

# Submission to Independent Facilitator

## Reforms for cooperatives, mutuals and member-owned firms

### Introduction

Australian Unity welcomes the opportunity to make a submission to the Independent Facilitator as part of the Government's consultation on reforms for cooperatives, mutuals and member-owned firms.

Australian Unity is a national health, wealth and living mutual company that provides services to almost one million Australians, including 300,000 members. Its core purpose is to support its members—and the broader Australian community—to access services that enable them to thrive. In that vein, Australian Unity currently provides services spanning health care, aged care, disability, wealth and independent and assisted living.

This submission proposes three interrelated amendments to the *Corporations Act 2001* (Corporations Act) that would:

- provide express recognition of mutuals
- harmonise directors' duties as they apply to directors of mutuals
- enable mutuals recognised under the Corporations Act, to raise capital in the form of a Mutual Capital Instrument

Further detail on each proposal is outlined below.

This submission should be read in conjunction with submissions made by Australian Unity to the Senate Economic Reference Committee's inquiry into *'The role, importance, and overall performance of cooperative, mutual and member-owned firms in the Australian economy'*. In particular, Australia Unity draws the attention of the Independent Facilitator to commentary on the distinguishing and valuable characteristics of mutual enterprises, including their capacity to: focus on delivering services that meet community need, support governments to deliver efficient human services, contribute to the broader Australian economy generally, and add resilience through increased diversity of corporate form.

An important feature of cooperatives, mutuals and member owned firms is that they adopt, to a greater or lesser degree, the Mutuality Principle. This, in broad terms, is that the relationship of member to the entity is not principally that of capital provider seeking a return in terms of either dividends on the capital contributed or appreciation of that capital, but to obtain the benefit of goods, products or services provided to members on desirable terms per se, or more desirable terms than offerings available from other, non-mutual organisations. Profits generated from the transactions between such an entity and its members are used to invest in improved future transactions, rather than provide an economic return on the membership interests themselves.

# Regulatory and Legislative Barriers to Competition

## *Background and Impact of Legislative Barriers*

The mutual form is not expressly recognised in the Corporations Act. Where it is recognised, it is as a company limited by shares<sup>1</sup> or as a company limited by guarantee<sup>2</sup>. Unlike other corporate forms that are currently regulated by the Corporations Act, mutuals can generally only source funding through retained earnings or directly sourced debt, such as bank loans<sup>3</sup>.

Australian Unity submits that the non-recognition of mutuals by the Corporations Act, places them at a competitive disadvantage as compared with other profit maximising, shareholding corporates, as it limits the capacity of mutuals to source funding (including in debt markets) that would enable growth.

If the mutual form received express recognition and support in the Corporations Act—and access to more commercially appropriate funding<sup>4</sup>—mutuals could more readily compete with other corporate forms. Such recognition would also provide mutuals the opportunity to further develop as a valuable, resilient and diversifying element of general economic activity—and to deliver community benefit.

### **Australian Unity as a case in point**

Australian Unity has been pursuing a long-term strategic vision to provide products and services that support wellbeing, create community value and address, what it terms, the “social infrastructure challenge”—that is, the development of appropriate social infrastructure to better manage chronic disease, support an ageing population and respond to other community needs in the face of demographic shifts.

Addressing these challenges will, in large part, require social infrastructure in the form of human services operations, and health, aged care and community facilities. Australian Unity has a strong history of providing these services, and is well placed to contribute to the development of this social infrastructure (including by supporting the growth of vital workforces).

However, the building of aged care, health and community facilities—along with building complex human services operations—will require large capital investments over the coming years. Without the capacity to obtain alternative sources of funding, Australian Unity, as one of the bigger potential providers of this infrastructure, will be hampered in growing its operations and remaining a competitive provider.

---

<sup>1</sup> Mutuals registered as companies limited by shares usually issue a limited number of modestly valued ‘member shares’ to each member as they join, and then redeem them when the member ceases to meet membership requirements (generally by no longer having a relevant product). The total amount of share capital involved is therefore generally small, and there is no dividend or other payment or capital accretion arising from economic performance. These shares, therefore, do not accurately reflect the underlying interests of members, nor do they reflect the value of the enterprise, especially when there are long-term accumulated reserves.

<sup>2</sup> Mutuals registered as companies limited by guarantee, are not permitted to issue equity capital under the Corporations Act. The guarantee amounts, besides being nominal, can only be called upon in the event of liquidation.

