Things Worth Fighting For: Facing Down the Demutualisers

Race Mathews

Demutualisation has recently become so widespread as to call into question the survival of mutualism as a significant force for economic and social well-being and community renewal in the twenty-first century. The lifecycle of mutualist bodies falls into three stages. Firstly, a utopian stage, where the vision and commitment of the founders energise their followers and enable the mutual to be established; secondly, a stage where the mutual assumes a more formal and institutional character in order to more effectively go about achieving its objectives; and, finally, the system stage where bureaucracy takes over, and the survival and self-interest of the organisation assumes precedence over the interests of its members whatever functional purpose it was originally intended to serve. The challenge for mutuals is to ensure that the degeneration phase of the cycle does not occur. Protections include legislation and contractual agreements precluding personal enrichment on demutualisation.

Mutualism

Let me at the outset recall the nature, purpose and proud history of the worldwide mutualist movement of which credit unions are an integral part. Mutualism is about self-help through co-operation – about resolute and principled households combining to bring about, through their shared efforts and enterprise, outcomes that would be unachievable for them in isolation from one another. Mutuals invariably emerge consequent on unsatisfied needs, as a means whereby access is obtained to goods and services that otherwise would be unavailable or unaffordable.

For example, the Rochdale Pioneers – the twenty-eight poor cotton weavers who established their co-operative store in 1844 and thereby gave rise to the modern consumer or retail co-operative movement – were responding to an unsatisfied need for affordable household necessities such as food and fuel. Friendly societies were a response initially to an unsatisfied need for funeral benefits, and later for unemployment benefits, sickness benefits and medical and hospital care. Access to affordable life assurance was offered by mutual life assurance societies, as was access to affordable home loans by building societies.

Agricultural processing and marketing co-operatives met a pressing need on the part of farmers to share in the value added to their produce beyond the farm gate. Worker co-operatives responded to the need on the part of workers for secure employment by enabling them to own their workplaces and jobs – by enabling labour to hire capital rather than capital labour. Trade unions were originally mutualist bodies or co-operatives, formed by employees in response to the need to obtain better working conditions and a just price for their labour.

Credit unions in their turn were at first a response to the need for affordable carry-on loans for smallholder farmers, and later for affordable consumer finance. For example, when my wife and I bought our first home in 1958, our housing loan from our bank was for a thirty-year period at a fixed interest rate of 3.5 per cent. However, when households like ours came to put sea-grass matting on the floor as was fashionable at the time, a simple refrigerator in the kitchen and a single-tub washing machine in the laundry, we were referred by our banks to hire purchase companies for loans at interest rates in effective terms of up to 60 and 70 per cent. As a result, families in the outer suburban Catholic parishes of Australia's major cities began to gather round card tables after Mass, pool such savings as they had and queue to borrow from the pool at interest rates that were affordable for them. In this way, parish credit unions were born.

A little later, neighbouring non-Catholic households looked over the church fences, saw what a good thing the Catholics had going for them and secured admission, thereby causing the parish credit unions to become community credit unions. Later again, some trade unions recognised that workplaces were every bit as much communities as were suburbs, and industrial credit unions were established. So obviously right was the credit union idea, and so urgent the need for affordable consumer loans, that Australian credit unions now have more than 3.5 million accounts – equal to one in every six of our population – and assets under management of more than $A34 billion.[1]

What follows logically is that mutuals must be sufficiently flexible to adapt to changing needs and circumstances – must be able to recognise when the needs for which they are established no longer exist, are less pressing, or are being

Journal of Co-operative Studies, 41.1, April 2008: 45-50 ISSN 0961 5784©

met on as favourable terms by other businesses and agencies. For example, the interest rates that my younger children, who are marrying today, will pay to a credit union for loans will be no less than is freely available from banks and a wide range of other conventional financial intermediaries, and the rate they receive for deposits will be no greater.

Mutuals must constantly reinvent themselves and re-target their resources so as to respond to new needs or those that are being experienced more widely or with greater urgency. In this way they avoid becoming what is referred to technically as 'frozen' mutuals. Re-invention in no sense means that credit unions should cease to be providers of affordable personal loans, but rather that perhaps radically innovative additions to their product mix should be adopted as changing opportunities and obligations may dictate. The operative concept is not 'instead of' but 'as well'.

