

Life Insurance (prudential standard) determination No. 2 of 2011

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Life Insurance Act 1995, sections 230A, 252

Under subsection 230A(1) of the *Life Insurance Act 1995* (**Life Act**), APRA has the power to determine (in writing) standards in relation to prudential matters to be complied with by all life companies or a specified class of life companies.

Under subsection 230A(5) of the Life Act, APRA has the power, in writing, to vary or revoke a standard.

Under subsection 252(4) of the Life Act, APRA may, on or after the cut-off day, vary or revoke a Prudential Rule. The cut-off day is provided for under subsection 252(2) of the Life Act.

Life Insurance (prudential standard) determination No. 12 of 2010 made on 13 December 2010 (**the old instrument**):

1. revoked *Prudential Rules No. 36 Restructure of Statutory Funds* made on 24 June 1999;
2. revoked *Prudential Rules No. 37 Termination of Statutory Funds* made on 24 June 1999;
3. revoked *Prudential Rules No. 38 Restructure and Termination of Statutory Funds Transitional Matters* made on 24 June 1999;
4. revoked *Prudential Rules No. 39 Adequate Adoption of Benefit Fund Rules or Amendments of Approved Benefit Fund Rules* made on 24 June 1999;
5. revoked *Prudential Rules No. 42 Approval of Amendment of Approved Benefit Fund Rules as Required by APRA* made on 24 June 1999;
6. revoked *Prudential Rules No. 43 Approval of Consequential Amendments of Company's Constitution* made on 24 June 1999;
7. revoked *Prudential Rules No. 44 Approval of Consequential Amendments of Company's Constitution as Required by APRA* made on 24 June 1999;
8. revoked *Prudential Rules No. 45 Joint Investments of Friendly Society Approved Benefit Funds* made on 24 June 1999;
9. revoked *Prudential Rules No. 46 Single Bank Account for Friendly Society Approved Benefit Funds* made on 24 June 1999;

10. revoked *Prudential Rules No. 40 Approval of Benefit Fund Rules made on 24 June 1999* as varied by Life Insurance (prudential rules) determination No. A1 of 2010 on 28 June 2010;
11. revoked *Prudential Rules No. 41 Approval of Amendment of Approved Benefit Fund Rules made on 24 June 1999* as varied by Life Insurance (prudential rules) determination No. A2 of 2010 on 28 June 2010;
12. revoked *Prudential Standard LPS 902 Approved Benefit Fund Requirements* made by Life Insurance (prudential standards) determination No. 18 of 2007 on 19 December 2007 (**LPS 902**); and
13. determined *Prudential Standard LPS 700 Friendly Society Benefit Funds* in the form set out in the Schedule to determination 12 of 2010.

The old instrument was expressed to take effect on 1 July 2011.

APRA has decided to revoke the old instrument and to make a new determination which includes additional provision.

Life Insurance (prudential standard) determination No. 2 of 2011 (**the new instrument**) makes *Prudential Standard LPS 700 Friendly Society Benefit Funds (LPS 700)*, to take effect from 1 July 2011. It applies to life companies that are friendly societies.

LPS 700 will now include a provision in relation to subsection 38(4) of the Life Act and correct a drafting error.

The new instrument also amends LPS 902. The amendment to LPS 902 is also for the purposes of subsection 38(4) of the Life Act, and the amendment will continue until 1 July 2011 when LPS 902 will cease to have effect.

1. Background

Subsection 38(4) of the Life Act prohibits a life company, including a friendly society, from borrowing money for the purposes of the business of a statutory fund (including an approved benefit fund in the case of a friendly society), if the result would be that the total amount of principal outstanding under unsecured borrowings would exceed an amount ascertained in accordance with the prudential standards.

Regulation 4.01 of the *Life Insurance Regulations 1995* had previously prescribed an amount for the purposes of subsection 38(4) of the Life Act. However, pursuant to the *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010* the prior reference in subsection 38(4) to the allowed amount of unsecured borrowing being prescribed in regulations made under the Life Act was amended to be a reference to the allowed amount of unsecured borrowing being ascertained in accordance with the prudential standards.

APRA does not intend to change the substance of what had previously been prescribed under Regulation 4.01 of the *Life Insurance Regulations 1995*;

accordingly, LPS 902 is being amended, and LPS 700 is being determined, to include the provision previously contained in Regulation 4.01.

LPS 700, as made by the new instrument, also corrects a drafting error in LPS 700 as made by the old instrument. Paragraph 14 of LPS 700, as made by the old instrument, contains requirements in relation to the provision of seed capital from the management fund of a friendly society to a benefit fund. One key requirement is that there is a maximum interest rate payable on the seed capital. There is a drafting error in LPS 700, as made by the old instrument, which establishes a minimum rate payable instead of a maximum rate. This error is corrected in LPS 700, as made under Schedule 2 of the new instrument.

LPS 700, as attached to the new instrument, is in identical terms to LPS 700, as attached to the old instrument, except that LPS 700 now also makes provision for the purposes of subsection 38(4) of the Life Act and corrects a drafting error.

Accordingly, except for the new provisions made for the purposes of subsection 38(4) of the Life Act and the correction of a drafting error, the new instrument makes corresponding provisions to those made under the old instrument.

LPS 700 will address the limits on unsecured borrowings on an ongoing basis from 1 July 2011. LPS 700 will include the same requirement in this regard as in LPS 902, as LPS 902 ceases to have effect on 1 July 2011. Together, these instruments will ensure the limit on unsecured borrowings is imposed on a continuous basis.

The revocation of the old instrument takes effect on registration of the new instrument on the Federal Register of Legislative Instruments.

2. Purpose and operation of new instrument

The purpose of the new instrument is to repeal the old instrument and to amend LPS 902 and to determine LPS 700 so as to make provision for the purposes of subsection 38(4) of the Life Act and correct a drafting error. In all other respects, the new instrument makes corresponding provisions to those made under the old instrument.

LPS 700 changes requirements imposed on industry in form only, not substance. The change moves requirements specified under Regulation 4.01 to a prudential standard and corrects an inadvertent error in the LPS 700, as attached to the old instrument. There is no change in the policy being applied to industry.

3. Regulation Impact Statement

A Regulation Impact Statement for the changes described in this explanatory statement was not required.