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Association of Building Societies and Credit Unions

31 October 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Sydney NSW 2001
By email: john.kluver@camac.gov.au

Dear Mr Kluver

Members' Schemes of Arrangement

Thank you for the opportunity to comment on CAMAC's June 2008 Discussion Paper *Members' Schemes of Arrangement.*

Abacus – Australian Mutuals is the industry body for credit unions, mutual building societies and friendly societies. For more information on Abacus and our 167 member organisations go to www.abacus.org.au.

Credit unions are generally companies limited by shares. Mutual building societies are generally companies limited by shares and guarantee. Most friendly societies are companies limited by guarantee or by shares and guarantee.

The key common feature of the overwhelming majority of Abacus members is that they are organised on the basis of the principles of mutuality, with each company member or shareholder having one vote. In companies where shares have been issued, such as credit unions, the shares are not transferable and each member has an identical shareholding of either one or five shares. Shares issued are more in the nature of a ticket of membership than a financial investment, although other shares issued may have elements of both characteristics.

Mutual companies are focused on member service rather than by a desire to achieve a financial return through the generation of profit on either capital or income account in relation to their shares.

Members of mutual companies cannot be equated to shareholders in non-mutual companies. Credit unions, mutual building societies and friendly societies were transferred from various State legislative regimes to the Corporations Act regime in 1999 through amendments that inserted a Schedule 4 to the Corporations Act.

The Explanatory Memorandum to the Financial Sector Reform (Amendments & Transitional Provisions) Bill No.1 1999 recognised that members of transferring financial institutions are, by and large, likely to be members in order to obtain financial services from the entities concerned.

"In that sense, they are akin to consumers of financial services rather than investors in financial services providers," the Explanatory Memorandum said.

Abacus members have an interest perhaps greater than ordinary listed companies in the operation of the schemes' provisions. The procedure provided in Section 411 for schemes of arrangement is typically the only means for mergers and other important corporate reorganisations to be achieved, other than by transfers of business.

Abacus members are generally not companies to which Chapter 6 of the Corporations Act easily applies.

Mergers between credit union members of Abacus regularly take place as transfers of business under the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Business Transfer Act).

However, if features of membership other than just a simple transfer of business engagements is required, other elements of the Corporations Act (eg the class rights provisions of Part 2F.2) can be attracted. In addition the whole may also require a scheme of arrangement.

If the arrangement is a demutualisation as defined in clause 29(1) of Schedule 4 of the Corporations Act, further disclosure is required (see clauses 29 – 33), a specific unconscionable conduct regime applies (clause 34), and the Court is given additional powers (clause 35).

Abacus provides the following comments on matters raised in the Discussion Paper.

Information to shareholders

Possible changes to facilitate effective disclosure of scheme information to shareholders, including in relation to the content and method of disclosure (Section 3.1)

The statute should indicate that the explanatory statement should include all information relevant to the question whether a reasonable person who is a member of the company or the relevant class should vote in favour of, or against, the matter being considered. This statement would focus disclosure on the constituency to consider the issue and the different considerations that each constituency might consider to be relevant. This would be equivalent to the general disclosure test in paragraph 636(1)(m) in takeovers, s710 in prospectuses or s1013E in PDSs.

Not only are prescriptive lists of disclosure issues no longer favoured in the legislation, but any attempt to be more prescriptive about disclosure would tend to focus attention on issues that arise in the circumstances of particular schemes and provide little guidance in relation to other more innovative schemes. This might suggest that the more innovative schemes are not permitted, which would reduce the utility of the scheme of arrangement facility.

There is, however, significant benefit in ensuring that other disclosure regimes attracted by a scheme proposal are harmonised with the disclosure in the explanatory statement.

For Abacus members that would include the demutualisation disclosures prescribed in Schedule 4 and the disclosures required for a business transfer under the Business Transfer Act. It is submitted that the scheme provisions, being the most general, should direct the court only to convene meetings on the basis of an explanatory statement where the court is satisfied that the explanatory statement addresses any specific disclosure regime applicable in relation to any element of the scheme. The legislation could then draw the attention of the Court to appropriate regimes that might be attracted, for example:

- if securities are to be issued – sections 710 – 713
- if other financial products are to be issued – sections 1013D – 1013K
- if shares are to be bought-back – sections 257D(2) and 257G
- if financial assistance is to be given in connection with a share acquisition – section 260B(4)
- if capital is to be reduced – section 250C(4)
- if the company is one to which Schedule 4 applies – clauses 29 -33
- if the company is a Financial Sector company and there is a transfer of business involved in the scheme – the Business Transfer Act and the Transfer Rules.

