Principles, Code of Conduct and Good Practices for Discretionary Mutual Funds

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Acknowledgements

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This code and these practices provide a benchmark for what good looks like. Through this, our sector will not only continue to perform strongly long into the future, but also provide new entrants with a framework of what is expected.

Jim Glossat
CEO, Capricorn Mutual

CEO MESSAGE

Melina Morrison
Chief Executive Officer

Dear Reader,

I am pleased to share with you the first industry Principles, Code of Conduct and Good Practices for Australian Discretionary Mutual Funds.

There is a renaissance in interest in mutual insurance and risk protection, with many stakeholders seeing potential for Discretionary Mutual Funds to help respond to hardening insurance markets, whether caused by 'usual' economic cycles and shocks, or by longer term environmental and social trends and challenges.

The Business Council of Co-operatives and Mutuals (BCCM) Discretionary Risk Mutuals Forum has developed this document over the past year and I thank the members of the Forum for their willingness to collaborate and contribute their time to this project. It is hoped that this document, which reflects the collective wisdom of Australia's most successful Discretionary Mutual Funds, will be a valuable educative resource for all stakeholders with an interest in this model including policymakers, regulators, industry associations, businesses, advisors, mutual managers and the wider community.

It provides useful background on the history of the co-operative and mutual movement, the key elements of a mutual, the differences between a mutual insurer and a Discretionary Mutual Fund, the regulatory framework for Discretionary Mutual Funds and, importantly, how discretion is typically exercised.

Signatories to this document make a voluntary commitment to:

- **Eight principles**, adapted from the international co-operative principles for the specific operating context of a Discretionary Mutual Fund, including **Member Ownership and Control**; and
- **20 behaviours,** contained in the Code of Conduct, including **always putting members first**.

They also seek to observe 42 good practices in relation to structure, board, management, audit and risk, finance and compliance that underpin the operation of sustainable, member-focused Discretionary Mutual Funds.

Signatories also demonstrate a willingness to work with peers to continuously improve standards in the industry.

I invite all Discretionary Mutual Funds and mutual management companies to apply to become signatories to the Principles, Code of Conduct and Good Practices by contacting the BCCM via info@bccm.coop.

"

People trust

Discretionary Mutual Funds

because *we are the calm centre* in a world of swirling risk and uncertainty.

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These Principles, Code of Conduct and Good Practices for Discretionary Mutual Funds have been developed jointly by the Business Council of Co-operatives and Mutuals (BCCM) and a working group of Australian Discretionary Mutual Funds through the BCCM Discretionary Risk Mutuals Forum[1].

[1] Comprising DMF members of the BCCM

CHAPTER 1:
OUTLINING PURPOSE

INTRODUCTION

There has been a marked increase in interest in Discretionary Mutual Funds (DMFs) as a substitute for conventional insurance that has sparked a resurgence in companies promoting the model and the ability to set-up and manage mutuals. This includes not only the major broking houses, but also a number of smaller firms and individuals.

In a submission to the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) Inquiry into a DMF for the amusement and leisure activity industry, the BCCM recommended the establishment of a set of good practice guidelines for DMFs. BCCM's proposal was accepted as a key recommendation of the ASBFEO report. The ASBFEO Inquiry said:

> "6.7. DMF Better Practice
>
> 6.7.1 There has been an evolution in Australia of what is considered 'good practice' in operating a DMF.
>
> 6.7.2 While this good practice is not documented and publicly available, those operating in and adjacent to the DMF sector speak about it and appear to have mostly a shared understanding of how it applies to their operations. While not everybody will agree with each of the items, **it may be wise for the sector or the Business Council of Co-operatives and Mutuals to consider the development of a documented 'best practice guide'**."[2]

Furthermore, the ASBFEO Inquiry Report stated that best practice guidelines would help ensure ethical standards and duty of care to members in relation to DMFs now being able to raise investment capital following recent changes to the Corporations Act[3]:

> "6.7.3 Best practice generally includes:
>
> 1. Ensuring an appropriate structure, which (as discussed below) could include either a Trust or a Company limited by Guarantee. Advisers to this project prefer the Company structure due to the greater suitability for providing good governance over a longer period, and the ability to raise Mutual Capital Instruments."

Following release of the ASBFEO Inquiry Report, the BCCM raised the issue within the BCCM Discretionary Risk Mutuals Forum. The members of the forum supported the BCCM proposal and following due consideration developed this set of Principles, Code of Conduct and Good Practices as a guide to good practice amongst Australian DMFs.

