Economic Reference Committee - Co-operatives & Mutual Entities (CMEs)

ASIC Response to Questions on Notice

9 March 2016

1. How long does it take to form a company? How is this done?

Around 98% of company incorporations are submitted electronically, with the other 2% submitted in paper by mail. Applications received electronically are submitted using third party software that transfers data to ASIC systems. Online applications are processed in real time unless a company name availability assessment or other check is required by ASIC staff. If a name assessment is required then they are generally completed within 30 minutes.

ASIC has a Service Charter commitment to process applications received in paper in 1 working day (8 hours). ASIC Registry has met all service charter measures in the past 2 years.

2. What is the average cost for online company registration services?

The cost is consistent whether lodged online or in paper. Third party service providers may add service charges for customers using their services. The cost to apply for the registration of a company is determined by Fee Regulations set by Government. [1]

Current costs for *Application for Registration of an Australian Company* are -

- Public company with share capital $463
- Public company limited by guarantee $382
- Proprietary company $463

3. Is there any reason why co-operatives are required to comply with Chapter 6D of the Corporations Act (including preparation and lodgement and supervision by ASIC) in cross border offerings of securities when they must also comply with disclosure requirements under the CNL?

Member shares are exempt from many requirements under the Corporations Act, including Chapter 6D: (see Regulations 6D.2.01 and 12.8.)

Offers of other classes of shares by a public company CME will require disclosure under Chapter 6D unless an exemption applies (e.g. for small scale offers or otherwise under s708).

4. What regulatory purpose exists for requiring investor focussed disclosure (Chapter 6D) for co-operative shares, when co-operative shares are not investment instruments?

As noted in question 3 above, member shares are already exempt from many requirements under the Corporations Act, including Chapter 6D: (See Regulations 6D.2.01 and 12.8.)

[1] Legislative references - Corporations Act 2001\117\1, Corporations Act 2001\118\1, Corps (Fees) Regulations 2001\Item 5(a) of Schedule 1

5. What regulatory objective is served by imposing two identical disclosure regimes (and costs) on co-operatives seeking to offer debentures or CCUs to persons in another state or territory?

ASIC cannot comment on the State based legislative regime for Co-operatives.

A co-operative that is regulated by ASIC and which seeks to issue debentures is subject to the same disclosure regime that applies any other entity that issues debentures.

6. What is the purpose of registration under Part 5B.2 of the Corporations Act?

If a registrable Australian body wishes to carry on business in one or more states or territories other than its home jurisdiction, it must be registered under Part 5B.2 of the Corporations Act. A registrable Australian body is a body corporate which has been formed or incorporated in Australia. Registrable Australian bodies include bodies corporate that are not companies, recognised companies, exempt public authorities, corporations sole, foreign companies or financial institutions. Certain unincorporated bodies can also be registrable Australian bodies. An association which is registered under a state law not recognised in other states will generally be a registrable Australian body.

ASIC Information Sheet INFO 60 contains some information about registrable Australian bodies: http://asic.gov.au/for-business/starting-a-company/how-to-start-a-company/registrable-australian-bodies/

A foreign company wishing to carry on business in Australia must be registered under Part 5B.2 of the Corporations Act. A foreign company is an incorporated or an unincorporated body that is formed in an external territory of Australia or outside Australia. It may sue and be sued or may hold property in the name of its secretary or other officer. Corporations sole, exempt public authorities and unincorporated bodies that have their head office or principal place of business in Australia are excluded from the definition of foreign company.

ASIC's website contains guidance relating to registration of foreign companies at the following web page: http://asic.gov.au/for-business/starting-a-company/how-to-start-a-company/foreign-companies/.

7. Is there a requirement for dual registration under both the Corporations Act and the CNL? If not then why is registration accepted from a co-operative?

There may be a requirement for dual registration under both the Corporations Act and CNL depending on the structure of the entity and where the entity carries on business.

