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8 April 2005

Dr Anthony Marinac
Acting Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Dr Marinac

Re: Inquiry into the Exposure Draft of Corporations Amendment Bill (No.2) 2005

Mutual Strategies Pty Limited appreciates the opportunity to make a submission to the Inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into the Exposure Draft Corporations Amendment Bill (No.2) 2005.

Our submission covers only the category of mutual companies – broadly companies with a one-member-one-vote rule and which do not distribute profit to members. As this matter does not appear to have been canvassed at any length before, we have attached a paper on the topic, the substance of which has been provided to the Treasury in response to their calls for submissions on the Exposure Draft of the Bill.

In brief, we do not support the removal of the 100-member rule for mutuals but believe it should instead be modified (as described in the attached paper) to discourage its use in a frivolous or vexatious manner. There are very few examples of vexatious or frivolous uses of this rule in the case of the many hundreds of mutual companies, with the exception of the NRMA. Its existence is important to the good governance of mutuals.

We support the other proposed changes in the Exposure Draft and would be pleased to respond to questions about this submission.

Yours faithfully

M W Sibree
Executive Director

Parliamentary Joint Committee on Corporations and Financial Services

INQUIRY INTO EXPOSURE DRAFT OF CORPORATIONS AMENDMENT BILL (NO.2) 2005

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I. Background

1. This submission is written in response to the Exposure Draft of *Corporations Amendment Bill (No. 2)* 2005. It deals principally with the "100-member" rule, which is the main subject of the Exposure Draft.

2. The "100-member" rule is established by s. 249D(1) of the Corporations Act. It allows for general meetings to be called (inter alia) by a requisition of 100 members. Its intention no doubt is to provide for a measure of "democracy" in a company and ensure that managements are responsive to members.

3. The 100-member rule has proven to be very expensive for some companies which have been beset by "vexatious requisitioners" of general meetings. Apart from the NRMA, the companies which have received publicity as being deleteriously affected have been listed public companies. The requisitioners, with little economic interest in the company, have sometimes sought to air business which is not directly relevant to the company or which would have little hope of support except by a small minority of shareholder members.

4. The rule is part of the array of corporate governance arrangements for companies and must be seen in that context. Removal of this rule will adversely affect the development of improved corporate governance in mutual organisations. Accordingly, this submission makes reference to some wider issues.

5. The notions of "mutual" and "membership" are discussed briefly in the Appendix.

II. Mutual Companies Affected Disproportionally by Proposed Changes

6. The 100-member rule applies not only to listed companies, but to companies which have no shareholding (companies limited by guarantee) or where there is a one-member-one-vote arrangement in place. The NRMA is an example of such a mutual, as is the RACV and other similar service enterprises. Replacement of the 100-member rule with 5% of the number of members would imply for a mutual company with a million members, a requisition requirement of 50,000 signatories, not 100 signatories. This is clearly a large change to how the law operates. In comparison, a general meeting of a company such as Woolworths Ltd (with 320,000 shareholders) or ANZ Bank (252,000 shareholders) might under current law be requisitioned by only one member, if that member were one of the three members with over 5% of the voting shares (as at June 2004). BHP Billiton has four such members (325,000 shareholders). One might argue that such a large shareholder would be "responsible" and has an economic interest aligned to that of the company, but might not always be so.

7. Many mutuals conduct substantial economic business with their members. A credit union depositor may have a million dollars on deposit or as a borrowing, or a friendly society member may have several million dollars in capital guaranteed bonds. Under current circumstances such a member needs to persuade only 99 others to join in a

challenge to management if he/she has a serious matter to put to the membership. To require that person to contact 5,000 others in a 100,000 member institution is unrealistic.

8. Clearly, the considerations for mutuals and companies with votes proportional to shareholding, are different. This was recognised in Chapter 15 of the 1999 report of the Parliamentary Joint Statutory Committee on Corporations and Securities (PJSC):

- The PJSC concludes that a 5% issued share capital test would be reasonable, given CASAC advice that this would be compatible with overseas practice.
- Large mutual companies such as the NRMA are in a special position and may need different provisions.

