

A Future or No Future: Credit Unions in a Globalising Economy  
Address to be Delivered by the Hon Dr. Race Mathews at the 41<sup>st</sup> Annual  
Conference of the New Zealand Association of Credit Unions, Hamilton,  
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My remarks today are not as I intended them to be as recently even as a little over a week ago. It was then my intention to talk with you today about the new and exciting opportunities that are opening up for credit unions and credit unionism in the context of a globalising economy – in summary, about opportunities for credit unions to move forward, in the words of a notable wartime speech by Winston Churchill, ‘to broad sunny uplands’.

Subsequent events require that I strike a more sombre note. In the intervening few days, a shadow has fallen over the credit union movement that calls into question whether expectations of so positive and promising a future for credit unions are realistic or tenable.

I refer to the announcement by the directors of the Connect Credit Union in Tasmania that they are seeking to have their credit union demutualised, as was previously the Sunstate Credit Union in Queensland.<sup>1</sup> The Connect Credit Union announcement marks a black day for credit unions. It will be seen to have been blacker still if it touches off for credit unions the sort of Gadarene rush to demutualisation that has so largely destroyed Australia’s mutual insurance societies, friendly societies and permanent building societies.

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.<sup>2</sup>

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<sup>1</sup> *Mercury*, 2 September, 2003.

<sup>2</sup> See, for example, Lewis G.J. 1992, *A Middle Way: Rochdale Co-operation in New South Wales 1859-1986*, Sydney, The Australian Association of Co-operatives. Remaining

It is not for me to speculate on the motives of those responsible for the proposed Connect Credit Union demutualisation, on the basis of what necessarily is at this early stage incomplete and insufficient information. It is enough to recognise that the consequences of their actions for the wider credit union interest – and thereby the public interest – may be catastrophic.

### 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. 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 1/2 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 million accounts – equal to one in every six of our population - and assets under management of more than \$A23 billion.<sup>3</sup>

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 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.

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<sup>3</sup> 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.

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 has 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’

### Reinventions

There is no shortage of mutualist bodies that have adapted to new community needs and thereby re-invigorated themselves, re-established their relevance and retained the involvement of their members. For example, a major US co-operative – Co-operative Services Inc of Oak Park in Michigan – was formed in the 1930s in response to an urgent local need for affordable, hygienic household milk delivery services. When the commercial dairies moved in with comparable services at a comparable price, the co-operative re-invented and re-tasked itself, so that the community capital it had accumulated was applied to meeting the need for affordable eye testing and spectacles.

Following the arrival of the optometric services corporations, the co-operative re-tasked its capital again, to meet the need for affordable accommodation and support services for older people. It now operates large apartment complexes – self-governing co-operatives within the over-arching structure of the parent body – in several states. Other examples of mutuals re-inventing or re-positioning themselves include the great complex of manufacturing, retail, financial, civil engineering, service and support co-operatives – now known as the Mondragon Co-operative Corporation (MCC) – at Mondragon in the Basque region of Spain, which I have discussed in detail in my 1999 book *Jobs of Our Own: Building a Stakeholder Society*, and the Canadian Desjardins credit unions that are discussed in my 2002 blue book *Turning the Tide: Towards a Mutualist Philosophy and Politics for Labor and the Left*.<sup>4</sup>

Closer to home – and on a much more modest scale – the Cobar Co-operative in NSW began as a traditional co-operative butter factory, and is now a retail co-operative meeting the needs of its customers and also keeping honest conventional competitors such as the giant supermarket chains. The former Macleay butter factory co-operative also has become a retail co-operative, and currently is planning an expansion into petrol sales and the establishment of a parking station and entertainment complex. Faced as the respective communities of Cobar and Macleay have each found themselves with the question of whether the assets of these mutuals should be re-targeted in response to a perceived new need or demutualised and distributed to its members, each of them has favoured the re-targeting option.

### Lagging Behind

Unhappily, where Australia is concerned, re-invention of mutuals such as at Cobar and Macleay – much less on the scale of a Mondragon or a Desjardins – remains the exception rather than the rule. Australia has lagged behind comparable countries in re-inventing old forms of mutualism and pioneering new ones. For example, we have not like

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<sup>4</sup> Mathews R. 1999, *Jobs of Our Own: Building a Stakeholder Society*, Sydney, Pluto Press, and Mathews R. 2002, *Turning the Tide: Towards a Mutualist Philosophy and Politics for Labor and the Left*, Melbourne, the Australian Fabian Society and Arena Publications (downloadable at [www.fabian.org.au](http://www.fabian.org.au)).

