The Hon. Bruce Billson
Australian Small Business and Family Enterprise Ombudsman
GPO Box 1791
Canberra City
ACT 2601

3 November 2021

Dear Ombudsman,

Discretionary Mutual Fund Review Interim Report – "The Show Must Go On"

We welcome your interim report "The Show Must Go On" which shines a welcome light on the insurance difficulties faced by many small business groups and associations; and the potential for a discretionary mutual (DMF) to offer a viable risk protection alternative.

Subject to the actuarial modelling and development of a robust business case, we concur that a DMF suits the industry represented by AALARA.

We consider that that the only regulatory reform that may be required is to address the issue of acceptable evidence of cover, given that a DMF cannot issue certificates of insurance in its own right. There are other ways in which this issue might be overcome which we address in this submission.

We do not consider that other regulatory reform is necessary. There are many other DMFs operating successfully under the current regulatory regime and there have been no instances of DMF failure since the regulatory reforms following the collapse of HIH. That said, the regulatory burden is a disincentive to creation of DMFs as an affordable alternative to insurance and some easing of the regulations to facilitate establishment and operation of DMFs would therefore be welcome.

We are grateful to have been consulted in the review stage and for this opportunity to make a submission.

Barriers to establishment and operation of a DMF

There are a number of hurdles to establishment and operation of a DMF which we address in this submission. The major hurdles are:

A. Development Funding

The first and most critical step, which is a cornerstone of the Regis process and key to the development of a successful DMF, is a feasibility study to evaluate the potential business case for the DMF.

During the past 18 months Regis has received many requests to consider the formation of DMFs in Australia. These included, during early 2020, discussions with a broker representing a number of AALARA's members. Regis has provided a number of detailed proposals to undertake feasibility studies for various groups including AALARA but, these have not been taken up. We believe that funding is the issue, and this highlights the first problem that is likely to be encountered in developing any DMF, namely who is going to fund the feasibility study, and if a recommendation follows to build and launch a DMF, who will fund the development costs?

B. Critical Mass

To establish a DMF it needs to have critical mass. Not only must there be sufficient entities who are likely to become members, with a minimum level of existing premium spend to fund the risk protection and operations of the DMF; but the members must share a commitment to risk management standards in their businesses.

C. Risk Capital

It is unlikely that member contributions will be sufficient to cover all the risk protection claims a DMF may need to cover, particularly in the early years of operation. Access will therefore be required to some form of contingent risk capital for losses the DMF cannot retain. Insurance or reinsurance purchased by the DMF is the normal route but, in some instances insurance or reinsurance may not be available, or the cost may be prohibitive.

D. Regulation

Creating and operating a DMF is not an operation that can be undertaken lightly. A properly constructed DMF, with appropriate risk management, governance and compliance, infrastructure and systems and processes; requires all the operations and infrastructure that would be required for establishment and operation of a small insurer. The capital requirements for DMFs and the regulatory burden are lighter as a result of ASIC rather than APRA regulation, but there is still considerable regulatory compliance as the discretionary protection provided by a DMF constitutes a financial product. An Australian Financial Services Licence with authorisation to issue and deal in miscellaneous risk products is required.

Responses to consultation questions:

1(i). Is there a need for action by government?

We believe that Government could do more to support small businesses address the consequences of insurance market dysfunction through the establishment of DMFs. Start-up funding is required for the development, build, and launch of the DMF. In the early years of operation, limited contingent risk capital may be required to cover claims the DMF is unable to absorb within its contribution base. AFSL licensing and compliance contributes not only to the cost and time to establish and subsequently operate a DMF, but represents a barrier to entry, particularly for small business groups and associations that are unfamiliar with the legislation for provision of a financial product.

We recommend that Government should investigate ways in which limited start-up funding might be made available for small business groups and associations looking to establish a DMF, together with access to contingent risk funding. Government should also consider ways in which the legislation might be modified to reduce some of the hurdles to establishment and operation of a DMF.

1(ii). Is there a proven incapacity for the industry to self-support a solution?

