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Mr Greg Hammond OAM

**Independent Facilitator reviewing the Report and Submissions forming part of the Senate Standing Committees on Economics Inquiry into Cooperative, Mutual and Member-owned firms**

Dear Mr Hammond

As a contribution to your preparation of a draft government response to the Report considering:

* regulatory and legislative barriers impeding Commonwealth-registered cooperatives and mutuals from accessing capital;
* how significant those barriers are;
* the pros and cons of inserting a definition of ‘mutual enterprise’ into the Corporations Act; and
* whether there should be regulatory and/or legislative changes to improve access to capital for ‘mutual enterprise’ businesses,

I offer the following discussion, not as an economist, lawyer or financial expert but as a humble historian who has researched the history of Australian cooperatives and kindred entities for over thirty years. Though I confess to an abiding faith in the idea of ‘self-help’ cooperation, I represent no one but myself and what follows is purely my own opinion.

As you may be aware I entered a submission to the Senate Inquiry and appeared before the Committee.

**Background**

In the wake of the 2008 GFC the Commonwealth Government made arrangements to guarantee deposits and wholesale funding in deposit taking institutions because they faced difficulties in accessing capital.

It is arguable that post GFC prudential regulations, in particular capital adequacy arrangements, whilst timely and wise, have had the unintended effect of hampering the development of customer-owned banks (COBA) relative to for-profit competitors insofar as mutuality fits uncomfortably within the framework, thereby reducing choice for consumers and impacting competition, particularly in the housing mortgage market.

Customer-owned banks (COBA) currently account for about 10% of the home loan market, a significantly smaller share than in previous decades, certainly the last century.

**Overcoming Barriers**

* Amend regulation to assist the prudent management of not-for-profit banks and insurance enterprises bolstering their competitiveness and improving their resilience
* Facilitate a conceptual, regulatory and capital-raising framework recognizing the different objectives and methods of CMEs enabling them to discharge their responsibilities to shareholders/members on an equal footing with for-profit companies in banking and insurance
* Facilitate appropriate reporting and accountability procedures for CMEs in respect of consistency, efficiency and transparency equivalent to those applying to for-profit firms but indicative of the mutual ‘difference’ i.e. place CMEs on an equal footing in markets in which the business models compete.
* Create a regulatory environment allowing for uniformity with regard to e.g. financial reporting, standards, compliance and legal structures with appropriate variations allowing for great differences in the size of CMEs and the financial difficulty small and even medium-sized CMEs face in this regard.

**Capital**

To spread risks CMEs require a more diverse capital base than the current regulatory regime permits. For example, they need to be able to issue instruments that qualify as reliable forms of equity capital.

It would appear CMEs are hampered by the present prudential arrangements from freely deploying funds as they see fit whilst complying with APRA and ASIC standards.

If Australian CMEs are to achieve or maintain competitiveness at national and international levels, they require adequate capital, not simply as insurance against market shock but for infrastructure development and to keep abreast of rapid developments in IT.

The question of CMEs accessing capital is not confined to external investors but extends to capital already available within the sector and its deployment in driving sector growth.

For capital-raising purposes CMEs generally have relied upon member contributions and debt. I see no compelling reason to fundamentally alter this equation, which underpins the democratic nature of cooperative enterprise. However, a role for government may exist in assisting the reticulation of capital within the sector. For example, in the UK mutual enterprises are legislatively enabled to issue securities (deferred shares).

There has been all manner of experimentation with innovations to improve CME access to external investor capital while avoiding demutualisation, including non-voting investors, subordinated unsecured debt security instruments, bonds, ASX listed debt securities, Cooperative Capital Units and other instruments. There is talk of ‘co-investment models’ with e.g. managed funds, private equity firms, mutual equity interests and wealthy individuals or families. Whilst scope may exist for accessing sympathetic external capital through such models, great caution is required, particularly where ‘White Knights’ are involved.