<sup>3</sup> The existence of cooperative and mutual legislation in the States and Territories reflects the need for “other” forms of bodies to be recognised in the law. Such alternatives, however, are relics of a time before a national company system. Issues of recognition and status of such entities in other States and Territories make them unsuitable vehicles for enterprises that participate in the national economy. In this context, it is notable that the UK has introduced Deferred Shares in the mutual and cooperative sector, recognising different historical hurdles but seeking to improve access to capital, in order that the sector might be more competitive and capable of investing to tackle current community challenges.

<sup>4</sup> This includes capital that sits on the equity side of the balance sheet and is classified as Tier 1 capital for regulatory purposes.

## Proposed Amendments to the Corporations Act

Australian Unity proposes three interrelated amendments to the Corporations Act 2001 that would:

- provide formal recognition of mutuals through the establishment of a new type of company under section 112—an ‘Incorporated Mutual Company’, which would be entitled to act as a company throughout Australia
- harmonise governance arrangements for an Incorporated Mutual Company with that of relevant shareholding companies, by clarifying the application of directors’ duties to the directors of mutuals and recognising the different interests established through a mutual organisation
- enable an Incorporated Mutual Company to raise a special form of equity capital, appropriate to its mutual status

Consequential amendments would be also required to section 254SA of the Corporations Act, and the *Income Tax Assessment Act 1997*. These are further explained below.

Australian Unity submits that in addition to enhancing competition and promoting growth, a clear and legislated framework for mutuals would provide an incentive for community groups and service-minded individuals to establish new mutuals with long-term, community service objectives. The potential for valuable economic activity to be pursued in areas, where other corporate forms may have limitations, is significant and includes a range of human services arenas, including indigenous community enterprise and social service activities. Recent government reviews, including the Harper Competition Review, have also identified that contribution that mutuals could make in this regard.

### **Proposal 1: Introduction of Incorporated Mutual Companies**

#### **Proposed Amendments**

Australian Unity submits that the mutual form should be expressly recognised in the Corporations Act through amendments to section 112, which would see the inclusion of ‘Incorporated Mutual Company’ as a type of company.

A company seeking to register as an Incorporated Mutual Company would need to meet the following minimum characteristics, which are largely in accordance with the Australian Securities Investment Commission’s (ASIC) Regulatory Guidance 147 (RG147).

#### **Features of an Incorporated Mutual Company**

A company is an Incorporated Mutual Company only if its Constitution:

- prohibits the issue of ordinary shares except to persons who are, or propose to be, active contracting parties receiving goods, products or services from the company, such shares being of the nominal variety, providing no dividends or capital accretion; and
- limits the membership qualification rules to be in accordance with relevant regulations relating to maximum waiting periods or minimum levels of participation; and
- provides that any surplus on winding up may only be distributed to either current members or a like institution or charity.

Further amendments would also be required to clarify that:

- there would be no liability on the members to contribute in the event of a winding up beyond nominal guarantee amounts and unpaid liabilities on shares or Mutual Capital Instrument

- companies limited by guarantee or by shares and guarantee would be able to (but not required to) change to being an Incorporated Mutual Company, or call themselves a Mutual Company provided that they meet the definition. Companies that do not meet the definition should be prohibited from using the term “Mutual”
- Incorporated Mutual Companies would also be able to convert into companies limited by shares provided they meet the relevant disclosure requirements specified in the Corporations Act (and any voting, allocation or other requirements specified in their constitutions)

### **Practical Effect of Amendments**

The express identification of the mutual corporate form under the Corporations Act, would serve as a necessary starting point for acknowledging the distinct personal wellbeing and community-focused purposes of mutuals, as compared with other profit-maximising forms.

Once recognised, the inclusion of mutuals in the Corporations Act would also allow for the sensible application of aspects of ASIC’s administrative framework (including disclosure and conduct standards, and relevant governance frameworks). This recognition, along with enhanced corporate governance standards, is likely to greatly improve the capacity of mutuals to access capital markets—both debt markets (which have been accessible in the past but with some difficulty) and equity capital markets (which have been largely inaccessible for mutuals in Australia). Our proposal to enable mutuals to access equity capital markets is set out below.

The express recognition of mutuals would also have the potential to help widen the pool of corporate structures in Australia, and provide some balance to what has, over recent decades, become increasingly a mono-culture of profit-maximising, shareholding corporations.

### ***Proposal 2: Appropriate Directors’ Duties for Incorporated Mutual Companies***

#### **Proposed Amendments**

Australian Unity submits that amendments should be made to the Corporations Act to clarify directors’ duties as they apply to directors and officers of an Incorporated Mutual Company.