9. This present submission argues in favour of a different treatment for mutuals from that proposed in the Exposure Draft for companies with shareholders.

III. The Position of Mutuals

10. Others have outlined the impact of mutual enterprises on the Australian economy and Australian society. Significant classes of mutual companies include:

- Large public-offer service companies such as the automobile clubs;
- Smaller "transferring financial institutions" which transferred from state regulation to the *Corporations Act* in 1999, such as credit unions, some building societies and most friendly societies;
- Most private health insurers;
- Many charities, schools, social clubs, sporting and community organisations;
- Possibly some co-operatives.

11. It seems to be the case that mutually-organised commercial concerns are on the wane, in favour of for-profit shareholder-based companies. The writer believes that introduction of a 5% hurdle for a members' requisition will reduce standards of governance in mutuals and reduce the possibility of legitimate challenge to managements. This will not help the sector which will prosper only with increased member involvement and/or demonstrated superior returns to members or the community at large.

12. In many of the above classes, there is, anecdotally, indifferent governance and certainly little member activism. The difficulty is not a surplus of interest in the affairs of the various companies thus requiring higher hurdles in requisitioning meetings, rather there is a need for greater member interest in what is being done in their name and overall member empowerment.

13. In some of the above company classes with which the writer is more familiar, there has been a rise in regulator activity: eg from APRA with the transferring financial institutions, and PHIAC with health insurers. This regulatory activism has in part compensated for the overall lack of interest by members in "their" institutions. Regulation still proceeds on the basis that company management is responsible to the membership base and will ultimately be controlled by it. This is a possibly faint hope in many circumstances, with few instances of contested elections for board positions, almost no examples of member-initiated resolutions at Annual General Meetings and virtually no member-requisitioned meetings. Perhaps this is due to the uncontroversial nature of

the management of such institutions or simply the fact that members of most such institutions have little feeling of ownership. This is despite failings in corporate governance in a few cases, requiring regulatory intervention (eg PHIAC in Queensland Teachers Health and also Federation Health, both perfectly solvent institutions).

14. There are of course outlier examples where institutions foster a sense of member involvement and this is clearest in some credit unions where, for instance, contested elections for director positions is the norm. However, as a general rule, most managements (ie directors and executives) are no doubt pleased to have a passive membership base to reduce both the complexity of their task and the risks of abbreviated tenure.

15. [Some mutual health insurers are structured to virtually eliminate the possibility of any form of challenge to management from members; the voting members are a small subset of company customers and are chosen by incumbent management.]

16. Rising interest rates and private health insurance premiums should increase the degree of interest which members display in their mutual. While details of product pricing etc should be left to management, the possibility of a challenge to management by members or by commercial competitors through a member should produce better results for members. For instance, further mergers of like-minded credit unions should produce greater efficiencies and downward pressure on mortgage rates, to soften the recent interest rate decision of the RBA.

17. An example is the much-needed merger of Australian Defence Credit Union Ltd with Defence Force Credit Union Limited, which have somewhat duplicated administration and distribution and serve the same markets in the defence forces. Such a merger might produce savings of at least $5m pa which could produce a one percent lowering of mortgage rates for borrowers. Further possible mergers, with (at first analysis) substantial benefit to members, exist in the teacher-related credit unions eg mecu Limited with Victoria Teachers Credit Union Limited. Giving members tools to demand this of their boards of directors seems a worthwhile goal. Commercial forces will produce entities with an interest in assisting members recognise these opportunities. The Exposure Draft proposes a mechanism to allow such matters to be more easily raised at the Annual General Meeting. This is welcome. However, mergers between mutuals depend as much on good timing as anything else, so a requirement to wait perhaps 12 months to ventilate an issue not supported by management may not be in members' overall interests.

18. It is interesting to note that the obvious merger of small health insurer Federation Health with nearby La Trobe Health, which had been stalled for years through the two managements apparently not seeing eye-to-eye, was finally effected by the regulator this month, to the long-term benefit of the members of both funds in a relatively small regional community. It would be a sad commentary on the governance of mutuals if obvious consolidation relied on the intervention of regulators.