As far as we are aware, a detailed feasibility study has not been undertaken to evaluate the business case for a DMF for AALARA's members. Until this is undertaken it is impossible to determine whether the industry can self-support a solution. Based on the anecdotal evidence provided by AALARA and its members to ASBFEO, we suspect that industry does not have capacity to self-support development and launch of the DMF and will need financial assistance to achieve this, as well as access to contingent risk capital until the DMF is financially self-sufficient.

2. If the government does not act to support the sector, what alternatives could the sector pursue?

The interim report indicates that the principal other mechanisms by which adequate liability insurance might be sourced by AALARA have all drawn a blank. Insurers cannot be compelled to underwrite the industry's risks and in the current environment we cannot readily see any other viable alternative to a DMF.

3. Are there any other groups or entities likely to be affected if the government does not take action?

The impacts on the amusement leisure and recreation sector have been well covered in the interim report. If forced out of operation there will inevitably be unemployment and health costs that will fall back on Government. This is not an industry that is facing change because of technology, Artificial Intelligence, or climate issues. Its current predicament is purely driven by the non-availability of affordable insurance.

In the current hard insurance market environment, there are many small business groups that are similarly affected to greater or lesser degrees. Small business groups that we are aware are facing challenges obtaining liability insurance include Architects, Building Certifiers, Physiotherapists to name a few. We are also aware of other small business groups facing challenges in obtaining property cover, for example Strata Corporations, Housing Associations and Alpine Accommodation property owners. Some or all of these groups may ultimately find themselves in the same predicament as AALARA's members.

4. Are there any other options for action that should be considered by the sector or the government?

The key to long terms success of a DMF is the quality of the members and the risk management that is applied in their businesses. The DMF is best placed to work with the member industry group to develop minimum standards for membership and risk protection. Industry commitment to develop and implement good risk management could be a key requirement for Government support for the DMF.

5. What other aspects of DMF better practice should be considered?

We concur with the contents of item 6.7 of the interim report. The DMF must be properly established with a strong governance framework and procedures. With no external shareholders to answer to and no requirement to produce shareholder profits, the DMF should be wholly focused on provision of affordable protection to members backed by a strong service ethic. In addition to promoting risk management and better standards, the DMF should be open and transparent with members. This can be achieved through control of the DMF residing with a Board with a majority of member directors which should ensure that member's interests remain front and centre. The Board should be supported by appropriate sub-committees including a claims committee so that Member Directors have oversight of the core protection issues affecting members and the DMF.

Small business groups and associations do not possess the skills or experience to establish and manage a DMF. Inevitably therefore, these functions will have to be outsourced. It is important that independent skilled management is employed. This aspect is addressed further in our responses to Questions 9 and 23 below.

6(i). Are the public policy considerations listed accurate?

DMFs are already recognised in Australian legislation and are a recognised model in many countries including the UK, US, and some parts of Europe. There are already many successful DMFs in Australia and we believe there is a strong case for supporting and encouraging further development of the choice and diversity that DMFs offer. Member-owned organisations inherently have a different philosophy to those that ultimately have to answer to the profit demands of external shareholders. The evidence shows that DMFs, where the owners are also the customers, have a very high customer retention rate, high satisfaction levels and low complaint levels.

Direct support can be provided in a number of ways including grants, subsidies, or repayable facilities. We address these further in our response to Question 13.

6(ii). Should additional considerations be included?

If government funding is provided, the principal public policy issue would seem to be the use of taxpayer funds to support discrete groups of consumers. The overarching consideration should therefore be the impact on these groups and the broader public and communities if insurance either cannot be obtained or can only be obtained on uncommercial terms. When weighed against the relatively small amounts of support that are likely to be required, we suspect that in most cases the arguments in favour of maintaining employment and secondary employment alone will be sufficient to satisfy the public interest test.

7. Is there sufficient evidence that a DMF, if appropriately formed and governed, could work for the various stakeholder groups?

