



Law Council
OF AUSTRALIA

Business Law Section

9 November 2021

The Ombudsman
Australian Small Business and Family Enterprise Ombudsman
(**ASBFEO**)

Email: inquiries@asbfeo.gov.au

Dear Sir

Feedback on ASBFEO's Preliminary Report, *The Show Must Go On: Is a discretionary managed fund the solution to the insurance crisis facing Australia's amusement, leisure and recreation sector?* (Report)

Introduction

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (**Committee**) provides in this letter its responses to the preliminary findings from the Report and where appropriate to the consultation questions posed by the Report.

The Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) including in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting small to medium enterprises.

Please note that the Committee's input may differ from that of other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

Background to the Proposal and the Report

The Report dated 20 October 2021 was prepared by ASBFEO following a review conducted in response to a proposal by the Australian Amusement, Leisure, and Recreation Association's (**AALARA**) to establish a Discretionary Mutual Fund (**DMF**) as a potential solution to the critical and immediate need for insurance in the sector represented by AALARA (**Proposal**).

The Committee understands that following the 2020 ASBFEO inquiry into the insurance market for small business, to which the SME Committee provided a submission, AALARA engaged with ASBFEO and across government to highlight the inability of businesses within their sector to secure insurance, to gain support for the establishment of a DMF for the sector and entered into a partnership with Aon to establish an industry-owned and operated DMF to provide accessible and affordable insurance for the benefit of their members.

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The ASBFEO review of the Proposal has been undertaken to allow ASBFEO to provide advice to government and the sector on the need to support businesses in securing critical insurance products and investigate whether the DMF model proposed by AALARA would resolve the insurance issues in that sector.

Responses to Report preliminary findings

The Committee appreciates that the Report seeks to comprehensively set out the issues framing the current concerning position of some small business sectors regarding their inability to obtain the public liability insurance cover they require to maintain their business activities, whether that inability is due to there being no such cover on offer in the market, or to any such cover being unaffordable, and to then assess whether the Proposal could provide a solution to those issues.

ASBFEO's preliminary findings from the review are set out in paragraph 1.2 .1 of the Report as:

- a DMF suits the industry represented by AALARA;
- a DMF may be a suitable way to address the current insurance crisis facing the industry;
- the suitability and durability of a DMF solution for the sector will depend heavily on
 - support for legislative reform from states and territories,
 - willingness to accept the solution by councils and land/showground managers,
 - the final makeup of the membership,
 - the cost of premiums and reinsurance,
 - the management of the DMF and any management costs, and
 - the size of any claims in the first few years of operation.

With respect, the Committee considers the solution being sought to enable those small business sectors, including members of AALARA, to have affordable access to the public liability insurance cover they require can be achieved as set out in the Proposal through a mutual fund but without the need for the 'cover' provided to be discretionary, where members only have a right to have their claims considered, rather than a right to be paid for a claim when agreed criteria are met.

The Committee notes that the Report indicates that the reason for benefit payments to be made from the mutual fund on a discretionary basis is to avoid having the fund contractually bound to make the payments when agreed criteria have been met. This discretionary basis for payment seems to be preferred because the Proposal indicates that if there is a binding contract, the contract would fall within the definition of 'insurance' and the fund would be required to be registered with and regulated by the Australian Prudential Regulation Authority (**APRA**) as a general insurer and abide by the applicable legislative and prudential obligations.

The Committee suggests that it would be preferable to establish a mutual non-discretionary fund (**MNDF**), which would operate in a similar manner to that proposed for a DMF, as the provider of a 'mutual risk product' to mutual fund members but with members having a right to have their claims paid and the fund having a legal obligation to pay claims. Mutual risk products are provided as an alternative to conventional general insurance products, as is the case under the Proposal.

It is the position of the Committee that small business members of the mutual fund should enjoy certainty of benefit payment for the cover required when agreed criteria for payment have been met. In the Committee's view, despite the Report saying that the Proposal considers it most unlikely that the fund would not exercise its discretion to make a payment

requested, because there would be no binding contract under the Proposal to make the fund liable to make a payment, the risk to a small business of making contributions and not receiving payment should be too high to accept and well outside the risk appetite of a small business.

The Committee notes that the APRA regulated legislative regime for general insurers was introduced following the collapse of HIH in 2001 to protect the interests of insureds particularly by strengthening the prudential framework requirements for general insurers, and, as noted in the Report, that the HIH Royal Commission recommended that DMFs be APRA regulated. The Committee also believes that the most prudent position to properly support the small business members who contribute to the fund under the Proposal is for the entity proposed to be registered as a general insurer and regulated by APRA.