[2] ASBFEO DMF Inquiry Report, 20 Oct 2021 p. 33
[3] Treasury Laws (Mutual Reforms) Act 2019

ABOUT THIS DOCUMENT

A primary purpose of the Principles, Code of Conduct and Good Practices is to provide a framework for good practice and to establish a voluntary set of minimum standards for DMFs and their managers that are readily available to members, intermediaries, regulators, and other stakeholders.

This document summarises the relevant legal and regulatory background and sets out the minimum standards that DMFs will aim to achieve at all times in the provision of discretionary protection and any related matters.

The Principles, Code of Conduct and Good Practices do not have any legal status; they are voluntary. Adoption of the Principles, Code of Conduct and Good Practices is voluntary and is a statement of intent by the signatory. The DMFs and mutual managers that have initially adopted them are listed in the Appendix.

Signatories, complaints and governance of principles, code of conduct and good practices

This document is stewarded by the BCCM Discretionary Risk Mutuals (DRM) Forum. All DMFs who are BCCM members are entitled to participate in the BCCM DRM Forum.

Any DMF or mutual manager may apply to be a signatory to the Principles, Code of Conduct and Good Practices by emailing the BCCM at info@bccm.coop. The BCCM may require copies of corporate documents to verify eligibility (i.e., mutual status). While any DMF may become a signatory and can then promote its status as a signatory, only DMFs that are BCCM members are entitled to participate in the DMF Forum. The DMF Forum may invite non-members of the BCCM to observe meetings.

Any complaints about a signatory in relation to their performance against the Principles, Code of Conduct and Good Practices should first be made to the signatory to resolve directly. Complaints can be made via info@bccm.coop, however if there is no evidence that the complainant has attempted to resolve the issue directly with the signatory, the complaint will be firstly forwarded to the signatory to resolve. If a complaint involves an allegation of conduct that amounts to breach of the criminal law, BCCM may refer the complaint to the appropriate authorities. If the complaint relates solely to a civil dispute with the signatory (rather than matters related to the Principles, Code of Conduct and Good Practices), then the BCCM will not deal with the complaint. Such a complaint may be referred to relevant external bodies at the discretion of BCCM without having any obligation to do so. All correspondence, including the complaint, must be respectful and use non-offensive language. If the complaint has been referred to the signatory and is not resolved in a reasonable time by the internal processes of the signatory, then the complaint will be tabled at a BCCM DMF Forum meeting and members (excluding the signatory, if they are a member) will decide whether or not to remove the signatory from the signatory list. The BCCM DMF Forum can also, independent of a complaint, decide to remove a signatory if it believes the signatory is bringing the Principles, Code of Conduct and Good Practices into disrepute.

Regardless of BCCM membership status, a signatory who is the subject of a removal decision may attend the DMF Forum meeting where this is being decided in order to provide their account of the matter.

If a signatory is removed, they are obliged to cease promoting themselves as a signatory.

All signatories agree to be bound by decisions of the BCCM DMF Forum about amendments to this document and the removal of signatories.

WHAT ARE MUTUALS?

Mutuals are organisations that are owned by and run for the benefit of their members. Members can be customers, suppliers, employees or a community of interest. Mutual enterprises (including co-operatives) exist in almost every sector of the economy in Australia, including agriculture, housing, health, retail, mobility, wholesale and community services.

Mutuals have existed for hundreds of years, and in the UK can be traced back to at least the 17th century. One of the first fire insurance companies, set-up in 1696, was a mutual. Widespread demutualisations in the 1990s and 2000s resulted in mutual businesses being converted into shareholding companies. In Australia, well known examples include NRMA Insurance and AMP. Customers found that service levels deteriorated, and the priority of the company shifted very firmly away from serving the interests of the customers to maximising the returns to shareholders and management.

In the UK, the mutual financial services sector includes mutual insurers, discretionary mutuals, friendly societies, credit unions and co-operatives. Similarly, in Australia the mutual financial services sector consists of mutual ADIs (credit unions, mutual banks and building societies), mutual insurers, friendly societies, DMFs, not-for-profit health funds and not-for-profit superannuation funds.