There is plenty of evidence amongst DMFs that Regis has established to demonstrate that these perform well for the various stakeholder groups. A number are referred to in the interim report. Assuming therefore that a feasibility study supports the business case for AALARA (with or without a level of support) there is no reason in principle why a DMF could not work for the various stakeholder groups. One issue that would need to be addressed is how to satisfy stakeholder requirements for evidence of insurance given the inability of a DMF to provide an insurance certificate. We address this further in our response to Question 15 below.

8. Are there other regulatory considerations that should be addressed?

The complexities of AFSL licensing and compliance currently represent a barrier to establishment of DMFs for small business groups and associations.

Obtaining a Financial Services licence for a DMF is beyond the means of most small businesses. There is a substantial licensing process which can be expensive and time consuming – the minimum period for the process appears to be 6 months but can be more than a year. The process also requires the prospective licensee to have appropriately experienced and qualified staff with demonstrable experience, infrastructure, systems policies, and processes. As a result, the majority, if not all, DMFs established in the past 10 years have been established under the umbrella of another appropriately qualified Licensee through an intermediary authorisation i.e., a Licensee authorised to deal and issue miscellaneous risk products thereby enabling the DMF to operate as an unlicensed financial product issuer. There are few, if any, checks and balances in the current system meaning it is potentially open to abuse with a “rent a license” approach.

8. Are there other regulatory considerations that should be addressed? Cont'd

We do not suggest that DMFs should be required to hold an AFSL as this would be counter-productive to fostering a climate for their development. We do recommend that licensees who act under intermediary authorisations to issue DMF products should be required to notify this activity to ASIC in advance of the commencement of the DMF offering membership and protection, and that ASIC should maintain a publicly accessible register of this information.

We note that the DMF industry is currently engaging with Business Council of Cooperatives and Mutuals to develop guidelines for best practice principles for DMFs. We support this initiative and suggest that licensees who act under intermediary authorisations to issue DMF products and those engaged in the management DMFs should adhere to the guidelines.

A further issue is that insurance brokers and others who do not have a miscellaneous risks authorisation on their AFSL are not able to advise or deal in mutual products for retail clients. Most small businesses will rely upon a broker to advise them, and as most small businesses constitute retail clients, the inability for broker to discuss DMF membership places a constraint upon acquisition of potential new members.

We recommend that Government consider amending legislation so that brokers be granted an automatic exemption allowing them to deal in mutual products subject to a limitation of only being able to provide general advice.

Another issue for DMFs arises under Section 47 of the Competition and Consumer Act 2010 (Cth). Where a DMF is formed by members of an association, and the DMF requires to limit membership of the DMF to members of the association. This can create a third line forcing issue which then needs to be taken up with ACCC for clearance. We submit that this is an unintended consequence of the legislation and recommend that Government consider amending legislation that grants automatic exemption to DMFs that wish to limit membership to certain groups or associations. This is on the basis that such limits on accessibility are designed to ensure a cohesive membership focussed on good management practices and standards.

9. Are the design, risk management, and governance suggestions appropriate?

The design of the DMF will be dependent on the outcome of the feasibility study to test the business case. A comprehensive feasibility study should include a detailed assessment of current insurances, risk exposures, profile and claims experience supported by analysis and modelling, consideration of DMF program structure including retention and transfer levels, operating model, overview of the tax and regulatory position, financial projections and a business case with options and recommendations.

As noted in the interim report there are a number of structures that could be considered. There may be others. There are many variables that will need to be considered. Cadence of member acquisition will be important. Will there be a block of members from day one? Will members join throughout the year as existing policies (where held) expire? Will renewals be co-terminus (so that all protections expire at a common date)? How will funding of operating costs and clams be dealt with during this period?

We agree that risk management is an important consideration. Without significant investment the risk management initiatives available at launch are likely to be limited, possibly confined to minimum entry standards and underwriting processes. It will take some time to further develop risk management practices across the membership, but this should quickly become a priority.

9. Are the design, risk management, and governance suggestions appropriate? Cont'd

One of the tools that can be quickly and inexpensively introduced in a DMF is education of members through sharing of high-level information about losses without naming and shaming. What happened why it happened, and how it could have been prevented. In a membership organisation like AALARA, these real examples resonate and are very effective.