What is central here is respect for the principle of the conservation of mutualist capital. Each generation of members of a mutual adds to its store of savings in the expectation that they will be passed on for the benefit of generations still to come. Mutualist bodies are in this sense trustees for the intentions of the dead and the inheritance of the unborn. It was not by accident that the names of some early mutuals included the word 'perpetual'. Change as may the purposes for which a mutual's capital is employed in conformity with changing circumstances, that it should be retained intact on behalf of the community is fundamental and mandatory.

The acclaimed science-fiction author Arthur C Clarke noted in his *2001: A Space Odyssey* that

> Behind every man now alive stand thirty ghosts, for that is the ratio by which the dead outnumber the living.

So too there stand behind current members of mutuals those who have gone before them, and ahead those still to come. Mutuals take seriously Chesterton's definition of tradition as "the democracy of the dead".

Demutualisation

All that is best and finest about mutualism has its antithesis – its dark side – in demutualisation. Demutualisation – the conversion into shareholder-owned proprietary limited companies of member-owned mutualist bodies such as mutual assurance and insurance societies, friendly societies, credit unions and co-operatives – has recently become so widespread as to call into question the survival of mutualism as a significant force for economic and social well-being and community renewal in our new century. It is so prevalent as to have acquired its own vocabulary. The term 'carpet-bagger' is widely used in Britain for the large numbers of people who have been joining permanent building societies in order to vote for their demutualisation and share in the distribution of their assets.

'Serial carpet-baggers' are those who join successive building societies in order to profit from successive demutualisations. There are also 'carpet-bagger' clubs that organise bids to demutualise mutuals, and 'carpet-bagger' vulture funds that invest in bringing about demutualisations. It is estimated that, in the case of a failed attempt to demutualise the giant UK Nationwide Building Society, 600,000 of the 4.6 million members qualified to vote had joined the society immediately prior to the poll for the express purpose of bringing about its demutualisation.

That so many mutuals have rushed lemming-like to demutualisation is due less to any intrinsic merits in the claims made for demutualisation than to the fact that it has to date largely escaped sufficiently comprehensive and rigorous scrutiny. That claims for demutualisation on the grounds of efficiency and effectiveness are not necessarily well-based, that major ethical and social issues arising from demutualisation have not been addressed and that the demutualisation process is dangerously open to misrepresentation and manipulation is apparent from consummated demutualisations such as of the AMP and NRMA Insurance mutuals and the Sunstate and StateWest credit unions, and failed or foiled demutualisations such as of Connect in Tasmania and the WA Police and Nurses Credit Society.

Irrespective of their success or failure, these demutualisations and would-be demutualisations raise key issues that call for rigorous scrutiny. Anecdotal evidence suggests that further credit unions are already in the sights of predatory demutualisers and the corporate law, accounting and public relations interests which benefit financially on so massive a scale from favouring demutualisations. As the

Chairman of Australia's peak credit union body, Credit Union Services Australia Ltd (CUSCAL), Richard Crosbie, told its 1997 Annual General Meeting,

> The Australian Financial Institutions Commission has indicated that in just one week they received at least twenty calls from interested parties who wanted to know more about the opportunities for demutualising credit unions, and, presumably, liberating their reserves.

CUSCAL's then General Manager of Movement Development and Business Services, Graham Loughlin, wrote in 2000,

> I'd be surprised if some of Australia's regional banks weren't already identifying larger credit unions whose market niche aligned with their development plans. (WCCU 2000)

The harsh reality is that credit unions and credit unionism are an endangered species. Consequent on a demutualisation feeding frenzy such as has so largely overtaken permanent building societies, friendly societies and mutual assurance societies, credit unions could rapidly become as extinct as the dodo and the dinosaur. Credit unions should be mindful of the example of the Rochdale-style consumer or retail co-operatives that were present in great numbers of Australian towns as recently as the nineteen-fifties, and are now mostly not only gone but erased from public memory as completely as if they had never existed. (Lewis, 1992)[2]