The key factor is that all are owned by their customers. There are no external shareholders. Well-known mutuals include banks like Great Southern Bank and insurers such as HCF and Australian Unity. Some examples of DMFs include Capricorn Mutual (motor trade small businesses), CivicRisk Mutual (local government), Employsure Mutual (SME businesses) and Unimutual (universities).

All mutuals have a common ethos – they exist to provide protection and benefits for their members who are both owners and customers. Mutuals do not exist to create profits for external shareholders. Their sole objective is to serve their members; customer service and satisfaction are paramount.

As a direct result of being owned by and run for the benefit of their customers, financial services mutuals provide a number of benefits for members, the community and governments.

Market competition and diversity

Mutuals are able to operate on tighter margins than investor-owned competitors because they do not need to price in dividends to shareholders. This drives business model competition that benefits consumers.

In 2021, mutual health insurers that are part of the Members Health Fund Alliance paid back an average

86.9 per cent of premiums to members in benefits compared to 83.6 per cent for the three listed health insurers.

Ethical conduct

Mutuals are the most trusted institutions in many markets with a focus on serving customers and the community.

A Roy Morgan June 2022 survey found

the average consumer satisfaction rate with mutual banks and credit unions was over 90 per cent while the major banks were at 77 per cent.

Value to members

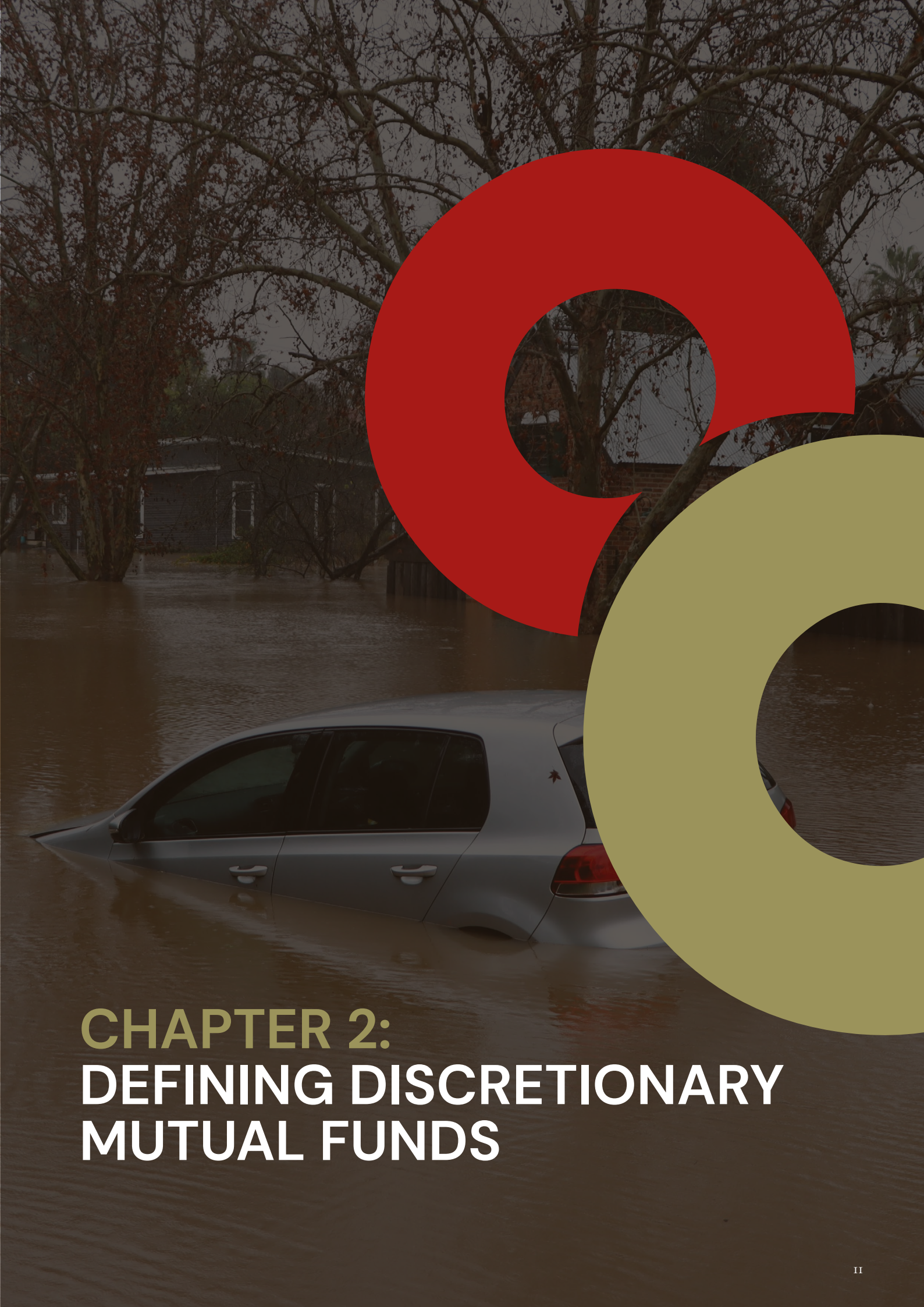
Surpluses are reinvested in better services or returned by way of lower premiums. Pricing is based on financial performance, not opportunistic responses to broader market trends.

