



4 March 2022

The Secretary
Economics Legislation Committee
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Submitted via My Parliament

TREASURY LAWS AMENDMENT (CYCLONE AND FLOOD DAMAGE REINSURANCE POOL) BILL 2022

Capricorn Mutual Limited (**Capricorn Mutual**) is grateful for the opportunity of making this submission to the Economics Legislation Committee (the **Committee**) in relation to the Treasury Laws Amendment (Cyclone and Flood Damage Reinsurance Pool) Bill 2022 (the **Bill**) which proposes to amend the *Terrorism Insurance Act 2003* (Cth) (the **Act**).

The purpose of this submission is to draw to the attention of the Committee an inadvertent omission from the Bill and to propose a solution that will rectify the omission and ensure the Bill serves its intended purpose.

SUMMARY

- The Bill, as presently drafted, limits the reinsurance pool to property damage and business interruption losses covered by insurance contracts only.
- In its current form, the Bill will put members of mutuals at a disadvantage and make it more difficult for mutuals to compete with insurers. This belies the purpose for which mutuals exist, which is to provide an affordable, accessible and industry-focussed alternative to insurance. Mutuals provide members with benefits not available from profit-focussed commercial insurers.
- To maximise the size of the reinsurance pool and to ensure the Bill fulfils its stated purpose of reducing the cost and increasing the availability of risk protection for small businesses and households in cyclone-prone areas, we respectfully submit that mutuals should be eligible to participate in the scheme and obtain insurance or reinsurance from the Australian Reinsurance Pool Corporation (the **ARPC**).
- We propose some solutions that would permit mutual organisations like Capricorn Mutual to participate in the scheme and thereby provide their members, particularly the owners of small businesses in northern Australia, with the benefits that are currently proposed to be restricted to customers of commercial insurers.

1. About Capricorn Mutual

Capricorn Mutual is a mutual: an unlisted public company limited by guarantee that operates on co-operative principles to protect automotive repair and service businesses against the risks arising from their businesses. Our organisation is owned by our automotive business members, their associates and by Capricorn Society Limited (**Capricorn Society**).

Capricorn Society was established as a co-operative in 1975 in Perth, Western Australia, to assist automotive repair and service businesses. Since its establishment, Capricorn Society has grown to offer a diversified range of products

and services to its members, including trade finance accounts, extended finance products, member networking events, risk protection and travel agency services. In providing these services Capricorn Society is supporting each member's business. Capricorn Society has over 23,000 members in Australia and New Zealand.

In 2003, Capricorn Mutual was formed exclusively for the purpose of providing risk protection services to members of Capricorn Society. The cost of insurance was becoming unaffordable for many automotive businesses and the objective of Capricorn Mutual was to pool Capricorn Society members' funds in order to provide a commercially-feasible alternative to insurance.

The principle of mutuality that guides Capricorn Mutual means that all of its members are involved in and have a say in the operation of our organisation. Capricorn Mutual's board is elected by the membership and comprises a combination of member and non-member directors who ensure complementary skills and experience are present at the board level and that members' interests are always prioritised.

Today, Capricorn Mutual protects around 10,000 small business owners who are also members of Capricorn Society.

By tailoring its risk protection to the automotive repair and services industry, and without any need to pay dividends to shareholders, Capricorn Mutual is able to offer an affordable alternative to insurance to small business owners across Australia.

Members' use of the services offered by Capricorn Mutual is the primary means by which Capricorn Mutual generates profits and these profits are returned by way of enhancing the services offered to members, including through increased benefits and through savings in the cost of their risk protection. On occasion, as was the case last year, excess capital is returned to members, which is a significant financial benefit to our small business owners.

Members understand that, by using Capricorn Mutual, they are supporting their ownership of Capricorn Mutual and the ability of the Capricorn Group to support them. It is that understanding which informs a member's decision whether to acquire the mutual risk product offered by Capricorn Mutual or to acquire a product issued by a commercial insurer instead.