Good governance is essential for the operation of any issuer of financial products and is particularly important in a DMF where the Board is ultimately responsible to its membership for both the acceptance and settlement of claims as well as the operation of a company that embraces all the operations requirements of a small insurer. For this latter reason management will generally need to be outsourced. It is far more than simply a fund manager and it is important therefore that manager holds its own AFSL with appropriate miscellaneous risk authorisations and shares a commitment to good governance and the mutual ethos. The relationship between the Board and the manager needs to be open and strong as the success of the DMF will jointly rest on their shoulders.

10. Does the timeline appear reasonable?

Assuming that the DMF is not seeking to launch with its own licence, we agree a timeline of 6 months from completion of the feasibility study is reasonable. Whilst we have established and launched a DMF in as little as three months we would not normally regard this as a realistic timeframe.

11. Are there alternative examples of government intervention that should be considered?

An option that Government could consider to support the sector would be the provision of insurance or reinsurance to the DMF by ARPC. This would require structural change or amending legislation to allow ARPC to operate as an insurer.

12. Are there other aspects that should be considered in terms of market conditions or capacity building for the DMF board and membership?

Market conditions will play an important in determining the financial structure of the DMF – what insurance and or reinsurance is available and at what price, what segments of the market are affected, what membership numbers can be expected at launch and subsequently, etc, etc, These are issue that will initially be considered during the feasibility study. Board membership cannot be formally determined until after the DMF is established. Regis' practice as part of, or at the conclusion of, the feasibility study, is to recommend the formation of a steering group drawn from potential representative members, who may ultimately form the initial Board. Thereafter a portion of the Directors should retire by rotation every three years. The membership therefore will have an opportunity to elect all the members of the Board over a period of time and an opportunity for the introduction of new blood.

13. What alternative models of financial support could be offered?

Whilst a matched grant could be one option for provision of start-up funding for development and build of a DMF, it may unfairly penalise smaller groups or associations. An alternative could be a capped grant which could be inversely relative to size, possibly with a minimum contribution percentage by members. There are practical difficulties with the latter part of this suggestion as our experience suggests that members will be reluctant to sign up until they know what the DMF product and pricing look like. This creates a situation where a proportion of the membership is asked to subsidise the start-up costs for others who join later.

13. What alternative models of financial support could be offered? Cont'd

At item 7.6 you refer to loans to the DMF. A loan could be used for either start-up costs or as a layer of contingent risk capital.

One of the challenges for a start-up DMF is that if started with a loan it is likely to have difficulty in meeting its financial obligations under the Corporations ACT or AFSL. For a loan to be effective it will probably need to be issued as subordinated debt.

An alternative for contingent risk capital would be to establish a Government draw-down facility that is only repayable when the DMF has a sufficient level of surplus from its ordinary activities. Repayment could be undertaken by instalments which are a fixed or scaled percentage of surplus.

14(i). Are the governance and reporting proposals appropriate?

The proposals at items 7.6.2 and 7.7 are broadly appropriate. Whilst we can see the rationale for inclusion of a Government representative on the Board whilst any loan facility is outstanding, appointment of the Government representative as a Director may result in conflicts. It may be preferable for the Government representative to have a standing invitation to Board meetings as an observer, and for such other checks and balances as required to be built into the terms of the loan facility.

14(ii). Is the suggested board make-up likely to provide the best results for the DMF?

We agree that the Board should always have a majority of directors drawn from the DMF membership. We think it too prescriptive to set the required number of Directors and composition. For a smaller DMF a smaller Board may be appropriate. We do agree that ideally the Board should contain one or two independent Directors with complimentary skill sets. A minimum of one Director (member or independent) should have appropriate insurance expertise.

15. Are there other issues that need to be considered in relation to interaction with states and territories?

With licensing and regulation being federally governed the principal issue is the inability of a DMF to provide an insurance certificate for the liabilities for which it provides discretionary protection. The problem also exists to a lesser extent with the provision of discretionary protection for property and assets, where mortgagees may require a certificate of insurance.