While many risk protection markets hardened,

Capricorn Mutual made a $6 million loyalty rebate payment to members in 2021.

The mutual market is growing again, offering more choices for customers. Eight in ten Australians are a member of at least one co-operative or mutual[4]. The mutual model has active government recognition, including through a bipartisan Commonwealth Parliamentary Friends of Co-operatives and Mutuals group.

[4] BCCM, National Mutual Economy Report 2021



CHAPTER 2:
DEFINING DISCRETIONARY MUTUAL FUNDS

WHAT ARE DISCRETIONARY MUTUAL FUNDS?

Discretionary Mutual Funds (DMFs) operate to provide financial protection for the consequences of a broad spectrum of property loss or damage and third-party liabilities.

DMFs products, whilst having many similarities to insurance products, are not contracts of insurance because the cover is provided on a discretionary basis. Members of a DMF have a right to have their claim considered but, unlike insurance, do not have a contractual right to indemnity.

DMFs have existed for more than 150 years. The oldest DMF still in business is The Medical Defence Union in the UK, which first offered assistance and indemnity to its members in 1885.

THE LEGAL AND REGULATORY BACKGROUND

The legal status of discretionary mutuals has been recognised in Australia following well-established case law in the UK and regulation there by the Financial Conduct Authority (FCA). The subject most recently came before the Australian courts during 2007 where the Court upheld that the protection provided by a DMF is not insurance.[5]

In the UK, the FCA Handbook says:

> "Contracts under which the provider has an absolute discretion as to whether any benefit is provided on the occurrence of an uncertain event, are not contracts of insurance. This may be the case even if, in practice, the provider has never exercised its discretion so as to deny a benefit..."

DMFs are not separately regulated in Australia but Discretionary Mutual products are financial products and accordingly are regulated by The Australian Securities and Investments Commission. DMFs are not regulated by The Australian Prudential Regulatory Authority (APRA) because the product is not insurance.

In Australia, a mutual company is now recognised under the Corporations Act[6] as one where each member has not more than one vote irrespective of the size of their financial or other contributions to the Mutual.

There is substantial regulation of DMF financial products under the Corporations Act. This includes the requirement for intermediaries providing financial product advice or dealing[7] in a financial product to hold an Australian Financial Services Licence (AFSL) issued by ASIC, with authorisation for miscellaneous financial risk products. A DMF that wishes to deal directly with its members without an intermediary is required to hold its own AFSL to both issue and deal in financial products. A DMF is not required to hold an AFS to issue a financial product as long as the financial product is distributed through an entity that holds an appropriate AFSL – i.e., one with authorisation to deal in miscellaneous financial risk products.

[5] Metropolitan Fire & Emergency Board v Capricorn Mutual Ltd, Supreme Court of Victoria 2007
[6] Corporations Act 2001 (Cth) Sec 51M
[7] Applying for, acquiring, varying or disposing of a financial product on behalf of another person

"As a membership-based organisation, Discretionary Mutual Funds are different. We exist solely for the benefit of our members. We're there for them as they grow and change, particularly in protection of their risks, which is where they need us the most.

Geoff Henderson
CEO, Unimutual

CHAPTER 3:
FOUNDATION AND FRAMEWORK

THE PRINCIPLES AND CODE OF CONDUCT

Examples of Principles and Code of Conduct considered

The following examples of principles and codes of conduct have been reviewed and considered during the establishment of Principles and a Code of Conduct for DMFs.