I salute at this point the rank and file members of the Connect Credit Union in Tasmania who so courageously fought off the incomparably better resourced would-be demutualisers of their credit union, and the Board of the WA Police and Nurses Credit Society which has rejected the attempted takeover and thereby demutualisation of their credit union by the demutualist Home Building Society. I am reminded that a recent report identifies costs to Connect members for their Board's demutualisation campaign as having totalled $1.2 million, and the resources of members opposed to the demutualisation as having been under $1000. (Robb & Crombie, 2006)

A press statement by the Police and Nurses Chief Executive Officer. Mr Fred Huis, reads:

> Mr Huis said the Board has written to Home Chairman, Tony Howarth, restating that a merger with Home and a loss of mutual status is not part of the credit society's vision
>
> He said Police and Nurses was also concerned about inadequate long-term protection for the benefits of mutuality, including product terms and conditions for Police and Nurses members and customers.
>
> "It has been the experience of other societies which have demutualised that member benefits have been eroded and ultimately sacrificed at the altar of greater profits for shareholders."
>
> "Home's duties post any takeover to act in the best interests of the company would, we believe, undermine any attempt to maintain benefits for our members."
>
> "Our long-term future and prospects are extremely positive and, in the absence of a compelling proposal, maintaining our mutual status is the best way we can continue to serve the needs of our customers and shareholding members."

Defending Mutuals and Mutualism

Demutualisations such as of the Sunstate and StateWest Credit Unions and the AMP and NRMA Insurance mutuals define and exemplify the magnitude and malevolence of the demutualisation challenge. What then is the remedy? What is needed in part – and among other key measures too numerous to mention in the time available to me today – is that mutuals, including credit unions, should be much more up-front, outspoken and aggressive in confronting and disproving the incessant bad-mouthing of mutuality by would-be demutualisers. What cannot be hammered home too strongly or too frequently emphasised is the simple and powerful truth that demutualisations all too often are consequent on perverse incentives – on a vilification of mutualism and massive contravention of the public interest, driven by the naked greed of their directors and senior managers for lavish allocations of stock options and grotesquely inflated remuneration packages.

Perverse incentives are likewise apparent as regards the corporate law, accounting and public relations interests that benefit financially on so massive a scale from favouring and facilitating demutualisations. Fees for consultancies and other professional services consequent on the demutualisation of NRMA Insurance are reported to have totalled $107 million. (Sydney Morning Herald, 2000) Is it likely that consultants will wholly retain their objectivity when they can be paid handsomely for advising on whether or not a demutualisation should proceed, and perhaps again for giving effect to it?

An obvious perverse incentive to demutualisation is that the remuneration packages of senior managers and maybe directors are invariably greater after than before demutualisations. For example, the Board of the AMP is reported to have allocated its since departed CEO Mr George Trumbull a remuneration package of free shares to the value of $10 million over a three year period following its demutualisation, together with a base yearly salary of $2.7 million. Following the termination of Mr Trumbull's services consequent on his flawed acquisition of the privatised GIO, he received severance payments totalling $13.2 million. Following the departure of Mr Trumbull's successor, Mr Paul Batchelor, consequent on his failed foray into the UK insurance market, Mr Batchelor is reported to be seeking – albeit not so far to have secured – severance payments totalling up to $22 million.

Severance payments to the departed CEO of the NRMA, Mr Dodd totalled $4.1 million, and the former Chairman of the NRMA received severance payments totalling $637,000. Had the mutuals named not been demutualised, options would have been unavailable, and it is inconceivable that remuneration packages and severance payments of so obscene a magnitude would have been approved. Is it likely that those faced with such great and glittering prizes will be wholly immune to their attractions, or that their objectivity will be unimpaired? Demutualisation is a logical – albeit perverse – outcome where bureaucracies see their self-interest is being better served by ceasing to be a mutual than remaining one.

