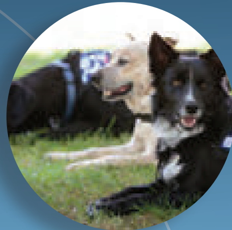

Raising New Capital in Mutuals

Removing the barriers to competition and choice

BUSINESS COUNCIL
OF CO-OPERATIVES AND MUTUALS

Front cover: This is an artists' impression of the internal courtyard within the Specialist Rehabilitation and Ambulatory Care Centre (SRACC) which is the first building to be constructed as part of the Herston Quarter Redevelopment. The image can be attributed to Hassell Architects.

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1. Executive summary

Co-operatives and mutuals are important Australian owned businesses

Co-operatives and mutuals are businesses owned by or on behalf of their customers, employees, a group of like-minded producers or a combination of these. They exist in every State and Territory of the Commonwealth. Australia has 2,000 co-operatives and mutuals and a combined membership base of more than 14.8 million.

These include some of Australia's best known brands including road side assistance organisations like NRMA, RACQ and RAC WA, a national healthcare and financial services business like Australian Unity, mutually owned banks such as Bank Australia, Defence Bank, Qudos, P&N, Teachers Mutual and Heritage, credit unions like CUA and People's Choice, and non profit health insures like HCF and RT Health. Co-operatives and mutuals are owned by Australians, pay their taxes in Australia and contribute to our nation's prosperity.

Corporate diversity matters

Among policy makers, a new awareness has emerged of the importance of spreading risk in economies by ensuring the presence of a plurality of business types. Along with listed investor owned firms and family owned enterprises and charities, co-operatives and mutuals have an important part to play in the biodiversity of our economy.

A vibrant economy requires businesses of all types to be able to compete, regardless of corporate form. This means that appropriate legislative frameworks are required that do not restrict particular types of firm from being able to access the finance capital that they need to facilitate their growth and development.

Corporate law should permit a range of capital raising options for co-operatives and mutuals

Whilst these businesses remain a strong component of the Australian economy it is clear that in an increasingly competitive global environment mutuals need to ensure they are equipped to compete in the future.

Like all businesses, co-operatives and mutuals need access to working capital to fund their growth and development.

However, the way that their capital is raised - through retained earnings - presents particular challenges to their ability to operate as flexibly as their investor-owned competitors do.

This is a function of the lack of legal options available for federally registered co-operatives and mutuals; the Corporations Act does not currently provide for them to issue securities to investors without risking their mutual status.

In many countries, mutuals do not face the same restrictions on raising capital as in Australia

Although facing the same natural limitations on raising capital as Australian mutuals, mutuals across the world raise additional capital in a variety of different ways. Some types of capital raised in Europe exhibit equity-like features and are available to institutional investors, whilst others are raised directly from members.

We can give examples of successful international businesses that have, for many years, been permitted to raise funds from their members and investing institutions, because this is permitted in the jurisdictions in which they operate.

In the UK, where similar barriers have existed to those in Australia, new legislation has been passed to enable mutuals to issue securities, which fit within the ethos, and purpose of these mutually owned businesses.

The Federal government should level the playing field for Australian mutuals

Currently, the only mention of mutuals in the Corporations Act 2001 refers to how they may be demutualised.

There is no statutory definition for a mutual in Australia: those businesses that describe themselves as mutuals do so voluntarily as an expression of their business purpose, rather than as a statement of corporate form.

As such, mutuals will typically register under Federal law as a company under the Corporations Act 2001. This means that mutuals may be a public company limited by shares, a company limited by guarantee, or a company limited by shares and guarantee.

By amending the Corporations Act to define an 'Incorporated Mutual Company,' and creating a new capital instrument for mutual businesses that currently have no permanent investment capital, the Federal Government would enable them to attract additional working capital to fuel the development of their businesses.

2. Mutuals in Australia

Co-operatives and mutuals are member based businesses owned by or on behalf of their customers, employees, a group of like-minded producers or a combination of these.

Co-operatives and mutuals are important to the prosperity of Australia. They help to create an economy and society that works in the interests of the widest number of people by sharing power in, and the rewards of, business.