Mondragon harnessed mutualism to bring about regional and local economic development on a scale and of a quality of truly awe-inspiring proportions.

We have not like the Desjardins credit unions positioned mutualism not only as banking with a human face, but also as an engine for job creation, not least in rural and regional areas. We have not like the United States developed new generation agricultural co-operatives as a means of enabling farmers to earn decent livelihoods and retain their rural lifestyles. We have not like Holland demonstrated through its Rabobank the triumphant effect to which mutualist principles and practices can guide and shape the growth, development and destinies of pre-eminent international financial intermediaries.

We have not like Japan positioned consumer or retail co-operatives at the cutting edge for new standards of consumer education and protection. We have not like Scandanavia used co-operatives as a key remedy for the burgeoning problem of people who are homeless, inappropriately housed or impoverished by the high cost of private rental housing.

We have not like Britain under the Blair government begun to think creatively about mutualism as a means of overcoming social exclusion, alienation, family dysfunction and community breakdown. There is no Australian counterpart for Britain's Co-operative Party to represent the mutualist interest in mainstream politics, and promote informed public debate by means such as the Co-operative Party's current 'New Mutuality' publications.

Enabling mutuals to more readily re-invent themselves will necessarily involve mutualism's adopting a much more prominent public profile, so that the public once again understands and values mutualism, and our political parties again take mutualism seriously. Not least there should be greater awareness on the part of the public and the parties of how other countries are using mutualism to remedy or alleviate current major public policy challenges such as unemployment, under-employment and job insecurity, and the consequent growth of poverty and inequality.

## Demutualisation

All that is best and finest about mutualism has its antithesis - its dark side - in demutualisation. Demutualisation - the conversion of member-owned mutualist bodies such as mutual assurance and insurance societies, friendly societies, credit unions and co-operatives into shareholder-owned proprietary limited companies - 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 expression purpose of bringing about its demutualisation.

I am reminded of the sequence in Johnny Woo's 1996 film 'Broken Arrow', where the chairman of the US Joint Chiefs of Staff calls a senior presidential aide on Air Force One to report 'Sir, we have a Broken Arrow'. Asked by the aide 'What's that?', the chairman explains that a nuclear weapon has been high-jacked. The aide replies 'I don't know what's more worrying: that it's happened or that you've got a word for it'. It is a sad commentary on our times that the need for words such as 'demutualisation' and 'carpet-bagger' should have arisen, or that they should in so relatively short a space of time have achieved so widespread a currency.

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 demutualisations such as of the Sunstate Credit Union and the insurance arm of the National Roads and Motorists' Association (NRMA). Both the Sunstate and the NRMA Insurance experiences raise key demutualisation issues not least for credit unions, that call for rigorous scrutiny.<sup>5</sup>

### The Sunstate Credit Union

The essentials the Sunstate Credit Union story are plain. As at 30 June, 1997, Sunstate had 19,358 shareholders and a further 2,725 depositing members without shares. The reserves of the credit union - its net assets - totalled \$8.036 million. The credit union's capital adequacy ratio of 12.9% was comfortably above the minimum prudential requirement. Operating profit in 1998 was expected to increase over 1997 by 18% or \$65,000, from \$371,000 to \$436,000.<sup>6</sup>

Sunstate was a viable credit union, which could either have remained in business on its own, or preserved its mutualist character through a merger with another credit union. Alternatively, if the directors believed in good faith that the credit union was not viable, they could in a worst case scenario have recommended that it be wound up, and its assets shared equally among its members in conformity with mutualist principles.

Instead, the directors and management of Sunstate made no attempt to defend the mutualist character of their credit union or retain the benefits of mutualism for its members. Far from recommending an amalgamation with another credit union, the Board's recommendation was that Sunstate should be merged with the First Provincial Building Society which is a publicly listed company. Far from ensuring that the assets of the credit union were distributed equally among its members, the Board recommended a grossly inequitable distribution.

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<sup>5</sup> For a further case in point - the failed takeover of the UK Co-operative Wholesale Society by an external corporate raider - see Appendix 1.

<sup>6</sup> Figures from First Provincial Building Society Ltd 1997, *Amalgamation Assessment and Financial Information and Reports*, Book 2, Toowong, Queensland.

