



**BUSINESS COUNCIL**  
OF CO-OPERATIVES AND MUTUALS

## ASIC Consultation Paper 325: Product design and distribution obligations

Submission to Australian Securities and Investment Commission  
11 March 2020

Product Regulation  
Strategic Policy  
Australian Securities and Investments Commission  
GPO Box 9827  
Brisbane QLD 4001

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To whom it may concern,

The Business Council of Co-operatives and Mutuals (BCCM) is pleased to make this submission to ASIC in relation to Consultation Paper 325: Product design and distribution obligations.

The BCCM is the national peak body for co-operatives and mutual enterprises in Australia. It is a member driven and funded organisation representing co-operatives and mutuals in all industries and regions.

In addition to responses to the specific proposals and questions set out in the consultation paper, you have asked for comment on the likely compliance costs, the likely effect on competition and other impacts, costs and benefits of the proposed regulatory guidance.

In connection with this request, we have set out below a series of questions in relation to the application of the ASIC's proposed guidance to mutual capital instruments (MCIs).

## Background

By way of background, provisions for the issuance of MCIs were introduced into the *Corporations Act 2001 (Cth) (Corporations Act)* as part of the reforms made in the *Treasury Laws Amendment (Mutual Reforms) Act 2019 (Cth) (Mutual Reforms Act)*, which commenced on 6 April 2019.

In summary, the Mutual Reforms Act:

- introduced a definition of “mutual entity”, now set out in section 51M of the Corporations Act;
- enabled certain mutual entities to amend their constitutions to provide for the issuance of MCIs;
- significantly amended the demutualisations provisions in Part 5 of Schedule 4 to the Corporations Act; and
- made certain consequential amendments (e.g. with respect to tax treatment, shareholding laws, share capital reductions, share capital buy-back provisions and companies limited by guarantee).

These reforms implemented recommendations 5, 7, 8 and 9 in the Independent Facilitator Review Report on Reforms for Cooperatives, Mutuals and Member-owned Firms (**Hammond Review**) which inquired into the barriers that mutual entities face in being able to compete,

and followed the earlier Senate Economics References Committee report on Cooperative, mutual and member-owned firms.

The recommendations in the Hammond Review are aimed at improving access to capital, removing uncertainties faced by co-operatives and mutuals, and removing or reducing other barriers to capital raising, in order to enable co-operatives and mutuals to invest, innovate, grow and compete. A key challenge faced by mutual entities in raising capital, identified in the Hammond Review, was their lack of access to the sources of capital that non-mutual companies can access by issuing ordinary shares.

To address this barrier to competition between mutual entities and non-mutual companies, the package of reforms in the Mutual Reforms Act was passed to “provide the mutual sector with greater certainty and confidence to be able to raise capital without the risk of demutualisation”.<sup>1</sup>

As further set out in the Explanatory Memorandum to the Bill:

*“Cooperatives and mutuals have historically been constrained in their flexibility and speed of growth as they have only been able to raise capital through retained earnings rather than issuing securities to investors. The amendments in the Bill to allow mutuals to raise equity capital removes a significant barrier to investment, innovation, growth and competition in the sector and provides mutuals with access to a broader range of capital raising and investment options.”<sup>2</sup>*

In doing so, the Mutual Reforms Act sets out a facilitative regime for the issuance of MCIs. In summary, the requirements for MCIs are:

- the issuer must meet the definition of “mutual entity” in section 51M of the Corporations Act;<sup>3</sup>
- the issuer must be able to meet the requirements of the definition of “MCI mutual entity” on issuance of one or more MCIs;<sup>4</sup>
- an MCI may only be issued as a fully paid share;
- dividends in respect of MCIs must be non-cumulative;
- the issuer’s constitution must set out the rights attached to the MCI with respect to participation in surplus assets and profits; and
- rights attached to an MCI may only be varied or cancelled by special resolution and either by special resolution passed at a meeting of the class of members holding shares in the same class or with the written consent of members with at least 75% of the votes in the class.

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<sup>1</sup> Explanatory Memorandum to the Treasury Laws Amendment (Mutual Reforms) Bill 2019 (Cth), [1.12].

<sup>2</sup> Ibid., [1.11].

<sup>3</sup> In summary, a company is a mutual entity if: (a) the company is registered under the Corporations Act; and (b) the company’s constitution provides that a person has no more than one vote at a general meeting of the company for each capacity in which the person is a member of the company.

<sup>4</sup> For example, it must be a public company which is not a registered entity within the meaning of the *Australian Charities and Not-for-profits Commission Act 2012 (Cth)* and which does not have any voting shares, other than MCIs, quoted on a prescribed financial market. The mutual entity must also have made certain amendments to its constitution.

A number of our members have commenced preparing for potential future issuances of MCIs. Several members have already amended their constitutions to provide for potential issuance of MCIs, while others are considering doing so at their annual general meetings this year or next, before the expiry of the “special procedure” for MCI amendment resolutions under the Mutual Reforms Act on 6 April 2022.

ASIC’s consultation is therefore particularly timely with respect to potential issuances of MCIs.