Co-operative Values and Principles

The International Cooperative Alliance is the global steward of the Statement on the Cooperative Identity – the Values and Principles of the co-operative movement. It is expressed as follows:

Co-operative Values:

Co-operatives are based on the values of **self-help**, **self-responsibility**, **democracy**, **equality**, **equity** and **solidarity**. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

Co-operative Principles:

1. **Voluntary and Open Membership**
2. **Democratic Member Control**
3. **Member Economic Participation**
4. **Autonomy and Independence**
5. **Education, Training, and Information**
6. **Cooperation among Cooperatives**
7. **Concern for Community**

The General Insurance Code of Practice (Australia)

The Insurance Council of Australia is custodian of the General Insurance Code of Practice. Its objectives are:

a. to commit us to high standards of service;

b. to promote better, more informed relations between us and you;

c. to maintain and promote trust and confidence in the general insurance industry;

d. to provide fair and effective mechanisms for resolving Complaints you make about us;

e. to promote continuous improvement of the general insurance industry through education and training.

The GICP is a voluntary code. It has been developed over a 25-year period and is very comprehensive as many of its stated practices reflect the legal obligations of insurers. This explains why the practice code is some sixty pages in length.

The ASX Corporate Governance Principles and Recommendations

The ASX sets out eight principles as a foundation to corporate governance for ASX-listed entities. These are:

1. Lay solid foundations for management and oversight
2. Structure the Board to be effective and add value
3. Instil a culture of acting lawfully, ethically, and responsibly
4. Safeguard the integrity of corporate reports
5. Make timely and balanced disclosure
6. Respect the rights of security holders
7. Recognise and manage risk
8. Remunerate fairly and responsibly

The BCCM Co-operative and Mutual Enterprise Governance Principles is an industry-led initiative tailoring the ASX Principles for CMEs. The BCCM's CME principles substitute "Members" for "Investors" and introduce an additional principle being that the purpose of a CME is to create, protect and return value to members.

The FCA Handbook

In the UK, the FCA Handbook and the Financial Services and Markets Act 2000 (FSMA) contain specific requirements for regulated firms. Most mutuals aim to meet these requirements, even though they are not legally required to do so.

The FCA handbook[8] sets out 11 principles for FCA regulated businesses operating in the financial services sector. These cover:

1. Integrity
2. Skill, care, and diligence
3. Management and control
4. Financial prudence
5. Market conduct
6. Customers' interests
7. Communication with clients
8. Conflicts of interest
9. Customers: relationships of trust
10. Clients' assets
11. Relations with Regulators

Although discretionary mutuals in the UK are not bound by the FCA principles, the essence of the principles reflects the fundamental nature of the relationship between a Mutual and its Members and, indeed, some of the FCA principles reflect duties imposed on any company and its board of directors in respect of its members both in the UK and Australia.