Similarly, legal recognition in the Corporations Act of ‘hybrids’ ostensibly to give greater access to capital because the one person one vote principle is ‘… sacrificing the ability to access external capital for democracy’ (4.30 Report), is dubious. Anyone even remotely aware of the history of CMEs in Australia knows this ‘half-pregnant’ notion is the first step on the slippery-slope to conversion to for-profit status i.e. producing precisely the opposite effect to the one intended (by those genuinely dedicated to the advancement of CMEs).

History also informs us, perhaps cynically, to be wary of boosters in mid to large ranged-sized CMEs arguing for a regulatory regime permitting faster growth for ‘the sector’, often code for individual empire building rather than a genuine commitment to social advancement through co-operation.

I say this from a personal belief formed over many years observing cooperatives behaviour in Australia and elsewhere that a CME sector consisting of numerous, decentralized democratic enterprises is more resilient, vibrant and productive than one dominated by the interests of a few large enterprises hungry for external capital. If such enterprises cannot balance the democracy-capital equation in satisfying members’ expectations and meeting competition, and members see no further value in retaining a cooperative/mutual structure, they are free to leave the sector. But whether they should be permitted to strip assets formed by previous generations of members and taxpayer subsidies as they leave, scot free, is a moot point. I would argue that in the event of demutualisation a portion of the proceeds should return to the CME sector for its further development, as in some overseas jurisdictions. Here, on the one hand, is a ready source of capital for sector growth and, on the other, a genuine incentive to cooperate.

**Cooperative Capital Units**

It has been argued that Cooperative Capital Units are flexible instruments with attributes of debt and equity useful in attracting capital from outside the membership and this may well be true but experience suggests that in all but a handful of cases they are inadequate for financing major infrastructure. Moreover, any provision for proportional voting in a primary cooperative to attract such capital, I believe, is spurious, although there may be case for CCUs in secondary coops, such as purchasing coops and the new trend in IT ‘platform

cooperativism’.

**Cooperatives National Law**

The Australian Uniform Cooperatives Law Agreement (AUCLA) committed jurisdictions to uniformity of regulation in an attempt to improve the regulation and administration of coops by reducing red tape and business costs.

The Corporations Act, I believe, says any security – share or debt – issued by a cooperative is an exempt security if offered within its state of origin under the CNL which has similar disclosure provisions as the Corporations Act. However, distributing coops trading interstate must demonstrate compliance under the Corporations Act by lodging a disclosure statement with ASIC or apply for an exemption. In either case coops face double lodgement costs, administrative and professional costs and fees.

Potential interstate or overseas investors are required to comply with CNL and the Corporations Act – another encumbrance.

The legal ambivalence in respect of the interface between CNL and the Corporations Act and the duplication, time and costs involved in compliance acts as a disincentive to the formation of new coops; especially those with national or international objectives; complicates the operations of functioning cooperatives and impels coops and potential co-operators toward a corporate model, easier to register and run, detracting from the adoption of a cooperative business model.

In this context I was surprised to read in the Report that this duplication was ‘deliberate policy’

Bearing in mind that not all states and territories currently subscribe to CNL and that the agreement was nearly three decades in the making (while the coop sector languished) it seems reasonable to characterise CNL as at best a work in progress and at worst a failed experiment. In either case, its relevancy in developing CMEs into the future in a globalised world is debatable.

I could not understand Report 4.20:

*While aspects of the Act (?) should be reviewed periodically to ensure they (sic) are achieving their respective outcomes, the Committee is of the view that it is appropriate to wait until all jurisdictions have legislation in place before this review takes place.*

That will be a long wait and is tantamount to doing nothing. The states and territories are in no hurry to speed things up – too many vested interests in preserving the status quo. Already decades have elapsed in bringing CNL to its present incomplete condition during which time opportunity costs to the cooperative sector have been inestimable.

As a minimum, exemption from onerous and expensive duplicated compliance procedures, where applicable, would assist CMEs overcome some of these barriers.

There may be a case for non-distributive and small to medium sized coops operating within a state or territory and with no ambition to trade beyond their borders to continue to be regulated under state or territory law but, ultimately, I believe CME members should be free to choose whether state/territory legislation or federal legislation better suits their aspirations and objectives.