19. The "price" paid when mutuals merge is management careers and board positions. There might be a requirement to adjust somehow for different assets which the parties bring to the table. Sometimes one party to a merger discussion cannot conceive that this will happen satisfactorily and no progress eventuates until there has been change at the top. Meanwhile members do not realise the benefit of merger. Although the credit union

movement is replete with examples of successful dealing with these issues, with a history of hundreds of mergers, other mechanisms to encourage merger are needed, to assist with stalled cases. Outside the credit unions, matters are also difficult, but with some notable successes. Note for instance, the merger in early 2005 of Australian Unity Limited with Grand United Friendly Society Limited, which was achieved after resolving a range of management, legal, members' equity and cultural issues.

20. In these circumstances, any reduction in the possibility of member activism should be avoided. To contact 5% of members to call a meeting in a large mutual is a virtual impossibility without a large public advertising campaign or direct mail-out by the requisitioners, using a copy of the members' register obtained under s.173 of the *Corporations Act*. Such a campaign may itself be destabilizing for a financial institution, even before the meeting itself is held.

21. It is noteworthy that in the special case of transferring financial institutions, the requirement under s.173 of the *Corporations Act* has been modified by regulation, making it more difficult to obtain a list of members. The regulations provide that the company's management and the would-be requisitioner have to come to an agreement about the use of the members register, before a copy is handed over! (*Statutory Rules 1999 No. 143* Schedule 1, Part 12.8.) This further reduces the opportunity for members to independently hold management to account.

22. What is to be done? Should a few poorly-motivated uses of the 100-member rule lead to changes which reduce the possibility that a member may choose to "take on" management? Or that an outside organisation may offer a challenging growth alternative, contrary to management's views? Such matters may be time-critical and waiting for the next annual meeting might be harmful to the company or its members.

IV. Proposal

23. This submission is founded on the assumptions:

- That managements of mutuals are currently not greatly motivated to seek out all opportunities to benefit members, particularly if these opportunities result in the business changing form and management losing control. Managements are uncomfortable about challenging industry colleagues with whom they often have long-term personal relationships;
- That an empowered membership base will become informed of itself, or via interested external parties which may seek some commercial opportunity for themselves in a way which advantages members; and
- That retention of the 100-member rule (qualified as below) will assist in members making their presence felt in a timely fashion.

24. Various alternatives have been canvassed, some recently by the Business Council of Australia (see - *Fresh Approaches to Communication between Companies and their Shareholders. A Discussion Paper.* Sept 2004). However none deal specifically with the issue of mutuals.

25. **Our proposal (for mutuals only) is that frivolous members' requisitions should be discouraged by requiring that any propositions put to a general meeting requisitioned by 100 members should receive a certain support level (say 20% of votes cast at the requisitioned meeting, or a turnout of at least 50% of eligible voters), otherwise part (say 30%) of the meeting costs should be borne by the requisitioners. The company might be empowered to secure a deposit or bond before proceeding.**

26. Certainly, the qualified capacity for a small number of members to requisition a meeting should remain and be in addition to:

- the 5% rule, and
- the proposed 20 member rule for AGM resolutions.

27. This submission does not deal with the issue of member communication. Members should be better informed about the strategic choices which directors make (or fail to make) on their behalf. There are some regulatory impediments to obtaining lists of members for the purposes of independently circulating material to members of transferring financial institutions (basically, credit unions, building & friendly societies). See para. 21 above.

# # #

Mark W Sibree
Executive Director
8 April 2005

Appendix: What is a “Mutual” - Membership.

1. There are slightly different approaches to the definition of mutualism taken in the tax law, the *Corporations Act,* the now-defunct *Financial Institutions Scheme* and in various State laws such as the *Pharmacy Practice Act 2004* (Vic). This submission does not attempt a complete discussion of this topic.