Registration under the Corporations Act

Depending on the co-operatives composition and activities, it may be required to be registered under Chapter 5B of the Corporations Act. For example, if the co-operative falls within the definition of an "Australian registrable body" under section 9 of the Corporations Act and carries on business in one or more jurisdictions other than its home jurisdiction it must be registered under Chapter 5B of the Corporations Act.

Registration under the Co-operatives National Law

A uniform set of national laws for co-operatives is being progressively introduced by the States and Territories (though not all states have implemented the new template laws). NSW is the lead jurisdiction for this national project and in May 2012 the NSW Parliament passed the Co-operatives (Adoption of National Law) Act 2012. This Act has the template CNL appended to it and refers to the template Co-operatives National Regulations (CNR).

Division 4 of the Appendix to the Co-operatives (Adoption of National Law) Act 2012 provides for registration of proposed co-operatives.

Registration under the CNL does not preclude a co-operative from also being registered under the Corporations Act if it wishes to carry on business in one or more jurisdictions outside its home

jurisdiction. Under section 12(1) of the Appendix to the Co-operatives (Adoption of National Law) Act 2012, a co-operative and a participating co-operative are each declared to be an excluded matter for the purposes of section 5F of the Corporations Act 2001 (Cth) in relation to the whole of the Corporations legislation. However section 12(2), subsection 12(2)(1)(c) does not exclude the application of the Corporations legislations to co-operatives or participating co-operatives to the extent that the provisions relate to the registration of a co-operative as a company under Chapter 5B of the Corporations Act. In other words it appears there was a deliberate policy decision made to apply both regimes.

8. What is the cost and what are the compliance requirements?

Australian registrable body

If a registerable Australian body wishes to carry on business in one or more states or territories other than its home jurisdiction, it must be registered under Part 5B.2 of the Corporations Act.

Prior to registering as an Australian registrable body the entity may complete an ASIC Form 410 Application for reservation of name and lodge it with ASIC. The application fee for an ASIC Form 410 is $46.00 though reservation of a registered name is only optional.

In order to register as an Australian registrable body the entity must complete an ASIC Form 401 and provide all accompanying requisite documents as set out in section 601CB of the Corporations Act.

The application fee for an ASIC Form 401 varies between $382 and $463 depending on the type of association it is.

Numerous post- registration obligations may apply including the requirements to:

- display the registered name at every office and place of business that is open to the public;
- display the Australian Registered Body Number on all public documents and negotiable instruments published or signed in the jurisdiction; and
- notify ASIC of changes to the registered Australian body's name, constitution, directors or equivalent and address of registered office.

Lodging fees and or late fees are applicable on some of the forms required to notify ASIC of certain changes.

The broader compliance requirements and costs of Australian registrable bodies vary significantly depending on the size, function, structure and culture of the organization.

9. What powers of inspection/inquiry/reporting does ASIC have over Part 5B.2 bodies?

ASIC has significant investigatory and information gathering powers under Part 3 of the ASIC Act. ASIC may make inspection and investigation as it thinks expedient for the due administration of the corporations legislation (other than the excluded provisions) where it has reason to suspect that a contravention of the Corporations Act may have been committed.

The reporting requirements differ depending on to extent to which the entity is controlled by a foreign company. Further guidance in relation to this issue is set out in ASIC RG58.

10. APRA have informed us that mutual ADIs can issue MEI (Mutual Equity Instrument) as a form of capital. Please confirm the status of the MEI under the Corporations Act. Is it the equivalent of a share, or is it debt or does it exist under the Corporations Act?

Mutual ADI's do not issue MEIs *directly* as a form of capital, but may end up with MEIs in their capital structure if they are required to convert their hybrid instruments. MEIs may result from a hybrid regulatory capital instrument issued by a mutual ADI that is required to convert – with MEIs issued on conversion rather than ordinary shares.

The aim of MEIs is to provide the Mutual ADIs with access to convertible regulatory capital in the same way that other ADI's have used convertible hybrids. MEIs were contemplated by APRA in Attachment K to Prudential Standard APS 111. It is anticipated the specific terms of the particular MEIs are to be included in the constitution of the mutual proposing to issue them.