A possible ‘lost leader’ role exists for the Commonwealth Government in rationalising this confused situation vis a vis CNL and Corporations Law. Indeed, thinking ‘big picture’, some States and Territories might eventually find it advantageous to cede powers for cooperatives to the Commonwealth particularly if it means improved growth, productivity, international competitiveness, the addressing of acute social and economic problems and employment. In this context it is worth noting that the Opposition already has a shadow minister for cooperatives.

**Accounting Standards**

Members’ shares are treated as a liability in cooperative balance sheets, not equity. Existing accounting reporting standards render the valuable social benefits delivered to the community by CMEs invisible, creating a false impression that coops are chronically undercapitalised. The adoption of accounting standards attaching monetary value to social benefits relative to costs otherwise incurred in their creation by alternative providers, including government, or the economic impact of the absence of these benefits upon communities, could enhance the profile and public confidence in CMEs, encouraging investment in their 'social capital'.

**Definition of ‘mutual enterprise’ in Act**

A proper recognition and definition of mutual enterprise in the Corporations Act would assist the operations and governance of CMEs, clarify director responsibilities and build consumer confidence. It could also help to differentiate not-for-profit CMEs from for-profit firms in the public mind while confirming a view that equally stringent regulations apply to each.

It would also help to put CMEs on an equal footing with for-profit firms in accessing Commonwealth funding currently available to corporations (above $500K, an applicant must be registered under the Corporations Act). Smaller CMEs registered under CNL, presumably, would be eligible to apply for larger Commonwealth funding.

The inclusion of a definition in the Corporations Act could clarify, give certainty and rationalise cumbersome State and Territory regulations hampering the progress of CMEs, help streamline formation and compliance procedures, speed up the formation process and reduce costs for groups wishing to create a CME.

A definition of a ‘mutual enterprise’ articulated by Australian Unity seems as good a start as any for possible inclusion.

**Development Investment Fund**

I agree with APRA that CMEs have at their disposal ample capital and believe they can grow organically and well if these resources are reticulated within. We are regularly told how significant the CME sector’s assets are in delivering ‘wake up’ calls to politicians. The issue, then, as foreshadowed above, is not simply access to external capital but the CME sector deploying capital it already possesses in developing the sector.

The Commonwealth might assist CMEs access capital by creating conditions for the development of a Development Investment Fund owned and controlled by CMEs e.g. for the issue of shares to each other, something of a ‘Holy Grail’ in Australian cooperatives’ history but essential for the sector to be taken seriously as a genuinely ‘self-help’ movement.

A Development Investment Fund properly constituted and under Commonwealth agency supervision, could materially assist the redeployment of sector capital encouraging growth.

**Small Co-ops**

The Report mentions small co-ops in passing and they are tangential to your Rview, viz:

‘… some cooperatives are regulated by state and territory legislation, the Facilitator may wish to make observations regarding any barriers such cooperatives face in access to capital should they arise during the course of the Review.’

I would argue that the CME sector through a mechanism such as a Development Investment Fund could responsibly administer capital and where applicable seed-fund small cooperative/mutual enterprises as evidence of its cooperative bona fides and in return for favourable taxation consideration. That is to say, a regulatory environment conducive to CMEs reinvesting not-for-profit tax-payer subsidised investments back into the sector and hence the community would be a real boon to the sector’s growth and the community’s well-being.

The Belconnen Health Co-operative shows what can be done with governmental development support, start-up funding from corporate and government sources and membership fees. Other enterprising groups in the e.g. health and affordable housing sectors throughout Australia could achieve similar outcomes with appropriate supports.

To the extent the Commonwealth’s powers extend to assisting the development of such enterprises, a possible ‘lost leader’ role exists.

**Conclusion**

It would not be fair to give CMEs special treatment but it would be fair to give them equal treatment through an unambiguous regulatory framework removing costly, complicated and time-consuming administrative duplication whilst enabling the freer reticulation of the sector’s considerable capital within the sector for growth.

Thank you for considering my submission to your Review. I hope it is helpful.

Yours sincerely

Gary Lewis

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