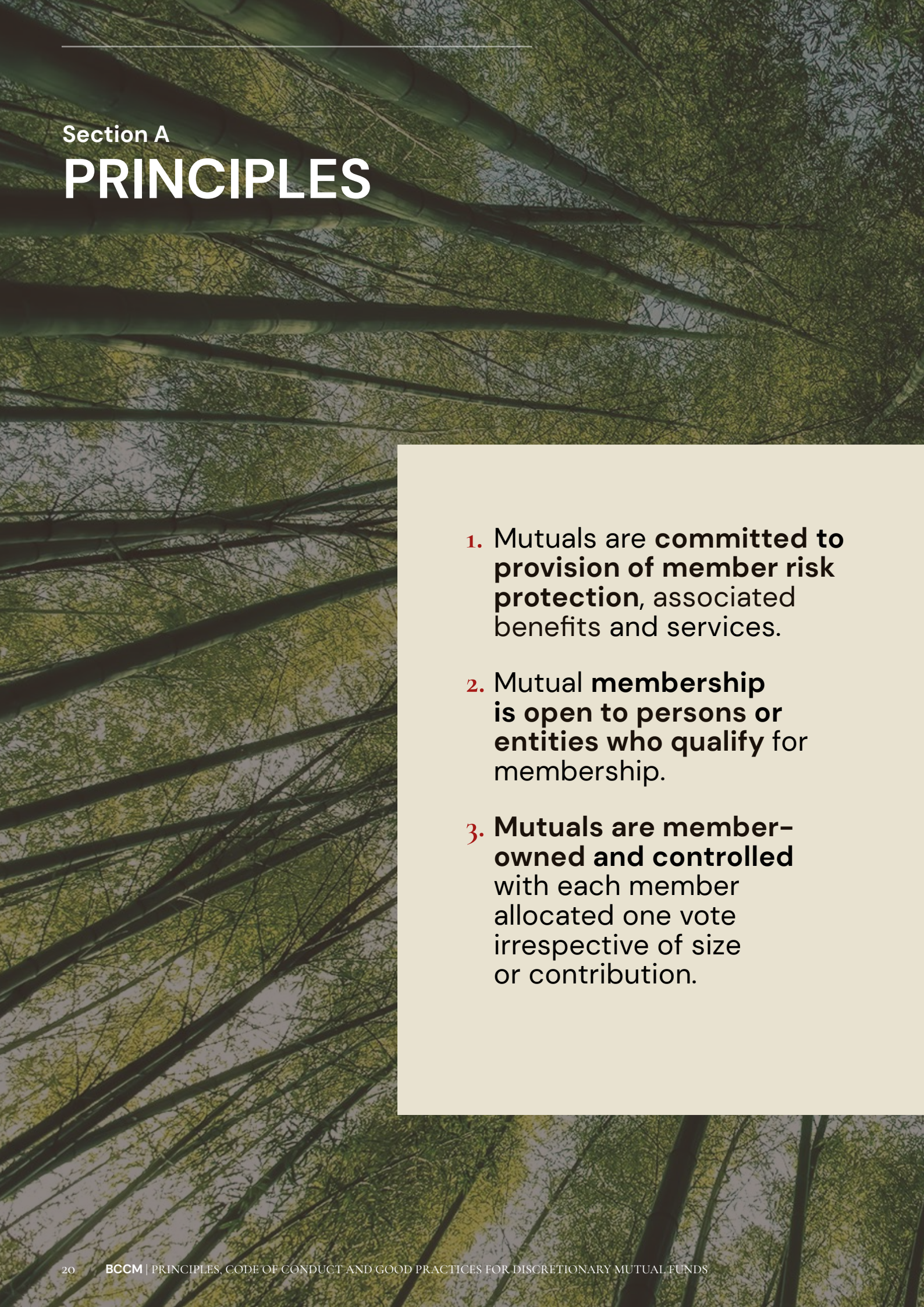
[8] www.handbook.fca.org.uk

"

Co-operatives and mutuals are here for the long-term and not a short-term solution. As they are member-focussed and not profit motivated, they are more likely to endure through difficult financial times.

Andrew Armitstead
CEO, CivicRisk Mutual

CHAPTER 4:
THE STANDARDS



Section A

PRINCIPLES

1. Mutuals are **committed to provision of member risk protection**, associated benefits and services.

2. Mutual **membership is open to persons or entities who qualify** for membership.

3. **Mutuals are member-owned and controlled** with each member allocated one vote irrespective of size or contribution.

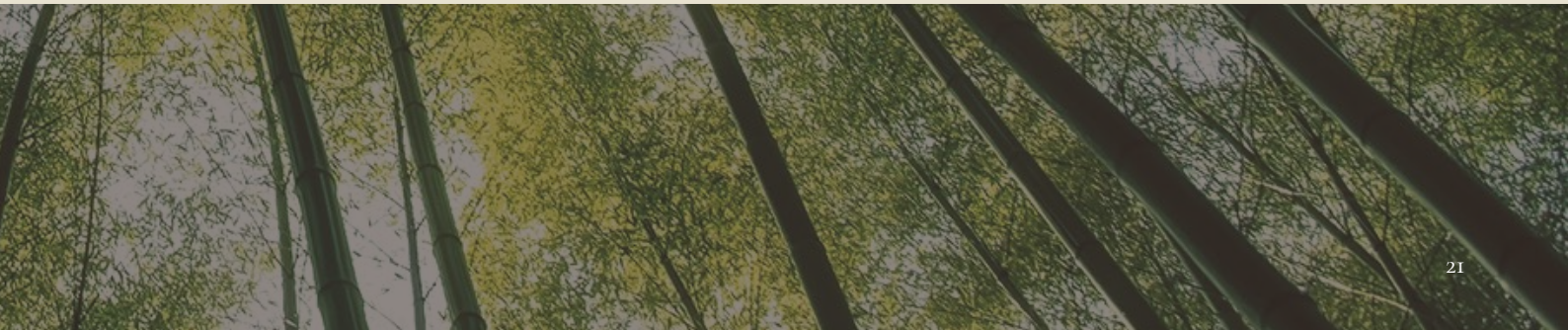
4. Mutual **members participate and contribute equitably**.