Today, three out of the top ten Australian private firms in the IbisWorld Top 500, are co-operatives. Member owned businesses exist in every State and Territory of the Commonwealth. Australia has 2,000 co-operatives and mutuals and a combined membership base of more than 14.8 million.

Eight in every ten Australians are members of a co-operatively or mutually owned enterprise. These include some of Australia's best known brands including road side assistance organisations like NRMA, RACQ and RAC WA, a national healthcare and financial services business like Australian Unity, mutually owned banks such as Bank Australia, Defence Bank, Qudos, P&N, Teachers Mutual and Heritage, credit unions like CUA and People's Choice, and non profit health insures like HCF and RT Health.

Each type of co-operative and mutual is defined by its own history, legal framework and market experience. Each has responded differently to changes in the size and impact of the sector but many share common challenges.

Their purpose is to serve their members, who are also their customers, suppliers, their employees or a mixture. They do not exist to serve external capital investors, It means that they can concentrate directly on the products or services that they exist to provide, instead of the economic reward for shareholders. It is a different way of doing business – with a different purpose.

Where there is a proper alignment between the products and services and the interests of the member-owners of the co-operative or mutual, this way of doing business works well. With good management it is efficient, with no leakage of value from the business, and provides a systemic advantage over investor owned firms.

Co-operatives and mutuals are owned by Australians, pay their taxes in Australia and contribute to our nation's prosperity.

3. Capital in mutuals'

We should distinguish at the outset between the need for a strong capital base to underpin the conduct of business, and access to development capital to fund new products and services and for the expansion of the firm.

Our focus is on the latter, where mutuals are most at a disadvantage to their competitors. Their main capital base is generally strong[1] and more than adequate for their day-to-day business, reflecting their prudent attitude to business planning.

However, the way that their capital is raised - through retained earnings, presents particular challenges to their ability to operate as flexibly as their listed competitors.

Mutuals must be able to play a full part in an economy with diverse corporate ownership, without being at a disadvantage to proprietary firms.

A lack of corporate diversity both reduces competitive pressure from the operation of different business models in the same market and adds greater systemic risk to the economy. Among policy makers, a new awareness has emerged of the importance of spreading risk in economies by ensuring the presence of a plurality of business types.

A vibrant economy requires businesses of all types to be able to compete, regardless of corporate form. This means that appropriate legislative frameworks are required that do not restrict particular types of firm from being able to access the finance capital that they need to facilitate their growth and development.

There are a number of important challenges facing mutuals that arise from the way in which they currently raise capital:

A lack of capital limits mutuals growth and the ability to develop new products

Access to capital permits businesses to consider innovations into new business areas. The restricted nature of mutual ownership means that often the funds are not available for this type of development, so new products and services are more slowly developed in mutuals than in their listed competitors. As a result, new products that require the investment of working capital to develop are more difficult to fund in a mutual, further limiting their ability to offer consumers choice and competition in the market place.

Firms must be able to more easily consider tactical acquisitions

Mutuals often lack the capital to take advantage of immediate, tactical acquisitions. By helping to facilitate the growth of the business and integrate supply chains through acquisition, new capital can help mutuals to compete with proprietary counterparts.

Without new capital many mutuals could be driven into inappropriate corporate forms through demutualisation

Lack of access to capital has been used as the key justification for this corporate change. The process of demutualisation has destroyed competition and member value in these businesses.

Demutualisation means that consumers would no longer have non-listed, member-owned options in the marketplace.

Mutuals need more alternatives to debt finance

Large mutuals have successfully raised funds via bond issues in recent years. These were significantly oversubscribed, indicating there is substantial institutional interest in investing in the sector.

However, debt is of lower quality than member funds for firms wishing to build their capital base. There is inevitably a limit on the amount of debt that can, or should, be raised.

Members' contributions to capital are untapped in Australia

There are a number of examples globally where members contribute to the capital base of co-operatives in the financial services industry. Examples from Canada and The Netherlands and across the European Union show how mutuals can enlist their members in raising capital through the issuance of co-operative shares.