A proposed amendment to the Corporations Act to enact this proposal could be formed as follows.

#### **Insert new part 12.3 in the Corporations Regulations, applying to Incorporated Mutual Companies**

##### **12.3.01:**

This Part modifies the application of subsections 180(2)(a), 180(2)(d), 181(1)(a), 181(b), 184(1)(c), 184(1)(d), 187(a) and 187(b) of the Act in relation to the directors and officers of a company.

##### **12.3.02**

A director or other officer of a corporation, in exercising their powers or discharging their duties, to act:

- in good faith in the best interests of the corporation; and
- for a proper purpose,

must take into account the interests of members of the corporation as recipients of the goods, products and services that the company provides to its members.

An equivalent provision should apply in relation to the interests of members for the purposes of a

scheme of arrangement.

### **Practical Effect of Amendments**

This proposal would not expand the current scope of directors' duties as contained in the Corporations Act. It would, however, clarify that directors of mutuals are required to consider the interests of members in relation to the goods, products and services that the company provides to those members. This would ensure that the different relationship of the entity and its members is expressly acknowledged and given effect in the way that directors exercise their powers and authorities.

### ***Proposal 3: Introduction of a Mutual Capital Instrument***

#### **Specific Amendments**

The Corporations Act currently provides for two types of security in relation to a company—a share or a debenture. Australian Unity submits that a new category of security should be created—a Mutual Capital Instrument (MCI).

The main features of the new instrument would be that it could only be issued as either a permanent or long term instrument not callable by the investor and in its basic form would be entitled to a non-cumulative return out of profits based on a formula. Prima facie as an equity investment, distributions on MCIs would be frankable. The instrument would entitle the holder to one (limited) membership irrespective of the number held. Further information is contained in the following table. The MCI's features are similar to those of the cooperative capital units that are allowed to be issued by cooperatives under NSW legislation, but subjects them to the more appropriate regulation of the prospectus regime of the Corporations Act and allows them to be offered throughout Australia. MCIs would then become part of the national market for financial products.

#### **Draft Suggested characteristics of a Mutual Capital Instrument**

- the MCI ranks behind all creditors of the company in respect of repayment of capital and is not entitled to participate in the distribution of any surplus assets on any winding up of the company
- the MCI is only redeemable at the company's option using a similar procedure to that of ordinary shares
- distributions on the MCI are:
  - i. payable in respect of a particular year and designated not cumulative
  - ii. calculated in accordance with a formula related to market interest rates or fixed but capped at a certain percentage return on the issue price
- The constitution of a Mutual Company may provide that holders of MCIs are eligible for membership, but may also limit their voting rights to exclude them from voting on mergers, dissolutions or demutualisations
- MCIs may be listed on the ASX

Additional legislative changes which may be required to make MCI effective for fund raising by mutuals include:

- the Income Tax Assessment Act to be amended to clarify that distributions on Mutual Capital Instruments are not unfrankable per se
- section 254SA of the Corporations Act 2001 would need to be amended to permit payments of

distributions to members of companies limited by guarantee, provided that the payment to them is in their capacity as a holder of a MCI and not as a member of the company who does not own a MCI

- MCIs would need to be added to the securities to which Part 6D of the Corporations Act applies (so that offers of MCIs would be covered by the prospectus regime rather than the PDS regime for other financial products) and be included in the definition of a security in section 761A to ensure that they are financial products and that the advice and conduct rules of Chapter 7 apply equally to MCIs

Consideration should also be given to the opportunity to permit franking for the returns on such instruments in the Australian context. This would allow tax-paying mutuals to utilise currently unusable franking credits and would also remove yet another competitive disadvantage which mutuals suffer in comparison to other corporates.

### **Practical Effect of Amendments**

This proposal would enable mutuals to access development capital to fund investment in growth. Mutuals could expand their services and compete more effectively with profit maximising entities. Importantly, it would also allow for an appropriate mechanism to capitalise retained profits and to establish a stronger equity base for mutuals. These aspects would in turn facilitate the raising of debt by mutuals, both in the form of debentures, other debt capital instruments and bank loans.

The proposal contained in Australian Unity's submissions would not have the effect of removing any of the rights of other corporate structures or provide mutuals with any access to funding which other entities cannot already replicate. In fact, "regular" shares will still, in many circumstances, be a more attractive investment generally than Mutual Capital Instruments because of their potential for capital gain (inter alia).