Despite the Report noting the industry does not support the entity under the Proposal needing to be a general insurer registered and regulated by APRA, it is the Committee's position that without the requirements that apply to a registered general insurer, the risk to contributing fund members of not receiving payment on a claim should not be acceptable to AALARA as an industry body representing small businesses.

The Committee also considers it is not appropriate to expect government to make legislative changes to enable its agencies or others such as local government bodies to accept that a potential payment that is subject to such risk could apply in lieu of a binding general insurance contract because in the Committee's view the risk purporting to be covered would in those circumstances have actually shifted to the government agency. In other words, the Committee is of the view that the existence of only a discretionary payment from the fund is tantamount to the contributing fund members effectively having nothing at all.

The Committee is also very concerned that it may not be appropriate for the ASBFEO as a government agency to support an outcome that such payments should be made on a discretionary basis.

The Committee does note that the Report recognises the requirement for the fund trustee to hold an Australian Financial Services Licence (**AFSL**), regulated by the conduct regulator the Australian Securities & Investments Commission (**ASIC**).

The Committee believes that should the proposed mutual fund be established, as the Committee has suggested, as a MNDF, it should apply for relief under ASIC IR 03-17, which contains information on ASIC relief for mutual risk products from having to be registered managed investment schemes under part 5C of the *Corporations Act 2001* (Cth) (**Corporations Act**). As an AFSL holder, however, the mutual fund would still be required to abide by the applicable provisions of Chapter 7 of the Corporations Act, many of which are, in any event, reflected in the Proposal.

It is the Committee's position that establishing the mutual fund as a MNDF registered as a general insurer with and prudentially regulated by APRA, and regulated by ASIC as an ASFL holder, would provide the small business members of the mutual fund with considerable comfort and mitigate the risks of making payments into a fund that is not prudentially regulated.

The Committee is aware from the Report that the 'DMF' industry is strongly opposed to requiring DMFs to be APRA regulated due to the prudential capital required of registered insurers, and considers that regulation would result in DMFs becoming unviable to operate. The Committee finds that opposition to prudential regulatory review troubling, given the benefit payment uncertainty risks borne by small business mutual members of DMFs. The Committee is of the view that it is preferable, if an alternative MNDF is not established, to

mitigate this risk to small business mutual members by strengthening the financial viability of the mutual fund as required when APRA registered, even if the timeframe to reach viability, and the amount of source and build up funding is more than needed if the mutual was a DMF, than to allow that risk to remain unmitigated.

The Committee is again concerned that it is also not appropriate for ASBFEO as a government agency to support opposition as raised by industry in the Proposal to the fund being regulated by APRA as a general insurer.

It is the SME Committee's position that the mutual fund's ability to provide the required cover to small business mutual members as a MNDF which is an APRA regulated general insurer should not differ, from a funding perspective, to the Proposal as it has been described for a DMF, other than for the amount of prudential funding required if APRA regulated, yet considerably reduces the risk the use of a DMF poses for contributing small business mutual members. On this basis the Committee submits that ASBFEO should support the Proposal, not with a DMF but with a mutual fund as a MNDF which is an APRA regulated general insurer.

The members of the mutual fund would be required to contribute to the fund, whether as a DMF, or as a MNDF APRA regulated general insurer, based on actuarial calculations to support funding for the pooled risk value of all members and the potential timing of benefit payments which should take into account each the claims history and risk profile of each contributing member and the potential value of benefit payments to be covered, subject as discussed in the Report to that funding being supplemented potentially initially by government grant, loan or capital contribution, and potentially a degree of tapering reinsurance until the funding pool reaches its viable ongoing value.

Should the ASBFEO accept the position put by the Committee that the mutual fund in the Proposal should be a MNDF as an APRA regulated general insurer, the Committee considers there would not be a need to approach government at any level, nor licensing and regulatory authorities to seek to have the requirements that small businesses have public liability insurance cover replaced with an accepted Certificate of Protection, nor to look to have legislation introduced to have a Certificate of Protection recognised as meeting the obligation for a small business to have public liability insurance cover in contractual arrangements such as loan agreements, leases, and operating licences.