This investment relationship with members builds stronger mutual ties between member and institutions.

1 BCCM (2015). 2015 National Mutual Economy Report. Sydney

3.1 Some international examples of mutual capital

Although facing the same natural limitations on raising capital as Australian mutuals, mutuals across the world raise additional capital in a variety of different ways. Some types of capital raised in Europe exhibit equity-like features and are available to institutional investors, whilst others are raised directly from members.

The European co-operative banking sector is a good example of where mutual institutions raise capital from their members. Co-operative banks account for around 20% market share of EU bank deposits and loans. Finland, France, Italy, The Netherlands and Canada have market shares in excess of 20% (32.8%, 22.8%, 33.1%, 34.5% and 37.9%)[2] whilst Austria, Cyprus and Germany have co-operative banking sectors with a market share in excess of 10% for credits and deposits (16.4%, 19.9% and 18.2% respectively).

Member capital takes different forms, depending on the jurisdiction concerned, but typically, it is in the form of par value shares that can be paid a dividend out of profits.

A distinctive benefit of co-operative banks is that they contribute to overall system stability by accessing an additional source of capital via members in addition to the investor base. Traditionally, co-operatives had higher levels of Tier 1 capital than other banks, although intensive capital raising efforts by shareholder banks since the crisis has changed this picture.

Co-operatives do still raise capital through commercial markets, which is a useful additional source of capital given the challenge of increasing capital levels solely by retaining member dividends.

To illustrate how this works, we would like to focus on two specific examples: Rabobank from the Netherlands and Desjardins Group from Canada.

Rabobank

Rabobank is a co-operative bank, founded in 1972, as a result of a merger between the regional central banks of the Dutch credit union movement. It is a secondary co-operative owned by 106 local banks. These banks in turn are owned by their individual members.

It is one of the largest banking groups in the Netherlands, and among the top 30 banks in the world. It made a net profit of 2.2 billion euros in 2015, an increase of 22% compared to 2014. Its Common Equity Tier 1 ratio amounted to 13.5% and in 2015 Rabobank further strengthened its capital ratio to 23.2%. It has 1.9 million members, and has domestic market shares of 20% of mortgages, 35% of savings, and 84% of food and agribusiness[3].

Rabobank's high capitalisation has proven to be a key success factor and has been vital for its strategic development.

However, over the last couple of decades, Rabobank could no longer generate sufficient capital by retaining profits to support its expansion into new products and markets both in the Netherlands and internationally. The option of accessing shareholder investment through a stock exchange listing was not regarded as an acceptable option for obtaining additional capital.

Rabobank had to consider how to access additional capital without introducing external shareholders whilst maintaining member control. Since the 1990s, Rabobank began to issue various types of hybrid capital market instruments including the member certificate.

The member certificate is a subordinated bond without voting rights and with an undefined maturity and a yield dependent on the realization of sufficient profits for capital formation. Such a capital instrument qualifies as Common Equity Tier 1 under European regulation. At that time, Rabobank still possessed a triple A credit rating and realised that there would be a large demand for member certificates among private individuals who were members. The certificates would carry a substantial premium due to their subordinated nature, but retail customers perceived the default risk of Rabobank as very low.

Rabobank issued these member certificates to about 150,000 members. The certificates were not publicly listed but traded on an internal market maintained by Rabobank. The internal governance mechanism remained one that was based on the principle of "one member, one vote." Over time, the total amount of outstanding member certificates increased steadily to over EUR 7 billion.

2 Exhibit 22: EACB European Co-operatives' Key Statistics 2010 (averaged for credits and deposits)
3 Rabobank (2012). The development of Rabobank.

In December 2013, Rabobank made these certificates available to external investors, institutional investors could now buy these certificates. Since January 2014, these certificates have been listed as Rabobank Certificates on Euronext Amsterdam and still count as core Tier 1 capital without voting rights.