It is not possible to answer specifically how MEIs would be treated under the Corporations Act as no instruments that have the possibility of converting to MEIs have been issued to date. Like hybrids there are no standard terms for the instruments that may give rise to MEIs or for the MEI's themselves. The determination will depend on the specific structure and form of the instrument (pre conversion) and the form of the MEI post conversion.

If the pre-conversion instrument and /or the MEIs into which they may convert are considered preference shares, then member approval requirements of Part 2H.1 of the Corps Act would apply. If both the pre-conversion instrument and subsequent MEI are legal form debt – then the instrument may not require member approval. Given that mutuals are likely to want to take advantage under APRAs prudential requirements of the post conversion equity like features of the MEI, then it is likely these instruments would need to meet the same requirements under the Corporations Act as a preference share. (i.e. Part 2H.1 of the Corporations Act.)

11. Please provide the relevant case law which supports the proposition that judges can and will take a broad interpretation of the interests of the member value rather than the narrow interpretation of the highest financial return.

The Corporations Act requires directors to make judgements *in good faith and for proper purpose* and to act *in the best interests of the corporation*: s181. The courts have not interpreted this duty as requiring directors to solely focus on achieving the highest financial return for shareholders.

In a co-operative, it is possible for some members to be interested solely in achieving a financial return, whereas other members may be interested in non-financial objectives.

The High Court considered how directors of companies with shareholders with competing interests should discharge their duty to act in the best interests of the corporation in *Mills v Mills*[2]. The court in that case found that:

- the directors would not be in breach of their duties provided they believed they were acting in the interests of the company, even where their decision adversely impacts the interests of one class of shareholders to the benefit of another class;
- where there are classes of shareholders with competing interests, the question becomes what is fair between the different classes of shareholders.

This case supports the proposition that directors can take a broader interpretation of the interests of member value and may make a decision that may not achieve the maximum financial return.

[2] *Mills v Mills* (1938) 60 CLR 150

In discharging their duty to act in the best interests of the company, boards should have reference to the company's constitution, which may include non-financial objectives.

12. You said that mutuals can issue a narrow range of capital instruments: What capital instruments, which are equity not debt for accounting purposes, can a mutual issue without demutualising - please give examples in the marketplace?

Part 5 of Schedule 4 ('Demutualisations') to the Corporations Act effectively applies to unlisted mutual financial institutions (including e.g. credit unions, building societies and friendly societies). This will also apply to most mutual ADIs that now use the term 'bank'.

If a modification to the company's constitution or an issue of shares would have the effect of varying or cancelling existing members' rights in ways specified in clause 29, this will amount to a demutualisation of the company and the company must comply with disclosure and adoption regime (unless exempted by ASIC under clause 30).

ASIC's Regulatory Guide 147 *Mutuality: Financial institutions* (RG 147) http://www.asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-147-mutuality-financial-institutions/ sets out how ASIC will decide whether a company has a mutual structure. RG 147 is primarily intended to provide guidance on how we will use our own idea of mutuality in considering whether we should grant relief (i.e. waivers from the law) to an individual company from the need to comply with the demutualisation disclosure and adoption regime prescribed in Part 5 of Schedule 4. RG 147 also serves as a guide for companies to consider in their own circumstances whether a particular constitutional modification or proposed share issue would impact on the company's mutuality.

RG 147 includes guidance on what ASIC has termed (for the purposes of our RG 147 guidance) 'investor shares'. As stated in RG 147, traditionally, mutual companies have not issued shares designed to produce a return based on the profits of the company. Investor shares of that kind might have a substantial impact on the focus of the company, and on its status as a mutual. In practice, however, a number of companies that consider themselves mutual now have, or will seek to have, a mixture of mutual members and investor shareholders. We accept that a limited purpose of returns to shareholders can co-exist with a purpose of services to members. In our view, what is critical for a company’s mutual status is its dominant purpose. A company can provide a return to shareholders and remain a mutual, provided that the return to shareholders does not become the dominant purpose.