There are some mechanisms by which a DMF can provide an insurance certificate. The principal example is a hybrid mutual structure where the DMF purchases a group insurance policy that sits above the DMF retention. However, where this insurance is not available, an alternative will need to be found.

Whilst Federal and State Government entities could be compelled to treat a DMF certificate of protection as equivalent to an insurance certificate, we do not consider this could be mandated for non-government entities. To attempt to do so could blur the lines between insurance and DMF with unintended consequences.

A mechanism therefore needs to be found which places the DMF certificate on an equivalent footing. A potential solution could lie in a government guarantee. This would operate so that for approved DMFs (which would naturally include those with a Government facility) the Government would guarantee the payment of any properly constituted claim (i.e., cover is current, claim falls with the wording, not caught by any exclusions, etc,.) on the DMF which is not honoured. Third parties could then be compelled to accept the DMF certificate where such a guarantee is in place. This would require harmonising legislation across the States or at Federal level.

__15a. Are the perceptions around discretion presented accurate? Are there other perceptions that should be considered?__

Our experience is that with good communication, transparent operation and a respected Board, concerns amongst members and potential members can be allayed with any negative perception quickly shifting to positive.

The bigger perception issue is amongst third parties who require evidence of insurance. When an insurance certificate can be provided this problem is immediately overcome. As we note above, we believe a Government Guarantee could resolve this issue.

__15b. Are there specific legislative barriers that should be considered?__

We are not aware of any other legislative barriers.

__16. Are the current safety standards/regulatory environment/Quality Assurance verification purposes fit for purpose? If not, how would you suggest these be amended?__

Whether or not the Australian standards related to the amusement industry are fit for purpose is outside the scope of our expertise and we leave others to comment.

__17(i). What needs to be undertaken to ensure consumer awareness around the DMF?__

In the consumer's eyes, the DMF needs to provide cover that has the same effect as insurance. If this is achieved either through legislative change or some other means (e.g., as outlined in response to Q15, above), the only need would be to note this on the ticket terms or any liability waivers in use by the business operator.

__17(ii). Are there alternative methods for consumers to manage their own risk?__

Many consumers will have life insurance through their superannuation. A minority may have some form of income protection. We note the comments regarding Flip Insurance which provides limited injury cover. These may provide some comfort to consumers but will not obviate the need for public liability cover for the operators.

__18. Are there other sectors that should be included in membership of this DMF?__

It is important that a DMF, which is a vehicle for parties to share risks and collectively manage those risks, is made up of entities that are comfortable to share risks with each other, have a commonality of activities and an understanding of those activities which can be used to develop better standards and improved risk management. The commonality of risk is essential to ensure that no sector of the membership ends up cross-subsidising another. The activities and risks faced by AALARA members and members of the Showman's Guilds have sufficient commonality to suggest they would be a good fit for this DMF. On the other hand, the caravan and outdoor adventure industry has a very different risk profile and would be unlikely to fit.

__19. Are the proposed DMF member entry requirements adequate? What additional requirements could be considered?__

Entry requirements to a DMF will firstly be dependent on the DMF's definition of a member as set out in the Constitution. Thereafter, the Board has the power to determine further entry requirements and retains absolute discretion over acceptance of members. A DMF for AALARA would be expected to set minimum entry standards prior to carrying out an underwriting assessment of potential members.

19. Are the proposed DMF member entry requirements adequate? What additional requirements could be considered? Cont'd

The underwriting assessment will provide the basis for calculation of the contribution as each member will be rated individually, as well as establishing what risk management actions are required. If the DMF receives Government support, it should be open to all members of the industry, but acceptance into membership will be reliant on meeting minimum standards at the outset and committing to further improvements that may be required as a condition of ongoing membership. In this way standards across the industry should be raised and the incidence and severity of claims should decrease. Improving the risk profile of the industry through this process should firstly enable repayment of any government facility. Thereafter, surpluses can be used to reduce the costs of protection, provide additional risk management, or both. Ultimately, the risk profile may improve to a point where commercial insurers re-enter the market.