2. Protection for small businesses and households in northern Australia

Capricorn Mutual protects small businesses across Australia, including in cyclone-prone areas in northern Australia. In those areas that we have identified as particularly cyclone-prone, Capricorn Mutual covers almost 500 small businesses. Just under 75% of those businesses are located in Queensland, with the remainder evenly split between the Northern Territory and Western Australia.

Capricorn Mutual's sole product is a mutual risk product. It is not an insurance policy but it is a financial product and it is therefore regulated by many of the same laws that apply to insurance. For example, it is subject to financial services regulation under the *Corporations Act 2001* (Cth) and *Australian Securities and Investments Commission Act 2001* (Cth). Similarly, product design and distribution obligations apply to Capricorn Mutual just as they do to general insurers. Capricorn Mutual's product disclosure statement, a copy of which is linked [here](#), demonstrates the breadth of risks that it covers.

As noted in the product disclosure statement, the Capricorn Mutual's product provides cover not only for the businesses owned by our members but also offers

protection for damage to their households, which means that the Bill also has a direct impact on our ability to provide cover for cyclone-related risks for our member's homes. Approximately 25% of our members in northern Australia rely on Capricorn Mutual to protect their personal risks including damage to their homes caused by cyclones and related events.

Capricorn Mutual holds an Australian financial services licence in order to offer and issue its risk protection and this means that it is bound by the same general licence conditions that apply to other financial services providers, including the duty to ensure its services are provided efficiently, honestly and fairly.

3. The purpose of the Bill - accessibility and affordability of cover

The stated purpose of the Bill is to increase the accessibility and affordability of protection for households and small businesses in cyclone-prone areas in northern Australia.ⁱ To achieve its purpose, the Bill proposes to allow insurers to reinsure cyclone risks with the ARPC at a lower cost than in the private reinsurance market.ⁱⁱ Since the cost of reinsurance is a significant factor in setting risk premiums, reducing the cost of reinsurance will, in turn, permit insurers to offer lower insurance premiums for households and small businesses with high cyclone and related flood damage risk.ⁱⁱⁱ

In order to ensure that the Bill achieves its goal, the Australian Competition and Consumer Commission will be tasked with monitoring insurers and evaluating the impact of the cyclone reinsurance pool and whether the savings it produces are passed on to policyholders.^{iv} This monitoring role will continue for four years commencing in the current financial year.

We respectfully submit that the goals of the Bill will not be fully met if it is passed in its current form, due to the inability of mutuals like Capricorn Mutual to participate in the scheme.

4. An important addition to the Bill - recognition of insurance alternatives

In its current form, the Bill provides that general insurers that cover eligible cyclone risks in Australia must obtain reinsurance for those risks from the ARPC.^v The purpose of mandatory participation in the scheme is to ensure the 'greatest possible' reductions in insurance premiums in cyclone-prone areas.^{vi}

For this reason, the Bill is proposed to apply not only to general insurers authorised under the *Insurance Act 1973* (Cth) but also Lloyd's underwriters and also unauthorised foreign insurers (insurers registered overseas which are not authorised by the Australian Prudential Regulation Authority (**APRA**) to carry on insurance business in Australia).^{vii} The ARPC will be expressly authorised to reinsure the eligible cyclone losses of all such participating insurers.^{viii}

The Bill recognises that some insurers may elect not to participate in the pool, either because the risk of eligible cyclone losses is negligible in the areas they cover or because their premium income for eligible cyclone losses is below the threshold prescribed by regulations.^{ix} Despite this, an otherwise-exempt insurer may elect to participate in the scheme.^x This flexibility ensures that participation in the pool is maximised, improving its ability to increase the affordability of insurance for cyclone and flood damage. It also provides small insurers with the option to participate in the scheme if doing so would provide them with access to the lower reinsurance premiums that would enable them to compete with larger insurers.

However, the Bill does not currently recognise the risk protection provided to small businesses and households in cyclone-prone areas by mutuals such as Capricorn Mutual.

Capricorn Mutual does not have the ability to participate in the scheme, based on the current drafting of the Bill, and will be substantially prejudiced compared with the premiums able to be offered by participating insurers, including those insurers for which participation is not mandatory.