5. Mutuals **exist solely for the benefit of members.**

6. Mutuals **deliver risk management education, training and sharing of information** to improve outcomes for individual members, the mutual and the community.

7. **Mutuals collaborate with other mutuals** in the interest of members, to raise community awareness and improve industry standards.

8. Mutuals **show concern for the wider community** outside the membership through their support of members.



Section B

CODE OF CONDUCT

The Mutual and its Managers will:

1. Place **the interests of Members at the forefront** of its operations and treat them fairly.

2. **Be respectful and transparent** in dealings with Members.

3. **Pay due regard to the information needs** of Members and **communicate** to them in a way which is **clear**, **fair** and **not misleading**.

4. **Take reasonable care to ensure the suitability** of advice and exercise of discretion[9].

5. **Manage conflicts** of interest **openly** and **fairly**, both between the Mutual and its Members and between the Mutual and its Managers.

6. **Provide empathetic claims handling**, **strong financial management** and **good governance.**

7. Always **endeavour to build** and **maintain the trust** of Members.

8. Conduct the business with **integrity** and with **due skill**, **care** and **diligence**.

9. Have **an effective Board of Directors** with the **appropriate range of experience**, **knowledge** and **skills**.

10. **Ensure** that **appropriately-skilled staff** and **resources are allocated** to the mutual management.

[9] See separate commentary on pages 30-31

11. Hold the **appropriate regulatory licences** and **comply with the regulations**.

12. Provide Members and prospective Members with a **clear explanation of the nature of discretionary cover before** and **at the point of sale**, and **in post-sales documents** given to Members.

13. **Use terminology** which is designed to make the nature of its products **clear**.

14. **Handle claims expeditiously**, **fairly** and **impartially** and **make prompt payment** of agreed claims.

15. Have in place **effective complaints policies** and **procedures** and **ensure that the complaints procedure is straightforward**.

16. **Maintain high governance standards** and **appropriate risk management systems.**

17. **Maintain adequate financial resources**, **including** where appropriate, **a supporting insurance or other risk transfer programme**.

18. Observe **good business practices in outsourcing arrangements**, including **undertaking appropriate due diligence**, and **avoiding undue additional operational risk**.

19. **Take all appropriate steps** to **avoid**, **detect** and **counter fraud**.

20. **Deal with regulators** in an **open** and **co-operative** way and **disclose** to the regulator **appropriately any matter of which that regulator would reasonably expect notice.**

Section C

GOOD PRACTICES

Members of the BCCM Discretionary Risk Mutual Forum determined that sound governance principles and practices are foundations of good management practices of DMFs. The Forum members reviewed their own governance and management practices, and these are summarised below as a guide. The list is neither exhaustive nor exclusive.

1 Structure

1.1 A Company Limited by Guarantee is the generally recommended corporate vehicle – it ensures member ownership and maintains the equality of members through the one member, one vote principle. It also ensures that all Members receive a copy of the Mutual's audited accounts and annual report.

1.2 One vote per member, irrespective of size or contributions.

1.3 Mutual constitution that defines eligibility for membership.

2 Boards

2.1 Member Director majority supported by Independent Directors as required to ensure sufficient skills and expertise.

2.2 A Director induction and professional development process to ensure understanding of the mutual, its membership and its business; and to ensure a broad membership perspective in all matters.

2.3 A clearly defined and documented Board Charter, which covers the objectives, role and responsibilities, and governance framework for Directors.

2.4 Appropriate sub-committees (claims, risk, finance and audit) with clear Terms of Reference.

2.5 Mutual Managers should not act as Directors of the Mutual[10].

2.6 Regular Board and Committee meetings (minimum of quarterly).

2.7 Clear purpose, strategy and business plan which is approved/reviewed by the Board annually and aligns activities to purpose.