The prevalence of susceptibility to perverse incentives to demutualisation is consistent with social movement theory. Social movement theory teaches that there is a lifecycle in the affairs of credit unions and other mutualist bodies that falls into three stages. There is, in the first instance, a utopian stage, where the vision and commitment of the founders energise their followers and enable the mutual to be established; secondly, a stage where the mutual assumes a more formal and institutional character in order to more effectively go about achieving its objectives; and, finally, a stage – usually referred to as the 'system' stage – where bureaucracy takes over, and the survival and self-interest of the organisation assumes precedence over the interests of its members whatever functional purpose it was originally intended to serve. Social movement theorists characterise the cycle in its entirety as comprising a 'generation-degeneration' process. The challenge for mutuals is to ensure that the degeneration phase of the cycle does not occur.

Safeguards

Amendments to Canada's Insurance Companies Act in 1999 disqualify directors and employees in demutualising insurance societies from benefits other than their entitlements as eligible policy-holders. Basque legislation requires that the assets of demutualising mutuals should be paid into a revolving fund for further developing current mutuals and creating new ones. The UK legislation includes provisions whereby mutuals are enabled to adopt asset locks as a means of protecting their assets against would-be demutualisers, and thereby render attempted demutualisations less likely. Why, it may well be asked, have no such elementary statutory precautions been so much as foreshadowed in Australia, much less enacted, despite the fact that demutualisation has been no less prevalent in Australia than – say – Canada or the UK?

It will be argued by some that if the current owners of a co-operative or credit union that has been operating for many years decide to demutualise the business, then it should happen – that if demutualisation is the will of the owners and it meets the legal requirements, then so be it. It is further argued that the remedy lies in education – in ensuring that mutuals more clearly articulate the benefits of their co-operative status among their owners and thereby foster belief in, and commitment to co-operative values and principles. (Reid, 2003)

Unhappily, such laissez-faire arguments greatly underestimate the magnitude of perverse incentives to demutualisation – of the current sovereignty of greed – or the disarray into which too many credit unions have allowed the involvement of their members to fall. As recent research into credit unionism has disclosed, most members of credit unions no longer understand or value mutualism. Moreover, credit union managers in too many instances have been drawn from conventional financial intermediaries whose philosophies are wholly alien and antipathetic to mutualism. Their boards are in too many instances ageing, and their elections too often failing to bring in new blood.

In some instances, mutuals have actively opposed the election to their boards of overtly mutualist candidates, as witness the rejection by the AMP board in 1970 of a slate of candidates standing for election to the board on a platform of vigorous adherence to mutualism, on the grounds that the candidates were insufficiently qualified. The candidates thereby rejected included Paul Landa, later an outstanding Attorney-General of NSW; the current Chief Justice of NSW, Jim Spigelman; and John Menadue, who became the head of several key commonwealth departments including the Department of Prime Minister and Cabinet, ambassador to Japan and CEO of Qantas.

There are disturbing parallels here with the insurance mutuals, building societies and friendly societies that have already demutualised or are actively contemplating demutualisation. Is it beyond the bounds of possibility that some managers and boards of major credit unions also have in their desk-drawers detailed blueprints for demutualisation, ready and waiting for the moment when opportunity knocks? Is it inconceivable that some mergers may have been instigated and consummated in order to fatten up major credit unions in readiness for demutualisation?

Would it not be all too human for credit union managers who neither understand nor are committed to mutualism – and credit union directors who have forgotten or never properly understood their mutualist value and principles – to be tempted by the prospect of lavish remuneration packages and windfall gains such as have accrued to their counterparts in some demutualised insurance societies and building societies? Who but a saint would not be tempted by the example of Mr Trumbull, in enriching himself to the tune of options worth $10 million from the abrogation of the mutualist principles he had a clear duty to uphold? Is it not romantic in these circumstances to suppose other than that education is a necessary but insufficient pre-requisite for mutuality, and that statutory safeguards against demutualisations are – under current conditions and for the foreseeable future – indispensable?

Meanwhile, UK building societies have in some instances been responding to the threat to their mutualist status by rule changes requiring new members to enter into an undertaking that any windfall gains accruing to them from a demutualisation will be paid directly to a nominated charity. In Western Australia, the Police and Nurses Credit Society and the United Credit Union are adopting rules to prevent new members from joining in the expectation of windfall gains consequent on demutualisations, and would-be demutualisers from building blocks of friendly shareholders in preparation for their bids. Might it not be prudent for all credit unions to now emulate these far-sighted safeguards?