In January 2014, Rabobank's CET1 amounted to EUR 31 billion, of which the Rabobank certificates constituted EUR 6 billion, a substantial part after the largest portion which was retained earnings. The outstanding amount of Additional Tier 1 was EUR 8 billion and that of Tier 2 instruments EUR 12 billion. Hence the total capital of Rabobank was EUR 51 billion, equivalent to a capital ratio of 21.3%, with a CET1 ratio of 13.6%. This was well beyond the required regulatory minimum thresholds of 8.0% and 4.5 % respectively.

The Desjardins Group (Mouvement des caisses Desjardins)

Founded in 1900, The Desjardins Group is now the largest association of credit unions in North America. It is a federation of 376 local Caisses populaires Desjardins, which serve 5.8 million members and has total assets of C$196 billion (As at 31 December 2012).

It undertakes a full range of financial services business, including current accounts, insurance, investment banking, business banking and related services. Desjardins is one of the best-capitalised financial institutions in North America with a total capital ratio of 17.2%[4]. It has a Tier 1a Capital Ratio of 16.0%.

Over the years, Desjardins has had differing types of capital stock, with members investing since 1900.

A new kind of share the 'F' share (federation share) designed to be Tier 1 under Basel III was launched in June 2012. Shares are issued through local caisses. Holders cannot redeem the shares but there is a closed stock exchange, and people are confident they can be traded with other members.

These kinds of shares have worked well for Desjardins - even during the financial crisis very few people asked for them back. For the next period, Desjardins will offer C$200m - C$300m a year to replace old stock[5]. These kinds of shares have worked well for Desjardins, with 'F' shares becoming the norm for Desjardins with new shares distributed to repay old offerings.

These instruments have been a highly successful way for Desjardins to raise capital with more than C$4 billion issued since 2012. They make clear to potential investors that – as with any investment - 'F' shares carry risk as they are loss absorbing. They issue a prospectus, and make clear that this product is not for everybody. The shares can be attractive for small businesses too.

Typically, purchasers do not usually consult a financial advisor. When the shares are bought the seller points out that this is not a deposit, that there could be no yield one year. However, institutional investors are not invited to purchase shares.

Typically individual investors hold a few thousand dollars each.

Desjardins formulated the 'F' share to meet Basel requirements. This is outlined as follows:

F Capital shares (since 2012):

- Issued by the Federation (unlimited number)
- Par value of $10, with medium risk level
- Can be repurchased by the trust fund when the member wishes to dispose of them
- Minimum deposit of $100
- May be issued to members of Desjardins caisses in Quebec, including auxiliary members
- The rate is voted on each year according to the Federation's policy
- Not covered by deposit insurance
- Buying and selling by the trust fund: An owner can ask the Federation to buy his/her shares to sell them to another member. The Federation is under no obligation to accept in order to ensure a supply-demand balance.

4 Desjardins Group (2015). 2015 Annual Report. Québec
5 Presentation to Mutuo, 2013

More on F Shares:

- May 1, 2012: the Federation obtained venture reporting issuer status from the Autorité des marchés financiers (AMF)
- The Federation has the right, by resolution of the Board of Directors and with the authorisation of the AMF, to unilaterally redeem F capital shares at any time
- The Federation may purchase F capital shares by private agreement with the authorisation of the AMF
- These capital shares, currently included in Tier 1 capital under Basel II, meet the upcoming capital regulatory requirements (Basel III) as Tier 1a capital
- In case of liquidation, no redemption unless each caisse meets regulatory minimal capitalisation requirements

The objective of the Federation shares is to reinforce financial stability by helping to meet new capital requirements, ensure that Desjardins remains among the best capitalised financial institutions within the industry, diversify capital sources and to engage members to participate in the capitalisation of the Desjardins Group.

3.2 Maintaining the integrity of mutual ownership

The key definition of a mutual, or any business for that matter, is related to the purpose of the organisation. For whom does it exist and whom does it serve? In making any alterations to the capital base of a mutual, there needs to be a way for external capital to co-exist with the fundamental owners - co-operative stakeholders.

By introducing a new investor share into mutuals, it is also important to install legally enforceable safeguards for those mutuals, to ensure that their core purpose of business is not perverted by a new class of shareholder, or that they risk demutualisation. Such provisions already exist in other legal jurisdictions, where similar shares are already in use.

