

Financial Services Insights

A Game Changer for Mutuals

New Law Expands Capacity to Raise Capital

Mutual Entities Bill 2018: Tranche 2

On 26 November 2018, the Commonwealth Government released for public consultation an exposure draft of the *Treasury Laws Amendment (Mutual Entities) Bill 2018: Tranche 2* (the Bill) which introduces a new bespoke capital instrument in the *Corporations Act 2001* for all eligible mutual entities.

Under the Bill, a mutual capital instrument (MCI) can be issued by eligible mutual entities that are companies limited by shares, companies limited by guarantee and companies limited by shares and guarantee.

There is a current Exposure Draft circulating and inviting submissions up until Christmas (24 December 2018). The following is a summary of the Explanatory Statement and the Bill.

Fundraising - Mutual Capital Instrument

The Bill will enable eligible mutual entities (including a company limited by guarantee) to issue MCIs and will provide mutual entities with access to a broader range of capital raising and investment options without risking their mutual structure or status.

Currently, mutual entities that are registered as companies limited by shares or companies limited by shares and guarantee, already have the power to issue shares and therefore have the power to issue MCIs.

However, *section 124* of the *Corporations Act* operates to prevent a mutual entity that is a company limited by guarantee from issuing shares.

Under the Bill, this restriction will be amended to allow eligible mutual entities that are companies limited by guarantee to issue MCIs.

Eligible Mutual Entities

Mutual entities that are registered as one of these three types of companies will be eligible to issue MCIs if they are:

- public companies
- do not have voting shares (other than MCIs) quoted on a prescribed financial market, and
- are not a registered entity within the meaning of the Australian Charities and Not-for-profits Commission Act 2012.

Once an eligible mutual entity issues an MCI it will become an '**MCI mutual entity**'.

MCI Power in Constitution

To be able to issue an MCI, the Constitution of an eligible mutual entity must provide:

- a. that it intends to be an MCI mutual entity for the purposes of the *Corporations Act*
- b. that all MCIs it issues must be fully paid
- c. that dividends in respect of MCIs are non-cumulative
- d. the rights attached to MCIs with respect to participation in surplus assets and profits, and
- e. that debts owed to a holder of an MCI by way of a dividend (as per *section 254V* of the *Corporations Act*) are to rank ahead of all other debts owed to members in a winding up but rank below all other debts.

The Bill provides for a special standardised procedure to allow a mutual entity to make the necessary amendments to its constitution to permit it to issue MCIs and which will be included in *Division 3* of the new '*Part 2B.8 – Mutual capital instruments (MCIs)*' of the *Corporations Act*.

The special procedure is only available for a fixed period of 36 months from the time the Bill receives Royal Assent and a mutual entity can only endeavour to facilitate the process a total of three times.

MCI Conditions

The rights attaching to a MCI can only be varied by either:

- a special resolution of all members holding the same class of MCIs, or
- obtaining written consent of 75% of the holders of the class of MCI.

MCIs are limited to one vote per MCI holder regardless of the number of MCIs the holder owns.

For a Company Limited by Guarantee

MCI mutual entities that are companies limited by guarantee will be able to pay dividends in respect of MCIs. MCI mutual entities must not pay dividends in respect of an MCI unless the payment of the dividend is fair and reasonable to its members as a whole (as opposed to only its shareholders or member interests).

A mutual entity that issues an MCI is not required to treat the holders of an MCI in the same way that it treats its members who do not hold MCIs.

A MCI mutual entity (a mutual entity that has MCIs on issue) will therefore have a share capital. To preserve the application of class rights to the mutual entity's other non-shareholder members *Part 2F.2* of the *Corporations Act* will apply to:

- a person who holds an MCI as if the entity is a company with share capital, and
- apply to a person who is member of the entity otherwise than as a MCI holder as if the entity is a company without a share capital.

As a company limited by guarantee which is a MCI mutual entity can also issue MCIs, the references to shareholder or ordinary shareholder in *Part 2J.1* of the *Corporations Act* (relating to share capital reductions and share buy backs) will be taken to also include other non-shareholder mutual members. Hence, all mutual members of MCI mutual entities that are companies limited by guarantee, will be able to vote on changes affecting share capital reductions and share buy backs.

The existing requirements for entities to obtain shareholder approval for share capital reductions, share buybacks and the provision of financial assistance relating to the acquisition of the entity's shares will be modified for MCI mutual entities so that approval is required from all members of the entity.

Demutualisation Restriction

To ensure that a mutual entity that issues MCIs is not able to demutualise without first dealing with any MCIs on issue, once a mutual entity becomes an MCI mutual entity, resolutions that would result in the entity ceasing to be an MCI mutual entity will not have any effect unless the resolution provides for all MCIs on issue to be cancelled.

Control and Tax

The Bill also contains consequential amendments to:

- the *Financial Sector (Shareholdings) Act 1998* and the *Insurance Acquisitions and Takeovers Act 1991* in assessing voting power are amended to ensure that an MCI mutual entity's non-shareholder mutual member's voting rights are taken into account
- the *Income Tax Assessment Act 1936* to clarify mutual status is not affected by having MCIs on issue, the payment of dividends in respect of MCIs and for having members who are member by virtue of holding an MCI.

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Mutuals seeking assistance with guidance on the application of the Bill, potential amendments to its Constitution to facilitate the issue of MCIs, the nature and potential structure of MCIs or preparation of a submission to Treasury before the 24 December deadline regarding the Exposure Draft, are encouraged to contact our **Corporate Advisory and Financial Services Principal, Michael Bracken**.



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