

What is a discretionary mutual fund?

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What is a discretionary mutual fund?

A discretionary mutual fund - or DMF - is typically a company owned and run by the members of an industry group to provide self-insurance.

Each member contributes an annual contribution to the fund, and in return, the fund provides protection for their risks. The annual payments create the aggregate, out of which claims and operating expenses are paid and to ensure the mutual's liability is capped, DMF's buy excess of loss cover from reinsurers.

The term 'discretionary' is used because the insurer (through a board of directors) uses its discretion to decide whether or not any claims made will be paid. The DMF also decides how any surplus money that hasn't been paid out in claims will be used. It could be reinvested for the benefit of members, such as in programs to improve risk management, or used to lower the future annual payments each member makes to the fund.

Membership is based upon a whole risk solution meaning each new member will be subject to a full risk review. The mutual is a membership for likeminded firms who value risk management and risk prevention to pool together to promote best practice.

Typically, the more members a DMF has, and the more diverse they are, the more successful it is, as the risks the DMF assumes can be spread more broadly. A DMF is a long-term proposition - to access the full benefits of membership, a term of five to 10 years is recommended.

How does a discretionary mutual fund differ to traditional insurance?

Under a traditional insurance arrangement, an insurance company agrees to take on the risks of policyholders in exchange for the payment of an insurance premium and commits to provide a payout in the event of a valid claim being made.

Insurance companies invest the money received from insurance premiums, with any financial returns distributed to shareholders, or kept for their benefit. If a policyholder makes a claim, it's likely their insurance premium will increase the following year, and sometimes insurance premiums increase even if a policyholder hasn't made a claim.

In a mutual there are no shareholders to generate profit for, therefore any surplus contribution can be reinvested and used to improve risk management or used to offset future annual payments.

Traditional insurance vs. discretionary mutual funds

	Traditional insurance	Discretionary mutual fund
Ownership and structure	Insurance companies are either publicly or privately owned for-profit businesses with shareholders.	A DMF is owned by its members, and is a company limited by guarantee, or a trust. It typically follows a not-for profit business model.
Risk	An insured's risks transfer to an insurance company upon payment of the insurance premium.	Upon contribution of an annual member payment, each member's risks as agreed transfer to the DMF.
Premium	Insurance companies collect insurance premiums and the funds are used to pay claims. If a policyholder makes a claim, their insurance premium will typically increase the following year. Sometimes premiums increase even if a claim hasn't been made.	Annual member payments paid to the DMF form the mutual pool, which is used for the payment of claims. The board sets the amount of the annual contribution each year, which is applied equitably to members.
Surplus funds	Surplus funds are invested by an insurance company to generate a return for its shareholders, not its policyholders.	Surplus funds are retained for the benefit of all member companies of the DMF. They can be used to improve risk management or, used to offset future contributions.
Claims	An insurance company guarantees that valid claims made under the terms of the policy will be paid.	All members have the right to have their claims considered, but the board of the DMF has discretion over whether or not to pay a claim.

Benefits of a discretionary mutual fund

A DMF may help some industries facing rising insurance costs manage their costs if member annual payments are set lower than insurance premiums.

Because there isn't insurance, many of the statutory state government charges that are added to traditional insurance premiums do not apply to DMFs.

A DMF can typically provide more extensive benefits and industry specific coverage due to its size and specialised nature.

By reinvesting surplus funds from the DMF into risk management initiatives, industries can improve their collective risk and reduce incidences of losses.

Because a DMF is industry-owned and based on the principle of mutuality, it's subject to a lower tax burden.

Important Note: SteadfastART 118 261 608 AFSL 298444

This information is to assist you in understanding some of the terms, implications, and common considerations with a discretionary mutual fund. This information does not take into account your specific objectives, financial situations or needs. It is also not financial advice, nor complete, so please discuss the full details with your Steadfast insurance broker as to whether a discretionary mutual fund is appropriate for you.