Investment from participating members is commonplace in many mutuals and co-ops. It is less typical to see external investors whose main interest is in a financial return from their capital. For co-operative purists, any introduction of external capital is potentially problematic as it introduces new stakeholders with different motives to the existing membership of the business.

It is easy to see how the interests of investors – which we can expect to want to maximise the return on their investment – can potentially skew the longer-term purpose of a mutual organisation serving its members. This can happen if investors receive a greater say than the individual members or a larger share of the operating profits. It is sometimes argued that this risk makes investor capital fundamentally incompatible with mutual philosophy and business models. But this does not need to be so.

In designing any new instrument, it is important to ensure that these principles are respected. The features of the mutuals' capital instrument govern the relationship between investors and the mutual, and we believe that investor capital may be welcomed if these principles are respected in any measures enacted.

Mutuals' Capital Instruments – key features to protect the integrity of the mutual purpose, avoid demutualisation and to retain member control

- New securities are permanent
- They may confer membership on the holders
- They could be owned by individuals or institutions
- Yet no member would have more than one vote as a result of holding the shares
- Investing members that did not trade with the business would be excluded from any member votes related to mergers or dissolution

The fact that member investment is common in many co-operatives suggests that there should be room for innovation in this area.

For example, co-operative banks in Germany (Volksbanken) raise capital from member investments. Desjardins Group in Canada, one of the most successful credit union groups in the world, routinely offers co-operative shares to its members. We can also look at examples of mutuals sharing ownership for part of their business with investors, such as Credit Agricole[6] where part of the business is listed on the stock market.

Different stakeholder types may coexist in a mutual so long as the principal members, for whom the original business purpose was designed, retain ultimate control.

In practice this is the day to day reality in most mutual businesses, where corporate debt finance means that banks and bond holders will be important stakeholders, each capable of influencing the business in order to protect their interests[7]. In such cases, new levels of sophistication are developed by mutual businesses in order to manage any potential conflicts while remaining true to the purpose of the business.

The justification for taking the step of permitting investor membership therefore requires one to take a pragmatic view of mutual ownership that recognises the challenges faced by businesses and the importance of flexible structures that facilitate the continuing growth of all types of firms.

6 The Guardian . 2015. Can co-ops compete ... in capital?. [ONLINE] Available at: http://www.theguardian.com/social-enterprise-network/2014/mar/18/can-coops-compete-capital-investors. [Accessed 4 May 2016].
7 The co-operative bank. 2015. Governance. [ONLINE] Available at: http://www.co-operativebank.co.uk/aboutus/governance. [Accessed 4 May 2016].

4. New capital instruments for mutuals – the UK experience

In the UK, as in Australia, mutuals have faced the inherent 'capital conundrum' that means they have not had the tools to raise investment capital without jeopardising their mutual status. They exist to serve their members, and demutualisation would mean abandoning their core business purpose.

This led mutuals in the UK to consider innovative ways to tackle the natural barriers to growing their working capital base. In the financial services sector, savings and loans mutuals, building societies, insurance mutuals, and friendly societies have each developed new capital instruments that have particular features suited to a mutual organisation.

Building societies have developed 'core capital deferred shares' and mutual insurers have designed 'mutuals deferred shares.' In each example, specific rights are attached to the shares, which themselves are equity-like and fully loss absorbing. New legislation was required in the UK to permit the issuance of these new securities, which in design, drew upon the experience of mutuals in other parts of the world.

Core Capital Deferred Shares (CCDS) - The example of Nationwide Building Society

Core Capital Deferred Shares (CCDS) are a new form of Common Equity Tier 1 (CET1) capital instrument consistent with the mutual ethos which support Nationwide's regulatory capital requirements.

Historically, Nationwide's Core Tier 1 capital base has been comprised of retained earnings, which were supplemented from time to time through the issuance of Permanent Interest Bearing Shares (PIBS) and Subordinated Debt.

