

# Life Insurance (Prudential Rules) Determination No. 2 of 2006: Prudential Rules No. 47 Applying To Life Companies That Are Friendly Societies

## Explanatory Statement

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This statement is issued by the authority of the Australian Prudential Regulation Authority ('APRA') under:

- *Life Insurance Act 1995*, subsection 252(1);
- *Acts Interpretation Act 1901*, subsection 33(3).

### Legislative Background

Under subsection 252(1) of the *Life Insurance Act 1995* ('the Act'), APRA has the power to determine (in writing) prudential rules prescribing all matters required or permitted by the Act that must be complied with by all life companies registered under the Act. Such prudential rules are 'legislative instruments' within the meaning of the *Legislative Instruments Act 2003*.

Subsection 82(1) of the Act requires every life company to give APRA financial statements as at the end of each financial year of the company. Paragraphs 82(5)(a) and (b) of the Act provide that these financial statements must be in the form prescribed, and signed, in accordance with the Prudential Rules made under subsection 252(1) of the Act. Prudential Rules No. 47 (PR 47) deals with such financial statements for life companies that are friendly societies (friendly societies).

Although section 82 does not appear in some published editions of the Act, it will continue to form part of the Act until it is repealed by Items 48 and 75 of Schedule 2 to the *Financial Sector (Collection of Data – Consequential and Transitional Provisions) Act 2001*. The repeal will not occur until APRA makes a reporting standard in relation to life insurers under section 13 of the *Financial Sector (Collection of Data) Act 2001* and, under section 15 of that Act, the reporting standard begins to apply to life insurers. Accordingly, for the time being, section 82 of the Act remains in effect.

Subsection 33(3) of the *Acts Interpretation Act 1901* provides that where an Act confers a power to issue an instrument the power shall, unless the contrary intention appears, be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to revoke any such instrument.

## **The Determination**

Life Insurance (Prudential Rules) Determination No 2 of 2006 revokes the PR 47 (made on 22 February 2005 under subsection 252(1) of the Act for the purposes of subsection 82(5) of the Act) and makes new PR 47 for the same purposes. The Determination will take effect upon registration on the Federal Register of Legislative Instruments.

The revoked PR 47 specified the form in which friendly societies were to produce financial statements each year to give to APRA and how they should be signed and audited. By virtue of Life Insurance (Prudential Rules) Determination No. 1 of 2005, they also included transitional regulatory reporting arrangements following the introduction of new Australian accounting standards based on International Financial Reporting Standards (IFRS).

The new PR 47:

- remove the transitional regulatory reporting arrangements in place pending the final changes to reporting requirements and actuarial standards necessary to address IFRS;
- incorporate the changes to the regulatory financial statements required as a result of the introduction of IFRS;
- reflect the changes to the Actuarial Standards made by the Life Insurance Actuarial Standards Board (LIASB) as a consequence of the introduction of IFRS; and
- incorporate the changes to the regulatory financial statements required as a result of the expiry of Australian Securities and Investments Commission (ASIC) Class Order 99/1225: Financial Reporting Requirements for Benefit Fund Friendly Societies.

## **Background to the Changes**

Australian reporting entities are adopting Australian equivalents of IFRS for reporting periods commencing on or after 1 January 2005. The accounting standards are available from the Australian Accounting Standards Board (AASB) website ([www.aasb.com.au](http://www.aasb.com.au)).

APRA's objective in its approach to IFRS is to continue to align its prudential and reporting standards with Australian accounting standards and principles to the extent practicable, as the latter provide a widely accepted basis for the recognition and measurement of assets, liabilities, equity, revenue and expenses. However, while consistency with general purpose reporting is an appropriate aim, it is inevitably subordinate to the primary purpose of the regulatory reporting regime which is to support the administration of the Act and the prudential supervision of the industry by APRA. Therefore, to the extent that elements of the general purpose accounting treatment are not appropriate for the administration of the Act or prudential

supervision of the industry, it is necessary that the form and/or content of regulatory financial statements differ from those of the general purpose accounts. These differences are set out in the Schedule to PR 47 and are commented on below.

Actuarial valuations and calculations included in regulatory financial statements prepared to meet APRA requirements must be determined in accordance with the actuarial standards. Conversely, a number of elements included in the solvency, capital adequacy and management capital standards, as well as the value of assets against which those capital requirements are compared, are derived from the regulatory financial statements. It is therefore necessary that these interactions between the regulatory financial statements and the actuarial standards continue to operate appropriately and effectively following the adoption of IFRS.

Prior to December 31 2004, ASIC Class Order 19/1225 exempted friendly societies from certain parts of the Corporations Law, including general purpose reporting based on Accounting Standard AASB 1038, provided they reported in accordance with the requirements of PR 47. As the class order was not extended beyond 31 December 2004, friendly society financial statements for general purpose reporting have been aligned with the requirements of the Australian accounting standards as they apply to other life companies for financial years commencing on or after 1 January 2005. The revised forms in the Schedule to PR 47 now reflect these changes.