### Questions arising from the proposals and questions set out in the CP325

The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 (Cth) (Act)* and the *Corporations Amendment (Design and Distribution Obligations) Regulations 2019 (Cth)* include certain exemptions in respect of the obligation to prepare a target market determination.

For example, as noted in the consultation paper, subject to certain avoidance provisions, section 994B(3)(d) of the Act provides that a target market determination is not required in respect of a fully paid ordinary share in a company (including a foreign company) issued to a retail client.

However, as noted in the consultation paper, “ordinary share” is not defined in the Corporations Act and the Revised Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 (Cth) (**Revised Explanatory Memorandum**) states that:

*“Consistent with existing practice, ‘ordinary share’ is to take its ordinary meaning having regard to the legislative context in which it is used and the purpose of the design and distribution regime. However, the use of the term ‘ordinary share’ is intended to distinguish such shares from other types of shares, particularly preferences shares.”<sup>5</sup>*

Further, the Revised Explanatory Memorandum states at [1.29] that: “Fully paid ordinary shares are excluded as they are fundamental to corporate fundraising”.

Relevantly, we note the following:

- the Explanatory Memorandum to the Bill which introduced the Mutual Reforms Act states:

*“As a type of share, a MCI is a ‘security’ for the purposes of the Corporations Act. Accordingly, MCIs are subject to the Corporations Act regulatory regimes that would ordinarily apply to the issuance of a share issuing including fundraising and disclosure requirements”;<sup>6</sup>*

- the Explanatory Memorandum to the Bill which introduced the Mutual Reforms Act states at [1.34] that “MCIs are distinctly different to preference shares”;

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<sup>5</sup> Revised Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 (Cth), footnote 16 at [1.29].

<sup>6</sup> Explanatory Memorandum to the Treasury Laws Amendment (Mutual Reforms) Bill 2019 (Cth), [1.33].

- the MCI provisions of the Corporations Act were introduced by the Mutual Reforms Act with the express intention of providing mutual entities with greater certainty and confidence to be able to raise capital, without the risk of demutualisation, to compete with non-mutual companies;
- in accordance with the requirements of the Mutual Reforms Act, MCIs must be fully paid;
- the Explanatory Memorandum to the Bill which introduced the Mutual Reforms Act notes that the amendments set out in the Mutual Reforms Act, which provide for certain existing references to ordinary shareholders in the Corporations Act to be taken to be references to all members of the company, were included in order to ensure that non-shareholder members (i.e., members by way of guarantee of a company limited by guarantee) would be taken to be ordinary shareholders for the purposes of these provisions, where a company limited by guarantee has MCIs on issue; and
- other than the features of an MCI which are required under the Mutual Reforms Act, as listed above, the features of MCIs are generally at the discretion of the issuing mutual entity.<sup>7</sup>

In summary, we submit that MCIs have been introduced into the Corporations Act to permit mutual entities to issue shares that can serve the same purpose in the capital structure as ordinary shares in a non-mutual company.

Accordingly, we seek ASIC's guidance on the following:

1. Would ASIC accept that MCIs are "ordinary shares" for the purposes of the exemption, under section 994B(3)(d) of the Act, to the requirement to make a target market determination?
2. If ASIC's view on whether MCIs fall within the exemption for "ordinary shares" is dependent on the features of the MCI in question, what is ASIC's view on the features which an MCI would require in order for it to fall within this exemption?
3. If ASIC considers that the product design and distribution obligations apply in respect of MCIs issued to retail clients, what guidance will ASIC give as to an appropriate target market for MCIs? For example, a mutual entity may wish to offer MCIs to its members/customers. That is consistent with the member-centric and customer-centric nature of a mutual entity. The members have already accepted the risks and benefits of membership in the mutual entity. Would ASIC disagree with an assessment of target market on that basis? Is there other guidance that ASIC is prepared to give as to the factors that should be taken into account in determining a target market for MCIs?

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<sup>7</sup> Where the issuing mutual entity is an entity regulated by the Australian Prudential Regulation Authority (APRA) and the issuing mutual entity seeks the inclusion of MCIs as regulatory capital, APRA's requirements for regulatory capital under its prudential standards prescribe additional requirements. In the case of mutually-owned authorised deposit-taking institutions and their authorised non-operating holding companies, these requirements (being the requirements for "mutual equity interests") are set out in Prudential Standard APS 111, *Capital Adequacy: Measurement of Capital*: see, e.g., Attachment K to APS 111. APRA is currently consulting with respect to these requirements for private health insurers, general insurers and life companies:  
<https://www.apra.gov.au/sites/default/files/Private%20Health%20Insurance%20Capital%20Standards%20Review.pdf> at [2.4.4].

4. We would be grateful for clarification as to ASIC's view on whether a mutual entity would be required, to the extent the product design and distribution obligations apply to it, to collect, to use (in making or reviewing a target market determination or in taking reasonable steps to ensure consistency with a target market determination), or at any stage to disclose with distributors or regulated persons, data which an issuing mutual entity holds with respect to its individual members or customers, other than in their capacity as MCI holders, where those members or customers may form part of a target market or do in fact hold MCIs, whether on an aggregate basis or otherwise.

We would welcome the opportunity to discuss our submission with you.

Yours faithfully,



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