASIC's response

We have decided that our policy should generally remain unchanged. That is, we will issue a written notice to cease the effect of all, or any part of, the demutualisation approval procedure rules only where a credit union's circumstances raise potential prudential concerns and APRA considers it necessary for a particular proposed transaction to occur expeditiously.

The responses we received have not demonstrated that there is a clear view among industry members that the 25% threshold for member participation is not achievable. The mutual banking industry body has also observed that the 25% threshold was reached in a number of instances and therefore has not proved an insurmountable barrier in every case. While the respondents agreed that there are additional costs and uncertainty of outcome as a result of this requirement, these costs were expected and intended.

The responses generally supported ASIC only taking action to switch off requirements in the rules to ensure that they do not apply in a way that was not intended. We consider that intervention to switch off the requirements in other circumstances would involve a significant risk of undermining the decision by members to adopt these additional procedural protections.

We think it is clear that the demutualisation approval procedure rules were intended to apply to a relatively comprehensive set of triggers, covering a broader range of transactions than those affecting the minimum criteria of mutuality as expressed in RG 147. Accordingly, we do not think it would be appropriate to consider switching off the 25% minimum member participation requirement for a transaction that may not constitute a 'demutualisation' (by reference to those criteria), but which otherwise involves a significant impact to the identity, character, nature or business of the credit union

We consider that it is not clear whether the rules were intended to apply to other transactions that do not significantly change the identity, character, nature or business of the credit union. While switching off the 25% minimum member participation requirement for approval of these kinds of transactions may reduce some costs and procedural uncertainty, we also consider that this involves risks for members. We would need to form a view on the nature and impact of a particular transaction and whether it would be important to members. We do not think that these risks would be sufficiently addressed by consultation with the mutual banking industry body.

On balance, we consider it is preferable for the demutualisation approval procedure rules to continue to apply in accordance with their terms, and that ASIC should not consider switching off the 25% member participation requirement where it would be necessary for ASIC to form a view on the nature and impact of the transaction on the identity, character, nature or business of the credit union, and the rights and interests of its members.

We consider that a minor change to our approach is appropriate to allow for the rules to be switched off where the only trigger for their application is the adoption of 'mutual bank' status and branding by a credit union involved in a proposed transaction. We consider that the application of the rules in this circumstance is an unintentional result of the conditions imposed by APRA on its consent for a credit union to use the term 'bank' or 'mutual bank' in its name.

Lowering the 25% threshold

- 36 None of the submissions indicated support for lowering the 25% threshold for member participation, as there would appear to be no policy justification for any other particular level of member participation.

ASIC's response

We agree with respondents that it would not be appropriate to impose conditions on any written notice to effectively lower the 25% threshold, as there appears to be no policy justification for a particular lower threshold.