## **Summary of Key Changes**

The proposed financial information reported to APRA under these Rules retains the primary presentation which distinctly reflects prudential requirements. This includes measures of profit or loss and retained earnings as necessary to support the appropriate application of the Act requirements relating to the distribution of surplus.

A separate reconciliation to key values in the general purpose accounts appears in forms B2 and C3 of the Schedule.

The new accounting standards also introduce a distinction between life insurance contracts (which are reported in accordance with AASB1038 - Life Insurance Contracts) and investment contracts (which are mainly reported in accordance with AASB 139 – Financial Instruments: Recognition and Measurement and AASB 118 – Revenue). Recognition of this distinction is necessary for prudential reporting. For friendly societies, it is expected that this will be largely automatic as it is expected that few benefit funds will contain a mixture of life insurance and investment contracts. Where they do, an appropriate means of accommodating this requirement has been determined.

The revised forms retain the requirement for companies to supply consolidated information. It is intended to review this requirement as part of the general review of life insurance statistics being undertaken by APRA.

The financial statements referred to in these Rules apply only to friendly societies. Although friendly societies are now subject to the same requirements as other life

insurance companies with respect to the principles of general purpose accounting, APRA intends to maintain, for the time being, separate Rules for friendly societies for regulatory financial reporting to APRA which will reflect the different management structure of friendly societies.

It is expected that there will be changes to reported surplus on first time adoption of IFRS. When a friendly society submits to APRA its regulatory financial statements prepared in accordance with Prudential Rules No. 47 for the first reporting period commencing on or after 31 May 2006, the friendly society must also submit to APRA the information contained in the Table concerning the derivation of any adjustments to surplus on first time adoption of IFRS. This table shows the reconciliation of the value of surplus before the introduction of IFRS with the value of surplus after the introduction of IFRS.

### **Explanation of the Changes**

Specific changes to forms in PR 47 are as follows:

#### **GENERAL**

Item	Comment
Assets in Benefit Funds	All assets are to be reported at fair value as determined in accordance with relevant accounting standards. Where the relevant accounting standard does not include a provision for the asset to be measured at fair value, the fair value of the asset is to be determined in a manner consistent with the fair value measurement of assets under other accounting standards which do include provision for fair value measurement.
Tax Assets and Liabilities	To the extent that changes to the value of assets recorded in the financial statements (as above) would also result in a change to the value of tax assets or liabilities recorded in the financial statements (in accordance with relevant accounting standards) then such change should be reflected in the value of those tax assets recorded in the regulatory financial statements.
Mixed Business Within a Single Benefit Fund	Where a contract (such as an investment contract with death benefits offered as a rider) is required, by virtue of Prudential Rules No. 49, to be unbundled into a mixture of contract types, then in addition

	to the information provided in respect of the benefit fund as a whole, information in relation to revenue, expenses and liabilities is also to be provided in separate columns for each unbundled contract type as if that business were held in a separate benefit fund.
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#### FORM B1 – BENEFIT FUND INCOME STATEMENTS

Item	Comment
BP4: Revenue Component of Life Insurance Contract Contributions	With the distinction now being made between insurance contracts and investment contracts, this item now only includes premium revenue (excluding deposits) in respect of life insurance contracts.
BP4A: Fees for Management Services rendered	This item includes all fee revenue, including initial fees, ongoing policy fees and asset management fees, on life investment contracts only.
BP9: Claims Expense	With the distinction now being made between insurance contracts and investment contracts, this item now only includes claims expense (excluding withdrawals) in respect of life insurance contracts.
BP11: Other Expenses	This item now includes any amortisation and impairment of Deferred Acquisition Costs (DAC) within a benefit fund.

#### FORM B2 – BENEFIT FUND RECONCILIATION TO OPERATING PROFIT/(LOSS) AFTER TAX IN GENERAL PURPOSE FINANCIAL STATEMENTS

BP22A: Adjustment for assets not held at fair value	Where there are assets in the benefit funds which are not reported at Fair Value through the income statement in the General Purpose Financial Statements, revaluations of these assets to determine Life Act Operating Profit will differ from revaluations of these assets as reported in the General Purpose Financial Statements. The revaluation at Fair
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	<p>Value (and any associated changes in the values of tax assets and liabilities) less the revaluation included in the General Purpose Financial Statements should be reported at this item.</p>
<p>BP22B: Adjustment for Assets revalued direct to equity</p>	<p>Where there are assets in the benefit funds which are not reported at Fair Value through the income statement in the General Purpose Financial Statements, revaluation of these assets to determine Life Act Operating Profit will differ from revaluation of these assets as reported in the General Purpose Financial Statements.</p> <p>The revaluation at Fair Value in the Regulatory Financial Statements less the revaluation included in the General Purpose Financial Statements should be reported at this item.</p>
<p>BP22C: Adjustment for initial fee net revenue</p>	<p>Where the Actuary determines, and can demonstrate to the satisfaction of APRA, that the calculation of the Policy Liability in accordance with paragraph 2.1 of AS1.04 would reduce the retained profits of the benefit fund to such an extent that it would unreasonably hinder the distribution of surplus assets from that fund, then, for policies that were in force at 31 December 2005, the Policy Liability may, with APRA's agreement, be determined in accordance with the requirements of Parts B and C of AS1.04. A reconciliation adjustment is required in such cases. The accumulated adjustment (as reported at item BP23B) will be equal to the difference between:</p> <p>BB21, Policy Liabilities, as reported in Form B6, less BB13A, Policy Liabilities ceded under Reinsurance as reported in Form B5</p> <p>and</p> <p>{ Net life insurance contract and life investment contract liabilities  Plus  Any liability held in respect of the</p>