Finally, given the Proposal was instigated by AALARA being advised by the Insurance Council or Australia that there are no insurers in Australia prepared to issue public liability insurance cover to small businesses in the Australian amusement, leisure and recreation industry, the Committee suggests that it may be opportune for ASBFEO and AALARA to approach government to consider broadening the remit of the Australian Reinsurance Pool Corporation to cover small businesses in industries where insurance cover required to enable them to maintain operations is not available. This could assist in enabling the mutual fund to obtain sufficient cover in its initial years to meet its benefit payment obligations, aside from contributions received.

Responses to consultation questions

In addition to the Committee providing its above responses to the preliminary findings of the Report, the Committee has also sought to respond below to the consultation questions raised in the Report.

The Committee wishes to commend the ASBFEO for the comprehensive details on all aspects of the Report, and confirms that it concurs with most of the content on process and

analysis and accordingly should be considered supportive on all aspects unless otherwise stated.

1. *Is there a need for action by government? Is there a proven incapacity for the industry to self-support a solution?*

Whether on the basis that the mutual fund is a DMF, a MNDF APRA regulated general insurer, the Committee recognises that initial funding support from government may be required, and otherwise does not consider there should be any need for government action, as aside from initial funding support the industry should be able to provide itself with a solution as in the Proposal, varied for the mutual fund to be a MNDF APRA regulated general insurer.

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

The Committee notes that if the government does not provide any initial funding support, the sector may need to raise funds elsewhere by providing a strong business case for the mutual fund to be established and grow to a viable ongoing entity. Another solution, or part solution, would be to have the remit of the Australian Reinsurance Corporation broadened to allow it to provide reinsurance to the mutual, and thereby reduce the level of funding establishment capital required.

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

The Committee refers to its prior answers on government support and also notes that the Proposal as varied could also be used in other small business sectors, or on a wider basis in the small business environment. The Committee considers that as the mutual fund model proves effective the ability to raise initial funds will improve as these entities become recognised as effective and viable funds.

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

The Committee refers to its response to Question 3 and also considers the Proposal, as varied, should provide an appropriate solution to the concerns around the ability of small businesses to obtain required public liability insurance.

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

As set out above, the Committee considers that better practice is for the mutual fund to be a MNDF APRA regulated general insurer, and also an AFSL holder. It also notes that ASIC and APRA as well as industry representative organisations like the Business Council of Co-operatives and Mutuals (**BCCM**) will have best practice guidelines or be able to work with ASBFEO or government to put these in place.

6. *Are the public policy considerations listed accurate? Should additional considerations be included?*

The Committee considers that in the current environment after the Hayne Royal Commission, the environmental impacts of drought, bushfires, floods and COVID, and the resultant hardening of the global insurance market, it is of critical importance that the financial viability of the mutual fund be secured to mitigate any further risks to small business of making payments to the fund and not receiving benefit payments

when expected. In addition, the importance of strengthening risk management practices in reducing risks to consumers, or in this case to small business mutual members, has been the subject of both regulator and media and community increasing recognition over the last couple of years. Accordingly, the Committee is of the view government policy should be to support ASIC or APRA regulated mutual funds (as opposed to DMFs) through direct initial funding support, and if considered appropriate through legislation to perhaps reduce the initial financial expense impact of a mutual fund needing to meet APRA prudential requirements.

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

The Committee, as advised, considers that the mutual fund should be APRA regulated, and ASIC regulated, rather than be a DMF.

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

The Committee refers to its previous responses.

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

The Committee is of the view the design, risk management and governance suggestions in the Report are appropriate and would apply to a mutual fund that is a MNDF regulated by APRA, as well as to a DMF.

10. *Does the timeline appear reasonable?*

From experience, the Committee thinks that a 3 to 6 month timeline to establish the fund may be too short, particularly if government initial funding support is to be sought and obtained, and if the mutual fund is to be a MNDF APRA regulated general insurer and hold an AFSL. The Committee considers that the time to establish the fund may be as long as 18 months to 2 years, with an efficient program team in place to progress the exercise.

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

The Committee notes again the references in the Report to the establishment of the Australian Reinsurance Pool Corporation in response to the inability to obtain terrorism insurance cover after the 9/11 attacks, and suggests that ASBFEO might consider approaching government to extend the remit of this corporation to cover , as was done for the cyclone reinsurance pool for Northern Australia, the reinsurance gap/top up requirements for mutual funds such as in the Proposal, or for a larger fund to cover the small business community more broadly if need be.

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

The Committee suggests that community and media sentiment should be considered as well as ensuring the Board of the mutual is made up of people with the appropriate skills and experience to be able to drive the entity through its initial establishment and funding stages so as to then get to a viable ongoing operating entity. The Board of the mutual, given its specialist purpose, should not simply be drawn from AALARA representatives. Rather, criteria for appointment to the Board should emphasise the

need for experience and technical knowledge of what is required for the management and control of such a specialist entity.