The Court should be satisfied that the disclosure addresses all the standards applicable to each element of the scheme.

Except if the Court otherwise orders, the proponent of a scheme of arrangement should be obliged to establish an appropriate Internet presence that sets out:

- a version of the current explanatory statement showing all changes to the version of the Explanatory statement shown to the court at the first hearing (initial explanatory statement); and
- a cumulative list of all changes made (and the date of making) to the initial explanatory statement.

Whether there should be greater statutory guidance concerning supplementary disclosures (Section 3.2)

No change to the explanatory statement should be allowed unless it is made at least five business days before the date set for the meeting or the date for the meeting is moved so that it is five business days or more after the date of the change. Otherwise supplemental disclosure should be encouraged based on s643, 644, 724 and 1014E.

Whether the required standard for formulation of an expert's opinion should be more consistent between bids and schemes (Section 3.4)

It is suggested that, consistent with the proposition that schemes of arrangement should be a flexible device allowing companies to deal with a wide range of expected and unexpected contingencies, the test for independent experts' reports should be equally flexible. While the current "best interests of the members" test is flexible, it tends to confuse because it seems to refer to issues of directors' duties rather than matters appropriate for an expert to report on to members.

It is suggested that if the compromise or arrangement involves existing members giving up existing rights, then the test should be equivalent to that contained in section 641. If that is not the case, the test ought to be one which directs the independent expert to compare the value of the existing interest of the relevant members with the benefits offered to them under the scheme. It is not necessary in the end to have a formulation so long as the subject matter for the comparison is clear.

Voting on schemes

The headcount test as it applies to companies limited by guarantee (Section 4.2.5)

As noted in the Discussion Paper, simply eliminating the headcount test would leave these companies without a mechanism for member approval of schemes.

Abacus supports retention of the headcount test for companies limited by guarantee.

Abacus opposes lifting the headcount test for these companies from a simple majority to 75 per cent. The simple majority test provides greater flexibility for schemes that do not involve matters that require a special resolution. An amendment to the company's constitution, a demutualisation, or any other proposal that requires a special resolution would require approval of 75 per cent of members who vote.

As noted in the Discussion Paper, the court has a broad supervisory role in relation to proposed schemes, reflected in the requirement that a scheme, even when approved by members, can be implemented only if also approved by the court.

Extension and simplification of schemes

Could the scheme provisions be adapted to accommodate the possibility of schemes being initiated otherwise than by the target company (Section 6.4)

Abacus does not support adapting the scheme provisions to accommodate "hostile" schemes.

Such a proposal opens the possibility of a mutual company being brought to a commercial standstill by an outside party with no obligations to the company's members.

As the Discussion Paper notes, the current legislation proceeds on the basis that the company will take the responsibility for proposing the scheme. The members are protected by the fiduciary duties of the company's directors as well as the supervisory role of the court.

Unlike a takeover bid for an ordinary listed company, a proposal for a change of control of a mutual company that requires a demutualisation means that the members are being asked two distinct questions:

1. Should we cease to be a mutual company and, if so, how should the company's economic value be allocated to members? and

2. Once I have been allocated transferable shares, should I accept this offer for my ownership stake?

This means that a takeover of a mutual company is necessarily a two-step process whereby members first decide whether or not their membership rights are for sale before deciding whether to accept a particular offer for those rights.

The implementation last year of a new regulatory framework for member registers of credit unions, mutual building societies and friendly societies allows for contact with members while protecting the confidentiality of members' names and addresses. The regulatory framework now better recognises that a mutual company's member register is its customer list.

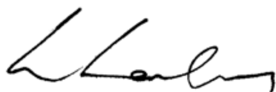
The framework provides for a new mailing house route where a mutual has not provided a copy of its register to an applicant within 28 days of first application.

Under this new "third party access" step, the following process applies:

- An applicant must certify that its proposed use of the register information is lawful and pay upfront the 'reasonable costs' of contacting members;
- The mutual must make arrangements with a third party service provider (e.g. a mailing house) for contact with members to take place;
- The applicant must provide the material to be communicated to members to the mutual body corporate, which then has 28 days to review and take advice on the proposed communication before submitting it to the third party service provider;
- If the mutual body corporate has reasonable grounds to believe that the person intends to use register information for a purpose or in a way that is unlawful, it can halt the contact arrangements;
- Timeframes apply for providing register details and a best efforts commitment applies for lawful contact with members via the third party service provider.

Please do not hesitate to contact me on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely,



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