Might it not also be proper and prudent for board members and senior managers pushing for demutualisations to be required to give clear evidence that that their advice and decisions have not been tainted by the expectation of benefits that the Canadian legislation would disallow? Where boards propose and CEOs champion demutualisation proposals, should there not there be a requirement for full disclosure of such financial benefits as may accrue to them, as was required of the StateWest CEO by the Federal Court?

Might it not be reasonable that they be asked to provide legally-binding undertakings that, in the event that a demutualisation proceeds and they retain their positions or are otherwise employed by the demutualised entity, they will not for a period of – say – five years accept overall remuneration greater in real terms than that to which they were previously entitled? Is it likely that any board member or senior manager who in good faith supports a demutualisation will do other than welcome so clear-cut an opportunity to demonstrate that their deliberations and decisions have been disinterested?

To remain silent in the face of major challenges to mutualism such as the demutualisation of a Sunstate and StateWest Credit Unions or the AMP and NRMA insurance mutuals – to pass by, as in the biblical parable of the Good Samaritan, on the other side of the road – is a strategic indulgence that credit unions and credit unionism can in no sense afford. To paraphrase a famous line from the poet John Donne, “No credit union is an island, entire unto itself”. No more is credit unionism an island distinct from other forms of mutualism. Credit unions would be well advised, in regard to demutualisation, to be mindful of a further line from Donne: “Never send to know for whom the bell tolls; it tolls for thee”.

Conclusion

At a time when the advocates of the statutory corporation school of state socialism, and their ‘greed is good’ counterparts in the corporate sphere such as Enron, Worldcom, HIH and OneTel have comprehensively discredited themselves, the way is open for mutualism to assume the larger role – locally, regionally, nationally and internationally – to which its merits so plainly entitle it. What has been identified mistakenly as an end to history marks potentially the birth of new opportunities and applications for mutualism. Mutual including credit unions now face a clear choice Will they now, by sticking to their core values and principles, move forward into the ‘broad sunny uplands’ of a better future? Or will they instead, like so many lambs led willingly to the slaughter, allow themselves to be demutualised – like Esau in the Bible surrender their birthright for a mess of pottage?

Dr Race Mathews is an Adjunct Professor in the Faculty of Business and Law at Deakin University. He was previously chief of staff to Gough Whitlam as Leader of the Opposition 1967-72, a federal MP, a state MP and minister, a municipal councillor and a board member and chairman of the Waverley Credit Union. His ministerial portfolios included Minister for the Arts and Minister for Police and Emergency Services 1982-87, and Minister for Community Services 1987-88. His *Australia’s First Fabians: Middle-Class Radicals, Labour Activists and the Early Labour Movement* was published by Cambridge University Press in 1994, and his *Jobs of Our Own: Building a Stakeholder Society* in 1999 by Pluto Press (Australia) and Comerford and Miller (UK).

References

Lewis G J (1992) *A Middle Way: Rochdale Co-operation in New South Wales 1859-1986*, Sydney, The Australian Association of Co-operatives.

Reid I (2003) ‘Stopping Demutualisation – Kiwis prefer NO Regulation’, *News Commentaries*, Sydney, Australian Centre for Co-operative Research and Development.

Robb A J and Crombie N A (2006) Defeating a Demutualisation: a case study. *Journal of Co-operative Studies*, Vol 39, no 3, December 2006, pp5-10.

Sydney Morning Herald, 19 February, 2000

World Council of Credit Unions (2000) ‘Demutualisation’ in *Credit Union World*, Volume 2, Issue 1, March 2000, p11.

Notes

1 For a history of credit unions in Australia, see Lewis G J 1996, *People Before Profit: The Credit Union Movement in Australia*, Kent Town, South Australia, Wakefield Press.
2 Remaining stocks of Dr Lewis’ invaluable book are held by the Australia-Pacific Co-operative Training Centre, Box 117, King’s Cross, NSW, 2011.