2.8 The board leads and works to instil a culture that supports the organisation's purpose and strategy.

2.9 The board leads meaningful engagement of stakeholders ensuring their interests are understood and considered.

2.10 The board retains absolute discretion to direct the management of the Mutual for the benefit of members.

[10] Exceptions may be appropriate in certain circumstances, e.g., during start-up phase

3 Management

3.1 Appropriately sized and skilled management team with commitment to the mutual ethos.

3.2 Clearly defined delegations to management.

3.3 Clear management agreements clarifying management remuneration and responsibilities.

3.4 Documented procedures across every major business function which should be regularly reviewed by management.

3.5 Close interaction with the Board with open and transparent dialogue.

3.6 Where appropriate, a clear outsourcing policy approved by the Board.

3.7 Where delegated by the Board, clear authorities, parameters and limits for the exercise of discretion.

3.8 Claims and underwriting policies and procedures that consider the interest of both individual members and the broader membership.

4 Audit and Risk

4.1 Clearly defined Risk Appetite Statement.

4.2 Independent Risk & Compliance function with direct access to the Board and Audit, Risk & Compliance Committee.

4.3 Member education, information sharing and risk prevention/mitigation function.

4.4 Business continuity plan.

4.5 Ensure appropriate level of risk exposure for members which may include insurance or reinsurance of the mutual and/or other risk transfer mechanisms to ensure that the mutual's and individual members' exposure is appropriately capped.

5 Finance

5.1 Appropriately skilled finance team supported by external specialists where necessary (e.g., actuaries).

5.2 Minimum of quarterly management accounting reports and cashflow forecasts to the Board.

5.3 Detailed claims reporting and reserving including provision for IBNR and prudential margin as agreed by the Board (target 75% as a minimum level of sufficiency).

5.4 Clear financial plan and objectives.

5.5 Policies for surpluses, investment and management of claims funds.

5.6 Clear delegated limits of financial responsibility with Mutual Directors required as authorisers and signatories for large payments

5.7 Appropriate segregation of duties.

5.8 Externally audited annual reports which are distributed to members.

6 Governance and Regulatory Practice

6.1 Documented policies which include WHS, Risk & Compliance Frameworks, Delegated Authorities, Risk Incident & Breach Management etc. Major policies are reviewed at least annually.

6.2 Clear processes to raise and manage complaints, issues and incidents.

6.3 A centralised Risk & Compliance system to record and monitor the identification and resolution of incidents and reportable situations.

6.4 Where marketing and distribution is undertaken directly by the Mutual or the Managers, appropriate controls to prevent mis-selling and/or conflicted remuneration.

6.5 Appropriate AFS Licensing for issuing and dealing in mutual risk products.

6.6 Annual reviews of AFSL compliance by the Risk & Compliance department, with a final report provided to the Board.

6.7 Established an independent legal advice service who track and report on relevant regulatory changes.

6.8 Annual General Meeting with opportunity for Members to attend either in person or online.

EXERCISING DISCRETION

A Member of a Discretionary Mutual has a right to have a claim considered, rather than a right to indemnity[11]. Ultimately, discretion is exercised by the Board, although the Board may delegate aspects of the exercise of discretion to others, for example, to its management company or a committee.

When discretion is exercised, it must comply with the requirements of natural justice. These are:

- **a person's right to be heard if they are likely to be affected by a decision**
- **the right to have a decision made by an unbiased decision maker**
- **the right to have the decision based on all relevant information and for irrelevant information to be ignored**

Each claim should be considered on its own merits, and in the light of the circumstances under which the Mutual is operating at the time. There must be no bias in favour of or against a Member, and those making the decision on a claim must act impartially.

Most claims referred to the Board will be dealt with on the basis of documents provided by the Member and the claims committee or managers, together with any written decision previously made which has been communicated to the Member. There may however be circumstances in which the Board considers, or the Member requests, that a fair decision can only be reached if the Member is allowed to address the Board in person.

The exercise of discretion, whether it be in favour of or against a particular matter, does not establish precedent. Each claim must be considered on its own merits, taking into account the situation of the mutual and such other factors as may be appropriate. For example, a matter where discretion to accept might be exercised at a time when the Mutual has a large surplus, might not be accepted in a situation where the Mutual has a smaller surplus or in times of economic uncertainty.

A general test that can always be applied is to consider how the exercise of discretion is in the best interests of the membership as a whole, as well as the Member concerned.

[11] The right to have a valid claim paid which is the case under a contract of insurance

Claims should be considered on their own merits. There must be no bias. And those making the decision must act impartially.

APPENDIX:

MUTUALS AND MANAGERS WHICH HAVE ADOPTED THE CODE OF CONDUCT

For more information

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Business Council of Co-operatives and Mutuals

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