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

The Committee notes that the Corporations Act now has provisions that enable capital raisings by a number of methods, including crowd funding or similar innovative approaches. The Committee suggests all options should be considered.

14. Are the governance and reporting proposals appropriate? Is the suggested board make-up likely to provide the best results for the DMF?

The Committee notes that the Report suggests a board of nine directors, a majority of whom (five) should be representative of the mutual members, with three independent experts and one government representative while government funding is on foot, perhaps for the first five years.

The Committee notes from the experience of its members that when establishing an entity to provide such specialist product as insurance, or an insurance equivalent mutual risk product to the sector, it could prove more prudent to initially have the board comprise a majority (five) of independent directors with a range of expertise in general insurance, a government representative as suggested to monitor the government's investment, and three directors representing mutual members. The Committee suggests that the initial five independent experts should comprise an actuary with general insurance experience and technical skills, a lawyer with general insurance experience and technical skills, an accountant with general insurance experience and technical skills, a former general insurance executive, and an experience financial services chair.

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

The Committee notes that should the ASBFEO accept the position put by the Committee that the mutual fund in the Proposal should be a MNDF APRA regulated general insurer that also holds an AFSL, there would not be a need to approach state and territory government, nor local government nor licensing and regulatory authorities to seek to have the requirements that small businesses have public liability insurance cover replaced with an accepted Certificate of Protection, nor to look to have legislation introduced to have a Certificate of Protection recognised as meeting the obligation for a small business to have public liability insurance cover in contractual arrangements such as loan agreements, leases, and operating licences.

Are the perceptions around discretion presented accurate?

The Committee considers that despite the arguments put forward in the Report to support payments from the fund being discretionary, the perceptions around the payments from the mutual fund being discretionary are accurate. The mutual fund members do not have a legal right to receive an indemnity payment for benefits they are looking to have covered.

Are there other perceptions that should be considered?

As raised earlier, the Committee considers it may not be appropriate for the ASBFEO as a government agency that advocates for small business to support the fund

making discretionary payments which exposes the small businesses that contribute to the mutual fund to an unnecessary risk of not receiving payments.

Are there specific legislative barriers that should be considered?

As mentioned, the Committee considers that if the mutual fund is a MNDF APRA regulated general insurer, there would be no need to consider or require any legislative changes to have a Certificate of Protection recognised as equivalent to having public liability insurance cover.

16. Are the current safety standards/regulatory environment/Quality Assurance verification purposes fit for purpose?

The Committee gathers that the inclusion of information on safety standards applicable to the amusement, leisure and recreation industries is to demonstrate the risk management applicable to the activities conducted by small business contributing mutual fund members in undertaking their business operations, which would assist in quantifying the potential value of payments to be made from the mutual fund.

The Committee is unable to comment as to whether the current safety standards/quality assurance verifications are fit for purpose, although notes that the mutual fund, whether a DMF, or a MNDF APRA regulated general insurer, should require all fund members to abide by these and if they are not fit for purpose, operate at a higher standard.

If not, how would you suggest these be amended?

The Committee suggests the industry work with the standard provider organisations to uplift the standards and quality assurance if they are currently not fit for purpose. Regarding the regulatory environment, as previously mentioned, the Committee considers it is preferable that the mutual fund be a MNDF APRA as a general insurer.

17. What needs to be undertaken to ensure consumer awareness around the DMF?

Consumer awareness that a small business undertaking activities in the amusement, leisure and recreation industry is generally through clear printed information on notices or on tickets, and the Committee considers this should remain appropriate.

Are there alternative methods for consumers to manage their own risk?

The Committee notes the Report raises the possibility of a small business partnering with another insurer to enable consumers to take out their own insurance to cover risks to them in participating in the activities undertaken by the small business. The Committee considers this could be an acceptable solution for some activities, such as scuba diving, bicycle riding, skydiving or jet ski riding, but notes there may be a number of activities where it would not be appropriate to have consumers take out their own insurance policy, such as Sydney Harbour bridge climbs.

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

The Committee is of the view that the establishment of a mutual fund to issue a mutual risk product as a MNDF APRA regulated general insurer could also provide a solution to other small business sectors that are finding public liability insurance cover

difficult to obtain. The Committee is also of the view that the ASBFEO should perhaps consider establishing such a mutual fund for the small business sector more generally.