ASIC has issued a number of individual relief instruments (i.e. waivers from the law), relieving an individual company in a particular instance from compliance with Part 5 of Schedule 4, either because ASIC determined the company to not have a mutual structure in the first place (clause 30(1)) or because ASIC was satisfied that the proposed constitutional modification or share issue would not result in a modification of the company's mutual structure. Relief has related to, but has not been limited to, instances in which a company proposed to be able to issue investor shares. RG 147's economic relationship and governance relationship tests can assist a company to consider whether the features of their proposal would impact on the company's mutual structure.

The MEI instrument stipulated in the APRA APS 111 Capital Adequacy: Measurement of Capital has features which are designed, with the economic relationship and governance relationship tests in mind, to allow mutual ADIs to issue regulatory capital instruments that are convertible to an MEI instrument without triggering the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act.

The unit trust structure employed by Murray Goulburn Cooperative Co Ltd is an example where a trust or other interposed entity is listed which holds an economic exposure to the mutual without undoing the mutual status.

The ASX Listing Rules Guidance Note 3, which was last updated on 30 April 2015, outlines the various options available to co-operatives and mutuals considering a listing on the ASX.

13. How long did it take for Murray Goulburn to list their unit trust? What was involved from a regulatory point of view?

The first written document was received by ASIC on 4 July 2014. The units were issued 12 months later on 7 July 2015 and commenced trading 10 July 2015.

Murray Goulbourn Cooperative Co Ltd (Murray Goulburn) proposed a capital restructure that provided access to new capital by issuing securities to new investors whilst retaining its co-operative structure. This presented ASIC with a number of novel regulatory issues that had to be settled. The transaction aimed to raise capital via the ASX though a listed unit trust (MG Trust) registered as a managed investment scheme. Investors in MG Trust were to receive distributions on the units, which will be equivalent to the dividends received by Murray Goulburn shareholders. However investors in the units have no voting rights in relation to Murray Goulburn. The structure was designed around prohibition in the Murray Goulburn constitution of listing of shares and provisions that only farmer suppliers could hold ordinary shares.

ASIC primary regulatory concern relating to this transaction was around the level of disclosure to investors in MG Trust and the ability for investors in the trust to seek redress over any breaches of continuous disclosure obligations by Murray Goulburn. It was also important that investors in MG Trust understood their limited control over Murray Goulburn as they held units in a trust and not ordinary shares in Murray Goulburn.

Murray Goulburn also proposed a facilitated private market to enable ordinary shareholders to trade their shares with one another and to allow units and ordinary shares to be notionally exchanged – providing farmer shareholders with access to the market. A range of regulatory accommodations were contemplated as the rebalancing mechanism evolved during the structuring of the transaction.

As is the case with many novel transactions, the final structure evolved (i.e. it was changed by Murray Goulburn) over a period of time based on feedback on regulatory requirements as well as commercial considerations. Specifically, ASIC provided comments on the Deed that was put in place by Murray Goulburn to address continuous disclosure concerns. ASIC also provided comments on the notice of meeting, capital structure booklet that was distributed to farmer-shareholders explaining the proposals, and the Product Disclosure Statement for the unit trust. The only formal regulatory relief (waiver from the law) required for the final transaction was relief from restrictions on short selling units in MG Trust following the IPO. This relief was consistent with our policy and routinely provided in the event of IPOs.

14. How will the CSF amendments apply to cooperatives?

CSEF Amendments aim to lessen the disclosure burden under Section 6D for *eligible fundraisings*. The legislation is not yet passed and remains subject to some debate. As currently drafted, eligible fundraisings are for public company limited by shares with less than $5million of assets and turnover. As presently drafted, companies limited by guarantee are expressly excluded. The legislation applies to the issue of ordinary shares through a third party platform that are expressly offered as a crowd sourced funding offer. On this basis we do not believe that this is something that would inadvertently apply to cooperatives and mutuals based on current drafting.

However, as the drafting of the legislation is still changing, we recommend that advice is sought from Treasury once the Bill is settled.