By way of illustration, the Prime Minister and Ministers recently announced an expectation that small business premiums may be discounted by up to 34%, and households up to 46%, as a result of the establishment of the reinsurance pool.^{xi} This would put Capricorn Mutual and other mutuals in a position where we simply could not compete with the pricing offered by commercial insurers. Due to the fact that a mutual's primary obligation is to deliver services and benefits to its members, rather than to distribute profits to shareholders, we cannot call on those of our members in unaffected areas to subsidise discounts of this magnitude for members in cyclone-prone areas in order to compete with for-profit insurers whose pricing is underwritten by the Government.

Capricorn Mutual is not a general insurer and does not issue insurance contracts. As a consequence, and based on the current drafting of the Bill, Capricorn Mutual:

- is not subject to the compulsory reinsurance provisions contained in the Bill; and
- cannot elect to participate in the pool voluntarily in order to access cheaper reinsurance premiums.

We respectfully submit that the inability of mutuals such as Capricorn Mutual to participate in the scheme and contribute to the reinsurance pool is an omission that it should be rectified in order to ensure the purpose of the Bill is achieved.

Enabling Capricorn Mutual and other mutuals which cover eligible cyclone losses to participate in the pool will have the following benefits:

- (a) ensuring the pool has the maximum available funds from the widest range of participants;
- (b) preserving the ability of Capricorn Mutual and other mutuals to continue to compete with general insurers by ensuring that mutuals are able to obtain reinsurance for eligible cyclone losses on terms that are competitive with those offered to general insurers; and
- (c) ensuring that the premium savings that the pool delivers to policyholders of general insurers are also made available to members of mutuals.

Preventing Capricorn Mutual and other mutuals which cover eligible cyclone losses from participating in the pool will have the following costs:

- (a) making cover comparatively more expensive for small business owners who have chosen to take out risk protection products with an industry-focussed mutual rather than with a commercial insurer;
- (b) reducing the ability of mutuals to compete with large commercial insurers and thereby reducing choice for consumers, particularly in cyclone-prone areas;

- (c) creating an additional barrier to entry for other mutuals that may otherwise offer cover in cyclone-prone areas;
- (d) reducing the size of available funds for the pool; and
- (e) the relative increase in the cost of, or loss of, cyclone-related cover provided by mutuals like Capricorn Mutual will lead to reduced competition in northern Australia because not-for-profit mutuals provide competitive pressure for commercial insurers, not just in relation to cyclone-related events but across the broader range of risks affecting small businesses and households.

5. Solutions

To enable mutuals such as Capricorn Mutual to participate in the scheme and thereby deliver the benefits referred to above, we propose the following alternative solutions for consideration by the Committee.

(a) *Expanded drafting to accommodate mutuals and mutual risk products*

Additional provisions could be inserted into the Bill so that references to 'pool insurance contracts' included 'pool mutual risk products' and so that references to 'general insurers' included 'mutuals' or 'public companies limited by guarantee'.

The advantage of this approach is that it provides certainty and clarity that the Bill is intended to bring mutuals within the ambit of the scheme.

The disadvantage, we acknowledge, is that practical considerations, such as the expected timing of the commencement of the scheme, may make this solution challenging to implement in the time allowed. We would nevertheless be happy to assist with drafting solutions if this option were thought appropriate by the Committee.

(b) *Drafting changes to permit indirect reinsurance of mutuals*

Like other mutuals, Capricorn Mutual purchases reinsurance in the global reinsurance market but it does so indirectly, via a related insurance company which, in turn, provides insurance for the risks covered by the mutual. As noted earlier, we do not issue insurance contracts to members and so there is no underlying insurance contract for which reinsurance can be obtained directly by Capricorn Mutual (whether from the global market or from the ARPC).