20. What else should be considered in the process of the final proposal development?

The feasibility study is critical. This will provide a framework for development of the final proposal. The primary questions to resolve are start-up funding, provision of contingent risk capital, operating model, including levels of risk to be retained and transferred, licensing and membership base. Behind this sits a myriad of tasks to establish, launch and operate the DMF.

Establishing a DMF is a significant project and will require a project leader and a project management team. The project management team should report to a steering group which as we note in our response to Question 12, should comprise a number of potential members.

21(i). Are the key success features identified accurate?

The six sub-headings listed in section 9 of the interim report are all integral features of operation of a successful DMF. All the underwriting recommendations by Ashurst are standard tools of the trade for well managed DMFs and can be used as required. DMFs with their membership makeup are well placed to strike the necessary balance between the use of carrots and sticks.

21(ii). Are there other features that should be considered?

Ultimately a successful DMF is one that is financially sound, whose members are managing their risks so that the DMF is able to price risk affordably, and whose members have a high degree of trust and satisfaction with the DMF (together = stickability).

Claims management is a key component of both the financial condition of the DMF as well as member satisfaction. After price, claims handling is likely to be the factor that the DMF is most judged upon. We comment further in our response to Question 24.

22. What other offerings to the DMF membership might increase 'stickability'?

An established DMF with a strong member base will already experience a high degree of member trust and satisfaction. This can be further strengthened through provision of further products or services. Financial products could include the provision of discretionary protection for different risk classes to the members. For example, many small business operators depend on good health for their livelihoods. An income protection product might suit AALARA and Showman's Guild members.

23(i). How important is contestability of service offerings?

We agree that there should be contestability of service offerings to maintain choice and competition in the market. It is undeniable that when brokers act as managers of DMFs potential conflicts can arise where the same brokers also act for clients wishing to become members of the DMF. Given the small number of experienced mutual managers in Australia, it is desirable to find an effective way to manage this conflict to maintain contestability.

We strongly disagree with the suggestion that the length of the initial management contract should be short with renewals at one- or two-year periods.

Developing and building a DMF is a complex process. Once launched the first two to three years of operation are critical and it is likely to be five years before the DMF is fully established and able to contemplate a change of management or taking the management in house. During this initial phase the DMF developer and builder needs to be heavily invested in the ultimate success of the DMF. This can only be achieved through continuity of management. That way there can be no escaping the obligation to build a structure that is robust and will stand the test of time. The DMF and the managers need to have an alignment of objectives through this period.

Continuity in the management is also important in managing relationships with both the Board, members, and external providers – particularly insurers and reinsurers. Frequent change is inefficient and substantially increases the risks in a start-up operation, particularly where the business has long tail implications such as public liability. A DMF that has a complete change of staff every one or two years is unlikely to be able to build the trust and report with the Board and members that is an essential part of the DMF glue. Risk management projects that may have a horizon of more than a year are unlikely to be commenced and there could be a potentially fatal misalignment of objectives.

A key function in a DMF is the mutual accounting which requires actuarial provision for claims. Whilst this may be undertaken in house by the manager throughout the year, an annual review and report will normally be required by the Board, and this will be reviewed by external auditors as part of the annual audit. Actuarial provisioning, particularly during the early life of a DMF, requires a consistency of approach which is unlikely to be achieved with frequent changes of the management team. For this reason, we would also advocate consistency with Independent Actuary and Auditor appointments.

In addition, establishing a DMF requires a significant investment in time and resources by the DMF manager, the full cost of which cannot realistically be recouped with a one-off establishment fee. A longer period is required during which the manager can receive a reasonable return on investment through a management fee.

23(ii). Are there other ways to ensure contestability?

We recognise that where Government support is involved a degree of contestability is likely to be a requirement of the support. Whilst the rationale set out above still applies, we can see a case for requiring a review after a number of years and this could be a condition where support is provided. Otherwise, it is ultimately a matter for the Board of the DMF to monitor the performance of the managers to ensure that the needs and interests of the members are foremost.