19. Are the proposed DMF member entry requirements adequate?

The Committee considers the proposed minimum entry requirements as listed in paragraph 8.3.2 of the Report to be adequate. The Committee also notes that the emphasis on risk management practices and claims history in order to enable more accurate assessment of the member risk profile and the potential costs of payments, and thereby assessment of the mutual member contribution costs and of amounts that may be required through additional funding options, would also be appropriately applicable if the mutual fund was a MNDF APRA regulated general insurer.

What additional requirements could be considered?

The Committee suggests that membership of AALARA could also be a member entry requirement, which would then enable the mutual fund to maintain engagement with a member to ensure information is regularly provided on risk management practices and other support activities.

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

As the Committee has mentioned, the establishment of the mutual fund as a MNDF APRA registered general insurer and approaching government to broaden the remit of the Australian Reinsurance Pool Corporation and additional aspects that could be considered in finalising the proposal.

21. Are the key success features identified accurate?

In the Committee's view, the key success factors listed in paragraph 9.1.1 of the Report for mutual funds are accurate to enable and maintain support and loyalty to the fund by small business contributing members.

Are there other features that should be considered?

The Committee notes that the most important demonstration of success will be that the mutual fund is able to provide its contributing members with public liability insurance cover, whether through a group policy or as a general insurer, as required to enable those small businesses to continue to undertake their activities, and to be able to make payment to them for any claims made as anticipated.

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

From their experience with professional indemnity insurers SME Committee members have recognised that by the insurer regularly engaging with information on better practice management and providing regular examples of circumstances in which claims need to be made, including examples of when the insurer has denied liability and the reasons for doing so, result in a strong relationship and loyalty bond between the insured and the insurer.

23. How important is contestability of service offerings?

The Committee notes that if the mutual fund is a MNDF APRA regulated general insurer and holds an AFSL, it will have regulatory obligations regarding its appointment of any service provider, but particularly the appointment of a mutual manager which as the major service provider would be a material outsourcing arrangement for the mutual fund. Likewise, the appointment of a mutual manager by a DMF would also be its major service provider.

These regulatory obligations, and in any event best practice, recognises that the appointment of material service providers should be for a fixed term, and reviewed regularly preferably through a tender or benchmarking process. An ongoing governance framework should also be in place for the manager covering operational management and receipt of reports and other regular interactive requirements to ensure the relationship between the fund and the provider remains healthy and productive.

Are there other ways to ensure contestability?

The mutual fund should adopt best practice governance frameworks and policies which should, from the Committee's experience, include requirements for regular benchmarking and tender reviews of services providers.

24. What are additional best practice claims handling procedures?

The recent introduction from 1 January 2021 of insurance claims handling as an authorised service under an AFSL is supported by information from ASIC including on best practice claims handling practices.

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

The Committee notes that from the experience of its members when an entity is being established in a particular form, such as the proposed mutual fund in the Proposal, it is not unusual for the entity's constitution to provide that any major change, such as demutualisation, requires a special resolution of members, being a requirement that 75% of members (usually those present and voting at a general meeting) vote in favour of a resolution to make the change.

Should government introduce a protection against demutualisation for the broader sector?

Given the constitution for the proposed mutual fund can include the requirements for a decision to demutualise to have to be passed by a special resolution of fund members, the Committee notes there should be no need for the government to introduce legislation banning demutualisation. The Committee notes It is also possible for the government, if it provides funding to the mutual fund, to include in its funding arrangements a condition that demutualisation does not occur while it is still owed funds, or any other appropriate time.

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

As raised earlier, the Committee does consider that having discretionary payments poses an inappropriate risk for small business fund members, and could also accordingly result in loss of public confidence in the use of a DMF.

What else could be done to encourage public confidence in the proposed DMF?

The Committee reiterates its suggestion that the Proposal be to establish a MNDF APRA regulated general insurer.

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

From the experience of Committee members, as a MNDF general insurer, the mutual fund will be a purchaser in the Australian general insurance market, whether for reinsurance or group insurance and accordingly should the market in future soften, the mutual fund should be aware and it will be open to it if need be to reengage with the insurance sector and take advantage of any appropriate offerings to benefit its small business member contributors.

If not, what proposal settings would enable the sector to take advantage of a softening market?

The Committee notes that under the Proposal the mutual fund may be established under the Corporations Act as a company limited by guarantee.

Further discussion

The SME Committee would be happy to discuss any aspect of this feedback. Please contact Coralie Kenny, Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully



Greg Rodgers
Chair, Business Law Section