As a consequence, Capricorn Mutual is not itself a party to a reinsurance contract and is therefore not able to, in the language of the Bill, 'maintain contracts of reinsurance with the Corporation'.^{xii}

Similarly, while the Bill expressly authorises the ARPC to enter into contracts that reinsure the reinsureds' liabilities under pool insurance contracts, mutuals like Capricorn Mutual are not themselves *reinsureds* that have liabilities *under* insurance contracts. As noted above, they are typically reinsured indirectly through an intermediated insurance company.

Put simply, the only practical difference between the reinsurance provided to insurers and the reinsurance provided to mutuals is that insurers enter into reinsurance contracts directly with reinsurers while mutuals enter into insurance arrangements with an insurer (typically a company related to the mutual) which then enters into reinsurance contracts with reinsurers.

This presents a potential solution that would enable mutuals to participate in the scheme, namely:

- (i) replacing references in the Bill to liabilities 'under' pool insurance contracts with the phrase 'in respect of' pool insurance contracts';^{xiii}

(This will better reflect the fact that the insurer of a mutual does not have direct liability for an eligible cyclone loss but instead is liable to indemnify the mutual for eligible cyclone losses for which the mutual is liable.)

- (ii) similarly, amending the definition of 'pool insurance contract' so that it refers to insurance cover 'in respect of' eligible property damage or loss, rather than 'for' eligible property damage or loss (with similar replacements in respect of business interruption losses);^{xiv}

(This would avoid the uncertainty as to whether insurance taken out by the mutual is correctly described as insurance 'for' property damage, since it is more accurately described as insurance in respect of property damage indemnified by the mutual.)

and

- (iii) where the Bill refers to property that is owned or occupied by 'the insured', that expression would need be amended to include a reference to members of the mutual (for example, 'the holder of a mutual risk product in respect of whose claim the insurance provides an indemnity').^{xv}

(This will clarify that the scheme will apply in situations like that of Capricorn Mutual where the property is owned by the holder of a mutual risk product, rather than an 'insured'.)

The advantages of this solution are its simplicity, it requires minimal drafting changes and it mostly uses terminology already contained in the Bill.

The disadvantage of this solution is that further thought may need to be given to the drafting required in (iii) above to ensure clarity in how it describes the holder of a mutual risk product.

(c) *Use the regulation-making power (with minor drafting changes to the Bill)*

If the solution preferred by the Committee is to minimise drafting changes to the greatest extent possible then we submit that the optimal solution would be to use the regulation-making power contained in the Act.^{xvi}

While it would still be necessary to make minor changes in the Bill of the kind described in paragraph 5(b)(i) above, the definition of 'pool insurance contract' need not be amended. Instead, the regulations could specify that a pool insurance contract includes a contract of the kind described in this submission, being one which provides cover to a mutual.^{xvii}

Alternatively, or in addition, the same result could be achieved by amending the permissive statement in the Bill so that the ARPC is expressly authorised to issue insurance or reinsurance contracts covering mutual risks.^{xviii}

Nothing in the Act, either currently or as proposed to be amended by the Bill, prevents the ARPC from insuring or reinsuring the risks indemnified by a mutual. The ARPC has the power to do all things necessary or convenient to be done for or in connection with the performance of its functions.^{xix} Its functions, once amended by the Bill, will include the ability to enter into reinsurance contracts for the purpose of operating a cyclone and related flood damage reinsurance pool.^{xx}

If it were thought necessary, the regulations could expressly prescribe that providing reinsurance in respect of mutual risk products falls within the functions of the ARPC.

The advantage of this solution is that it avoids the need to make drafting changes of the kind described in paragraphs 5(b)(ii) and 5(b)(iii) above.

The disadvantage of this solution is that the regulations will be disallowable and subject to Parliamentary scrutiny, which means that Capricorn Mutual and other mutuals will be at risk of such disallowance. However, we trust that appropriate consultation with mutuals and their members will take place in advance of the making of the proposed regulation such that the risk of a disallowance motion is minimised.

In the time available, these are the solutions we have identified as most suitable to giving full effect to the goals of the Bill and bringing mutuals like Capricorn Mutual, and the small business owners who are their members, within the reinsurance scheme.