24. What are additional best practice claims handling procedures?

We are concerned by the comment at item 10.3.2 of the interim report that "consultations with regulators have uncovered an amount of concern that the discretionary nature of a DMF will lead to valid claims being denied". In Regis' experience this is completely at odds with the facts. Risk protection DMFs, whether dealing with wholesale or retail clients, are required by the legislation to produce a PDS. Inter-alia, the PDS must contain an explanation of the discretionary nature of the protection and must include the protection wording which, just like an insurance policy, states what may be protected and what is excluded. The single difference is the exercise of discretion and the language of the wording which states "may pay" rather than "will pay". The point is that whilst the Board retains discretion, it must be exercised fairly, not capriciously. If a DMF refused to pay valid claims that fall within the wording, it would very quickly lose member trust and see a member exodus.

Of course, a DMF will reject claims that are not valid – for example those caught by exclusions or falling outside the period of protection. However, this is where discretion gives the DMF much greater flexibility by being able to consider and accept claims that fall in grey areas or in some circumstances, even claims which may fall within an exclusion.

Claims procedures in DMF should be structured to work with and support the member through what can be a difficult and stressful time. Claims handlers in DMFs need to be empathetic towards members and non-adversarial when dealing with contentious points.

In addition to strenuously defending unmeritorious claims by third parties against members, DMFs can take a strong position on pursuing recoveries. This will ultimately benefit the DMF as well as improving the member's loss record.

Finally, with a claims committee as a sub-committee of the Board, DMFs are able to make claims decisions quickly with a minimum of bureaucracy. This can be a significant advantage when dealing with large claims or members under financial strain following a loss, where the DMF can often authorise the release of emergency funding against the claim.

25(i). Should the DMF include a constitutional protection against demutualisation?

Ultimately the Constitution of the DMF should provide the necessary protection by ensuring that any proposal for demutualisation requires approval by the membership at an AGM or EGM. Further protection has been granted through the Treasury Laws Amendment (Mutual Reforms) Act 2019 enabling issue of MCIs.

25(ii). Should government introduce a protection against demutualisation for the broader sector?

We do not consider there is currently a need to introduce regulation in this area, but for any DMF that receives government support, a condition thereof could be that the DMF may not demutualise within a set period after cessation of support.

26(i). Is public confidence in the DMF likely to be an issue?

For a DMF for AALARA, we refer to our comments in response to Questions 15 and 17(i). Backed with a Government guarantee we do not consider that consumer confidence is likely to be adversely affected. Indeed, compared to insurance with an offshore insurer, confidence may be strengthened.

26(ii). What else could be done to encourage public confidence in the proposed DMF?

Communication, leadership by example and quick, non-contentious claims settlement.

27(i). Are there appropriate mechanisms to reengage with private sector/industry market solutions over the life of the insurance market cycle?

The DMF should review its risk retention and transfer structure at least annually and a well-managed DMF will be keeping a close watch on market trends with a view to re-engaging when and where appropriate. Managing the level of risk retained in the DMF and the amount expended on risk transfer for high level and accumulation risks is a key responsibility of the Board and managers.

It has been noticeable that the introduction of a DMF in a market that has previously shunned the risks in question often encourages the market to either reverse its original view over time or provide support for the DMF going forward.

27(ii). If not, what proposal settings would enable the sector to take advantage of a softening market?

A softening market brings more challenges to a DMF than a hardening market. Whilst insurance and/or reinsurance purchased by the DMF may be more affordable, this is likely to coincide with the point at which price competition for DMF members becomes toughest. The DMF needs to position itself during the hard market to ensure that it can ride out the soft market cycle when it price competition is at its toughest. This does not mean making hay whilst the sun shines, though building a level of reserves is obviously prudent. What it does require is engaging with members so that the true value of the DMF is properly understood and they will continue to support it through the soft part of the cycle.

Yours sincerely,

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