These instruments no longer meet regulatory requirements and will gradually be phased out under the grandfathering regime introduced by CRD IV.

CCDS have been developed in response to the need to have sufficient flexibility to raise capital in the ever changing regulatory landscape. The UK Prudential Regulatory Authority (PRA) and the European Banking Authority have confirmed that they have no objection to CCDS qualifying as capital under CRD IV / CRR. Importantly, CCDS work in the same way as shares but the rights are limited, as there is only one vote regardless of how many CCDS an investor buys and the dividend is capped - this ensures that Nationwide's mutuality is safeguarded.

CCDS are the most junior-ranking investment in the Society and Nationwide outlined in its prospectus that investors would sit behind all other depositors or creditors. It said: "In the event of an insolvent winding-up or dissolution of the Society, an investor in CCDS would lose the entire amount of its investment and, even on a solvent winding-up or dissolution; an investor may recover none or only some of its investment."

The Society issued 5,500,000 CCDS on 6 December 2013 raising £500m from City investors with a coupon of 10.25 per cent. Nationwide says that its entirely new class of shares could provide a new model for building society funding.

Mutual insurers and friendly societies – Mutuals deferred shares

In March 2015, the UK Parliament approved landmark legislation for friendly societies and mutual insurers to permit them to issue 'Mutual Deferred Shares' for the first time.

These financial services mutuals conduct insurance and savings business in the interest of their members, but they currently have no share capital.

They raise working capital through retained earnings over time and some issue debt in the form of bonds. In a business environment that expects minimum levels of capital adequacy and liquidity, this means that such member owned firms are at a disadvantage to their stock market listed competitors, which have separate investor share capital.

Mutual deferred shares will enable both individuals and institutions to invest in mutual businesses, providing new funds for:

- Tactical acquisition and growth strategies
- Innovation in new investment areas
- Developing new relationships with members
- New product development
- Alternative strategies to demutualisation

The Mutuals' Deferred Shares Act 2015 deals with the challenge of how to raise additional external capital in a co-operatively owned business, whilst maintaining its core mutual purpose of providing the best service and quality for the member owners.

It complements changes made to Building Societies legislation in 2013, to enable similar shares to be offered to institutional investors.

The legislation ensures that:

- Mutual deferred shares are permanent
- They confer membership on the holders
- Institutional investors may now become members of these firms
- No member would have more than one vote as a result of holding the shares
- Investing members that did not trade with the business would be excluded from any member votes related to mergers or dissolution

In addition, it has been agreed with UK Regulators that deferred shares will qualify as tier one (highest quality loss absorbing) capital in the regulatory assessment of the strength of these financial institutions.

HM Treasury and Regulators are currently drafting the regulations that will govern the first share issuance, expected in 2016/17.

5. Towards an Australian solution – Mutuals' Capital Instruments

In Australia there is a great opportunity to grow the co-operative and mutual sector. As in all business sectors, however, access to working capital is a key requirement for the development of new products and services.

Australian mutuals are hampered in this regards, with less access to capital than their investor-owned competitors. This is because they have to use legislation that has not been designed to facilitate the mutual purpose of their business.

Unlike in other parts of the world where mutuals have their own separate legislative framework, Australian mutuals typically register under Federal law as a company under the Corporations Act 2001. This means that mutuals may be a public company limited by shares, a company limited by guarantee, or a company limited by shares and guarantee.

Each mutual will have adopted a governance model appropriate to its corporate purpose. These take a variety of forms, with varying qualifications for membership.

Those firms that are limited by shares typically issue redeemable preference shares to qualifying members. Typically, these are very small, nominal amounts of share capital, which firms provide against in their accounts. Companies limited by guarantee have no share capital and their only option to raise funds is through retained earnings and debt. Though there is the option to issue shares in a 'company limited by shares and guarantee' this has not been taken up.

In order to raise investment capital for the growth of their business, those mutuals that are permitted to issue shares currently risk diluting their mutual purpose or losing their mutual status by introducing new shareholders with different interests from their members.

This means that they are at a disadvantage to other types of business. They do not have an option to raise capital in a way that is sympathetic to their mutual purpose and restricts the influence that investors can have on a business.