We would of course be open to consulting with the Committee in more detail to identify further alternatives and to provide more information about the important role played by mutuals in the community or to share with you commercially-sensitive information about the value of property Capricorn Mutual protects in cyclone-prone areas.

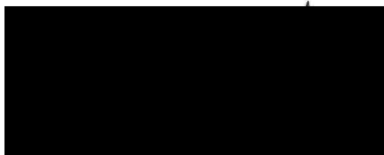
6. BCCM

Capricorn Society was the driving force behind the establishment of the Business Council of Co-operatives and Mutuals (**BCCM**). The BCCM is the peak body for co-operatives and mutuals at a national level in Australia and exists to promote the role of co-operatives and mutuals in the national economy. Capricorn Society was the first member of the BCCM, which now has 59 members, including leading Australian co-operatives and mutuals.

Capricorn Mutual has been liaising closely with the BCCM in relation to the potential impact of the Bill on mutuals and, together with the BCCM, we reiterate the important role that mutuals play in providing small businesses and households across Australia with an affordable, accessible and industry-focussed alternative to profit-driven commercial insurance products. We fully endorse the BCCM's submission informing the Committee about the significant contribution that mutuals make to businesses and households in northern Australia.

We would be happy to provide further information about Capricorn Mutual, its products and the role played by mutuals if that would assist the Committee's inquiry. If there is an opportunity to be heard by the Committee through either public or private hearings then we would welcome that opportunity to assist the Committee further.

Yours thankfully,



Jim Glossat
CEO, Capricorn Risk

-
- ⁱ Commonwealth, *Parliamentary Debates*, House of Representatives, 9 February 2002, p 9 (The Hon. Michael Sukkar MP, Assistant Treasurer, Minister for Housing and Minister for Homelessness, Social and Community Housing); see also paragraphs 1.9 and 1.14 of the Explanatory Memorandum to the Bill.
- ⁱⁱ Paragraph 1.8 of the Explanatory Memorandum.
- ⁱⁱⁱ Paragraph 1.7 of the Explanatory Memorandum.
- ^{iv} *Mid-Year Economic and Fiscal Outlook 2021-22*, the Hon. Josh Frydenberg MP (Treasurer) and Senator the Hon. Simon Birmingham (Minister for Finance), p 299.
- ^v Schedule 1, item 9, subsections 8A(1) and (3) of the Bill.
- ^{vi} Commonwealth, *Parliamentary Debates*, House of Representatives, 9 February 2002, p 9 (The Hon. Michael Sukkar MP, Assistant Treasurer, Minister for Housing and Minister for Homelessness, Social and Community Housing); see also paragraph 1.14 of the Explanatory Memorandum.
- ^{vii} Schedule 1, item 9, subsections 8A(9) and (10) of the Bill.
- ^{viii} Schedule 1, item 9, subsection 8A(4) of the Bill.
- ^{ix} Schedule 1, item 9, subsections 8A(5) and (7) of the Bill.
- ^x Schedule 1, item 9, subsection 8A(8) of the Bill.
- ^{xi} The Hon. Scott Morrison MP et al, *Morrison Government to deliver reduced premiums through reinsurance pool*, accessed 2 March 2022, <https://www.pm.gov.au/media/morrison-government-deliver-reduced-premiums-through-reinsurance-pool>.
- ^{xii} Schedule 1, item 9, subsection 8A(1) of the Bill.
- ^{xiii} Schedule 1, item 9, subsections 8A(1), (4), (8), (9) and (10) of the Bill.
- ^{xiv} Schedule 1, item 9, paragraphs 8B(2)(a) and (b) of the Bill.
- ^{xv} Schedule 1, item 9, paragraphs 8B(2)(a) and (b) of the Bill.
- ^{xvi} Section 43 of the Act.
- ^{xvii} Schedule 1, item 9, paragraph 8B(1)(b) of the Bill.
- ^{xviii} Schedule 1, item 9, subsection 8B(4) of the Bill.
- ^{xix} Section 11 of the Act.
- ^{xx} Schedule 1, item 10 of the Bill.