Of 4 million shares in the First Provincial Building Society offered to members of Sunstate, 200,000 were reserved for directors and 200,000 for employees. The effect was to make directors eligible for benefits roughly 300 times greater than those likely to be available to other members of the credit union. Employees also were made eligible for greater benefits than most members were likely to receive. Twenty-five thousand shares are reserved for the former General Manager of the credit union, who also was allocated an entitlement to take up such further unreserved shares as might turn out to be available.<sup>7</sup>

Most of all, members who did not wish or could not afford to take up their entitlement to shares - or were not qualifying members - were effectively denied their interest in the assets of the credit union, and received nothing whatsoever in return. Estimates at the time of the amalgamation suggest that 86% of the members of Sunstate were unlikely to receive anything in exchange for giving up their entitlements to its reserves, and only 14% to benefit.

That no regulatory objection to the merger was offered reflects poorly on the regulators. That the court did not feel able to intervene reflects poorly on laws and the legislature.<sup>8</sup> That individual directors instigated or were party to the merger brings into question whether they at any stage properly understood mutualism or were genuinely committed to mutualist principles.

Given that six of the seven directors of Sunstate had held office for periods in excess of twenty years and the seventh director for ten years, the question arises: on whom can credit unions rely to protect their mutualism? Would not the founders of Australian credit unionism would literally be turning in their graves if what has happened at Sunstate were to be known to them?

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

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<sup>7</sup> Figures from Loughlin G. 1997, 'Sunstate Credit Union/Forst Provincial Building Society - Transfer of Engagements', in *Credit Union Services Corporation Bulletin* No 311/97.

<sup>8</sup> *Herbert Stanley Rolfe and Ors v Sunstate Credit Union Limited and Ors* (1997) 1109 FCA (23 October, 1997).

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'.<sup>9</sup>

### NRMA Insurance

The essentials of the NRMA Insurance story are likewise plain.<sup>10</sup> The demutualisation of NRMA insurance was in no sense consequent on a failure of mutualism. On the contrary, in the year prior to its demutualisation, NRMA Insurance had, by the account of its then CEO, Mr Eric Dodd, achieved an increase in its operating profit from \$116 million to \$329 million. In Mr Dodd's view, the NRMA's ability to achieve strong profit growth in a year that included the single biggest insurance catastrophe in Australia's history was a measure of the company's strength. The *Australian Financial Review* reported him as stating 'This year's strong result, in the face of such high claim activity, vindicates – in part – the decision to diversify the business of NRMA Insurance'.<sup>11</sup>

As a mutual, NRMA Insurance had not like the demutualised National Mutual Life Society under-performed financially and been taken over by the French insurance giant AXA. It had not like the demutualised Australian Mutual Provident Society (AMP) incurred losses totalling more than \$5 billion consequent on its flawed acquisition of the privatised Government Insurance Office (GIO) and its failed foray into the UK insurance market, and a consequent fall in the price of its shares from a

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<sup>9</sup> World Council of Credit Unions 2000, 'Demutualisation' in *Credit Union World*, Volume 2, Issue 1, March 2000, p. 11.

<sup>10</sup> For more extended discussions of the demutualisation of NRMA Insurance, see Mathews R. 1999, 'NRMA Demutualisation' in *Journal of Australian Political Economy*, Number 44, December, 1999, and Mathews R., 2000, 'Looting the Mutuals: The Ethics and Economics of Demutualisation' in *Dissent*, Number 3, Spring/Summer, 2000.

<sup>11</sup> *Australian Financial Review*, 3 September, 1999.

peak of \$22 to a recent trough of under \$4.50, thereby rendering it vulnerable to a likely takeover by the National Bank of Australia.<sup>12</sup> It had not like the demutualised Colonial Mutual Life Society also been taken over by a bank. It had not like the demutualised New Zealand based Tower Insurance incurred losses such as to have caused its share price to fall from their issue price of \$NZ5.65 to \$NZ1.40 - such as have obliged it to undertake a recent \$NZ200 million capital raising, thereby giving rise to renewed speculation about a possible takeover by interests such as those associated with Sir Ronald Brierley.