2. A mutual company for the purposes of this submission is a governance concept. A mutual is a company where each member has the same equal voting power in election of the directors, in requisitioning meetings of members or in voting on resolutions put to general meetings, etc. Many mutuals are companies limited by guarantee. Some are companies where each and every member has one share of the same class which generally has a nominal fixed value. The constitution of a mutual prohibits the distribution of profit to its members; this is described as “not-for-profit” although indeed the company may make a profit and pay tax on it, adding to the NTA of the business. The members of a mutual do not “own” it; they simply participate in its governance if they wish.

3. There is considerable variety in how mutual institutions are structured. This variety and the scope for management taking advantage of unusual structures is one reason why mutuals have been successful over a very long period in meeting the needs of members. Equally, it is also a good reason to ensure that members have full armoury of devices to protect their interests and monitor management’s proposals.

4. Members of mutuals typically are also its customers. Many such members may not be aware of rights they have as members, considering merely that they may have purchased a commercial product from such and such an organisation. Their interest in the mutual organisation extends to ensuring that they receive value for the product or service purchased and no further. They have little economic stake in the long-term future of the business, in contrast to a shareholder of a company with a share capital who is vitally concerned about such matters.

5. Some mutuals are structured so that not all of its customers are members. They confusingly describe their customers as “members”, but these “members” have few if any rights in relation to governance (as described above). Examples are some health funds such as Medical Benefits Fund of Australia Ltd and NIB Health Funds Ltd, where the members for governance purposes are a much smaller group of people (50 to 100) than the large body of health insurance contributors/customers. Such arrangements, where the directors have considerable influence in selecting the company’s members, could be said to be defensive so as to provide long-term stability for management.

6. In the case of Defence Health Ltd the members are the Chief of Army and the Chief of Air Force. For Navy Health Ltd the Chief of Navy appears to have appointed the directors as members, who hold office at his pleasure. Both are companies limited by guarantee and have a combined customer base exceeding 70,000 in the defence community and their families.

7. Also there are hybrids, where there are guarantee members with equal rights in addition to a body of shareholder members with variable numbers of shares (eg IMB Ltd).

8. Even though mutuals prohibit the distribution of profit to members, in the event of demutualisation, the members may profit once-off by receiving shares in exchange for their governance interest. In cases where customers are not members, they have no such rights, even if they have contributed to reserves through their business over a long period. The *Corporations Act* has a series of comprehensive provisions (see – *C.A.* Part 5 of Schedule 4.*)* designed to ensure scrutiny by ASIC and full information to members of transferring financial institutions if they are to vote on a demutualisation or a change to members' rights. (In the right circumstances, these provisions may be effectively avoided by a Court-approved Scheme of Arrangement, where other protections for members may apply.)

9. There are many mutuals where members would benefit from a demutualisation, trade sale of the underlying business or merger with a like entity, but these opportunities are often not energetically explored or presented to members.

Biography

Mark Sibree has a decade of successful experience as Managing Director of the mutual Australian Unity Group, with highly regulated financial and healthcare businesses ranging from funds management to health insurance. Initially in a turnaround situation, the business flourished and grew substantially in financial strength, management depth and customer satisfaction under his leadership. Growth occurred both organically and by way of acquisition and merger, often employing innovative techniques. Mark represented the interests of the Australian friendly society industry in its negotiation with governments, in the industry's transition from State law to the *Corporations Law* over the period 1995-1999.

Since leaving Australian Unity in mid 2002, he founded Mutual Strategies Pty Limited concentrating on the application of M&A experience in the area of mutual enterprises and their governance.

Prior to his period as CEO of Australian Unity and its predecessor, he was responsible for the Amcor Group's venture capital activities, which ranged from genetic engineering to the operation of a brown coal mine. Other business experience centred around information technology as a manager in manufacturing and service enterprises as diverse as Clemenger Australia, PA Management Consultants, APPM Ltd and ICI.

He has been a board member of a number of private and public sector enterprises and official enquiries. In addition he spent 8 years as a director or chairman of peak employer bodies.

Mark has an MBA from Melbourne University, a BSc with Honours in Physics from Sydney University and is a Fellow of the Australian Institute of Company Directors and Member of the Australian Computer Society.