This problem has been recognised and resolved in other jurisdictions where specific capital instruments exist for mutuals to raise funds in an orderly and sympathetic manner.

The problem in Australia can be solved entirely through a small legislative change, mirroring the changes that have taken place in the UK and the custom and practice in many other parts of the world.

Part of the issue is that there is no statutory definition for a mutual in Australia: those businesses which describe themselves as mutuals do so voluntarily as an expression of their business purpose, rather than as a statement of corporate form.

The lack of a clear definition of an incorporated mutual and the absence of any mutual-specific options for such firms to issue securities is a major barrier to the growth and development of the sector. It is an artificial constraint on competition, with mutuals either needing to rely on retained earnings and debt, or consider losing their mutual status by issuing investor shares designed for proprietary companies.

By amending the Corporations Act to clearly establish the basis of an incorporated mutual company and creating a new capital instrument for mutual businesses that currently have no permanent investment capital, the Federal Government would enable them to attract additional working capital to fuel the development of the mutual sector.

Summary proposal

- The amendment is a modest addition to the Corporations Act
- It may be used on a voluntary basis by mutual businesses
- It fixes the anomaly that does not recognise mutuals in law
- It permits mutuals to issue investment capital with out demutualising
- It mirrors similar legislative amendments in the UK and other countries

The following section illustrates the scope of the amendments to the Corporations Act 2001that would be required, and the nature of such a 'Mutuals Capital Instrument.'

A new Capital Instrument for Australian Mutuals

1. A new capital instrument (MCI) is required that mutual businesses may issue to their members.

2. Such an instrument should be created through an amendment to the Corporations Act 2001.

This would be a new section '5E, Incorporated Mutual Companies.'

3. It will be available as an option that qualifying mutual businesses may choose to adopt within their constitutions. This will include mutuals registered as companies limited by shares, limited by guarantee, and limited by shares or guarantee

   a. It is envisaged that the legislation would state that 'Incorporated Mutual Companies are bodies corporate (therefore capturing all of the above) that adopt the definition of a mutual written into the new section. The benefit of this approach is that it can be adopted by firms amending their rules without radically altering their existing corporate structure.

   b. The new section will need to define 'Incorporated Mutual Companies.' The Incorporated Mutual Company becomes a company which satisfies the definition of a mutual as above.

   c. It will be voluntary for firms to decide whether or not to adopt any changes, including subsequent alterations to their rules.

   d. Once the section is established, it could form the basis, for creating an entirely new mutual corporate form.

4. The amendment will define which businesses may qualify as 'mutuals'

   a. This definition should be permissive and based on the key ownership features of mutuals.

   b. It should not conflict with ASICs Regulatory Guide (RG147) and the ATO definition of mutuality for taxation purposes.

5. The amendment will set out the features of the MCI:

   a. It will be an 'equity like' security in that it will be permanent, loss absorbing, investment capital.

   b. We envisage that MCI would have certain minimum characteristics (e.g. rank behind all creditors) but that each mutual would be able to determine other features to suit their business. This will enable APRA regulated mutuals to design terms that will qualify MCI as core tier one and others to be more flexible in their approach.

   c. At the same time, it will retain features consistent with the mutual purpose of such a business. For example:

   5.1 MCI will be available only to members of the issuing mutual and qualifying purchasers, as defined in the rules of each mutual.

   5.2 Any potential purchaser not currently in membership will be required to qualify for membership of the mutual. Issuing firms will have the flexibility to choose which membership rights are conferred.

   5.3 Regardless of the number of MCIs held, each member will be entitled to only one vote.

   5.4 No person who is a member only through holding MCI will be permitted to participate in votes on mergers, dissolutions or demutualisation.

   5.5 No mutual may issue MCI in excess of 49% of its total balance sheet value.

6. MCI should possess the relevant features to qualify as core equity tier 1 capital in mutual ADIs.

7. MCI should possess the relevant features to qualify for the release of franking credits.

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GPO Box 5166
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Sydney

www.bccm.coop

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