The senior business writer of the Melbourne *Age* newspaper, Stephen Bartholomeuz – no friend of mutuals – has written recently that ‘Given the depth and complexity of AMP’s problems, however, preserving AMP’s independence would be a remarkable, and unlikely achievement’.<sup>13</sup> The Chairman of AMP, Mr Peter Wilcox, told AMP shareholders at their recent AGM that ‘To put it simply, AMP had too much of your money in the wrong business at the wrong time in the wrong place’.<sup>14</sup> The business writer of the *Sydney Morning Herald*, Anthony Hughes, describes Tower’s financial performance subsequent to its demutualisation as ‘shocking’.<sup>15</sup>

Most of all, NRMA Insurance had no problems that were insuperable by reason of its status as a mutual, and no compelling reason to demutualise. The Marsden-Copernican Report – the report of a consultancy commissioned by the NRMA board at the expense of NRMA members but to this day never made public – concluded categorically that the contrary was the case.

As the *Australian Financial Review* has reported – and the NRMA has to this day not denied – the Marsden-Copernican report stated that the case

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<sup>12</sup> For a significant warning that a greater risk of such debacles is intrinsic to demutualisations, see Fliegelman A. M., Maloney K.W. and Riegel R.L. 1998, *March of the Mutuals – A Rapidly Evolving World: Mutual Holding Company and Demutualisation Activity*, New York, Moody’s Investor Service Global Credit Research, p. 7. The authors note in a prescient passage that: ‘One almost universal reason that mutual insurers provide for conversion is to facilitate acquisitions of other companies. ... However, any transaction is a relatively high risk affair; unwise transactions have often been known to inflict unexpected (and even serious) harm on an unprepared acquirer’.

<sup>13</sup> Bartholomeuz S. 2003, ‘Cicutto Shows His Hand Early But Has NAB Jumped the Gun?’, *Age*, 29 August, 2003.

<sup>14</sup> *Sydney Morning Herald*, 16 May, 2003

<sup>15</sup> *Sydney Morning Herald*, 2 July, 2003.

for demutualisation was essentially philosophical, with no challenges confronting the group that could not be overcome within its then current mutual structure. In particular, the report concluded that:

- NRMA's governance problems were not exclusive to mutuals and were not insoluble.
- The case for retention of the mutual structure rested largely on whether the board and members saw value in retaining the objectives of mutuality.
- If mutuality was valued, then there was no cogent reason to demutualise.
- There were no tax disadvantages to NRMA's acquisition aspirations from its status as a mutual.
- NRMA was not short of capital.<sup>16</sup>

The report likewise highlighted the outstanding success stories of such thriving mutually owned financial intermediaries as Holland's Rabobank and the great Desjardins credit union federation in Canada.<sup>17</sup>

The Board of the NRMA suppressed the anti-demutualisation Marsden-Copernican Report and relied on a report supportive of demutualisation from Credit Suisse First Boston consultants (CSFB). Getting to the bottom of the whole murky business of how the demutualisation was brought about – of who did what and for what reasons and by whom the bills were paid - might defy the powers even of a Royal Commission.

### Defending Mutuals and Mutualism

Examples such as of the Sunstate Credit Union and NRMA Insurance define 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

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<sup>16</sup> *Australian Financial Review*, 12 July, 1999

<sup>17</sup> *Australian Financial Review*, 10-11 July, 1999. The board had a further credibility problem, in that its arguments for the demutualisation of NRMA Insurance alone contradicted statements in the 1994 prospectus for demutualising the the insurance and road service businesses together. The 1994 prospectus reads: 'Selling off NRMA Insurance would effectively split the NRMA apart. The NRMA's strength lies in the value of both road service and insurance, with each benefiting the other. If they were to be separated, each would be weakened. The value of the combination is greater than its parts. Separating the two would mean splitting the staff of the NRMA, thereby destroying the very culture which made the NRMA a success'. NRMA Holdings Ltd 1994, *Prospectus*, Sydney, p. 11.

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.<sup>18</sup> 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

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<sup>18</sup> *Sydney Morning Herald*, 19 February, 2000

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 *Australian Financial Review* has quoted a prominent – albeit un-named – New York insurance industry lawyer as warning that stock options are the real motivation for all insurance demutualisations. The reference here is not to the relatively small parcels of shares that are passed out to policy-holders in return for their membership entitlements, but the mammoth allocations of share options to favoured individuals such as Mr Trumbull. It is the strong view of the lawyer quoted that, but for the corrupting and corrosive allure of stock options, the rush to demutualisation of insurance mutuals would not have occurred. Do away with the prospect of stock options, and the incentive for demutualisation is largely eliminated.

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 organization 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 parliament is currently considering legislation whereby mutuals would be 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.<sup>19</sup>

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

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<sup>19</sup> See, for example, Reid I. 2003 'Stopping Demutualisation – Kiwis prefer NO Regulation', *News Commentaries*, Sydney, Australian Centre for Co-operative Research and Development.

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 other than the Connect Credit Union 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. 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 their advice and decisions have not been tainted by the expectation of benefits that the Canadian legislation would disallow?

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 Credit Union, a Connect Credit Union or NRMA Insurance – 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

This year marks the fiftieth anniversary of a memorable speech by the Reverend Martin Luther King Jnr that began ‘I have a dream’. We here today also should have a dream – a dream of a new mutualism whereby credit unions revitalise themselves and re-connect to their members by responding as effectively to current as to past needs – a dream where they rise as effectively to new challenges such, for example, as regional economic development, job creation and the provision of affordable rental housing, as effectively as hitherto to the need for affordable personal loans and countering the hire purchase racket – a dream not least where the talk is not of demutualisation but of mutualist renewal.

Standing by the grave of the father of the co-operative movement and father of mutualism, Robert Owen, as I did in the northern summer of 1989, it seemed to me that nothing about mutualism as we know it today would have unfamiliar or unacceptable to Owen. I was then as now reminded that we in the mutualist movement – be it through credit unions, building, friendly societies, general co-operatives or mutual assurance societies – are the custodians of one of the most powerful ideas of which history has record. I was reminded also of Victor Hugo’s

prophetic observation that nothing is so powerful as an idea whose time has come.

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 and HIH, 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 which Churchill spoke? 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?

### Appendix 1

#### The Failed Takeover of the UK Co-operative Wholesale Society by an External Corporate Raider

How co-operatives succumb to - or narrowly avert - takeover and demutualisation by external corporate raiders is exemplified in dramatic terms by the attempted takeover in 1997 of the British Co-operative Wholesale Society (CWS). The essentials of the CWS takeover story are plain.

The CWS was founded in 1863, as the wholesale and manufacturing arm of the British consumer co-operative movement. It is now Britain's largest co-operative body. The CWS has annual sales of more than £3 billion, operates more than 500 food stores, supermarkets and hypermarkets and employs more than 35,000 workers. It is also among the largest funeral businesses and largest farming operations in Britain. It includes Britain's second largest mutual assurance society, with some 35 million members, and Britain's most rapidly growing bank - the Co-operative Bank - with some 2 million customer accounts.

In 1994 factories operated by CWS were sold for £111 million to an entrepreneur, Andrew Regan. Regan then acquired an investment company, Lancia, which made a further offer of £500 million for the non-food businesses of the CWS and Britain's second largest consumer co-operative body, the Co-operative Retail Society. When Regan's offer was refused, he mounted a hostile takeover bid for the CWS in its entirety. The bid required that the CWS should first be converted to a public company. It was Regan's intention to then sell off the bank and other major assets to cover his outlays for the takeover, and thereby acquire for all practical purposes at no cost the profitable core business of the CWS as a major food retailer.

In the event, Regan's bid was unsuccessful. Senior managers within the CWS were exposed as having accepted bribes from Regan for - among other things - turning over to him confidential financial information and membership lists. Regan's major financial backers - notably Hambros and the Nomura Bank - then withdrew their support. The CWS launched private criminal prosecutions against Regan and three associates, including the two CWS managers, and civil proceedings against Hambros and Regan's lawyers, Travers-Smith-Braithwaite. The *Daily Mirror* reported that Regan could face a prison sentence for "aiding and abetting theft and receiving stolen goods".

The High Court judge in the criminal proceedings branded the conduct of the defendants as "the clearest case of a gross, wilful and disgraceful breach of confidence". The prosecution has since been taken over by the Crown Prosecution Service. Hambros and Travers-Smith-Braithwaite have both had to make "abject apologies" to the CWS, and pay substantial compensation. Three Directors of Hambros have had to resign, and other staff have been disciplined.

In the event, the CWS has survived, with renewed determination to re-invigorate its businesses and enable its members to fully appreciate its distinctive character as a mutualist body. Even so an alternative outcome in which the takeover bid was not defeated is readily imaginable. Members could easily not only have lost their co-operative but forfeited their equity in it for a fraction of its real value. Mr Regan could have walked away with a smile on his face and an increase in his net worth approaching £1 billion.

Nor can mutualist bodies such as the CWS necessarily count on understanding or sympathy - much less active support - from external sources such as the media. On the contrary, much of the media was actively supportive of Regan. Arguments were put against the CWS, such as that "The collective good which is supposedly at the core of such bodies is often a shibboleth behind which complacent management can hide".

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