	<p>Management Services Element of life investment contracts  Less  Any asset held in respect of the Management Services Element of life investment contracts } as reported in the general purpose financial statements.</p> <p>The adjustment reported at this item will be equal to the change in the accumulated adjustment over the reporting period.</p>
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**FORM B2 – BENEFIT FUND RECONCILIATION TO NET ASSETS AT THE END OF THE PERIOD IN GENERAL PURPOSE FINANCIAL STATEMENTS**

BP23A: Accumulated adjustment for Assets not held at Fair Value	Where there are assets in the benefit funds which are not reported at Fair Value through the income statement in the General Purpose Financial Statements, revaluations of these assets to determine Life Act Operating Profit will differ from revaluations of these assets as reported in the General Purpose Financial Statements. The accumulated revaluation at Fair Value (and any associated changes in the values of tax assets and liabilities) less accumulated revaluations included in the General Purpose Financial Statements should be reported at this item.
BP23B: Accumulated adjustment for initial fee net revenue	(see comment under Form B2, Reconciliation to operating profit/(loss) after tax in general purpose financial statements in respect of the corresponding item)

**FORM B5 – BENEFIT FUND BALANCE SHEETS**

This form now includes additional detailed breakdown of assets by whether they are held directly, via unit trusts, or otherwise.

Item	Comment
BB2: Receivables	Receivables including Outstanding Premiums, but not including DAC arising

	in respect of policies, which is included as part of Policy Liabilities.
BB10C and BB11: Investment Property	“Investment” added for clarification. Now excludes owner-occupied property. Also subdivided between “marketable” and “other” to enable direct calculation of liquidity ratios.
BB12: Property, Plant and Equipment	“Property” added for clarification – this item includes owner-occupied property
BB13A: Policy Liabilities Ceded under /reinsurance	This item is required because BB21, Policy Liabilities, is reported gross of reinsurance.

#### FORM B6 – BENEFIT FUND BALANCE SHEETS

BB16A: Seed Capital	Seed capital must be reported separately from Borrowings
BB21: Policy Liabilities	Policy liabilities are to be reported as a liability of the Benefit Fund
B22: Unallocated Benefit funds, B22A: Retained Profits	Net Assets are to be divided between Unallocated Benefits and Retained Profits

#### FORM B13 – COMPONENTS OF OPERATING PROFIT IN THE BENEFIT FUNDS

#### FORMS B14 – COMPONENTS OF POLICY LIABILITIES IN THE BENEFIT FUNDS

These are new forms which are required because friendly societies are now required to report under Margin on Services in respect of life insurance contracts.

#### PART C – MANAGEMENT FUND

##### GENERAL

Under General Purpose Financial Statements, benefit funds are consolidated. For reporting to APRA, benefit funds are to be excluded in order to highlight the performance and capital strength of the management fund separate from the benefit funds

#### FORM C1 – MANAGEMENT FUND - INCOME STATEMENTS

Initial Fees	This item includes any amortisation of any deferred fee liabilities
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FORM C2 – MANAGEMENT FUND - INCOME STATEMENTS

Amortisation of Deferred Acquisition Cost	Any amortisation of a Deferred Acquisition Cost asset is included here, rather than in other expense items.
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FORM C3 – RECONCILIATION TO OPERATING PROFIT/(LOSS) AFTER TAX IN GENERAL PURPOSE FINANCIAL STATEMENTS

Adjustment for assets held at different values in the general purpose financial statements	Where there are assets in the management funds which are not reported at Fair Value through the Income Statement in the General Purpose Financial Statements, revaluations of these assets to determine Life Act Operating Profit will differ from revaluations of these assets as reported in the General Purpose Financial Statements. The revaluation at Fair Value (and any associated changes in the values of tax assets and liabilities) less the revaluation included in the General Purpose Financial Statements should be reported at this item.
Adjustment for Assets revalued direct to equity	Where there are assets in the management funds which are not reported at Fair Value through the Income Statement in the General Purpose Financial Statements, revaluation of these assets to determine Life Act Operating Profit will differ from revaluation of these assets as reported in the General Purpose Financial Statements.  The revaluation at Fair Value in the Regulatory financial Statements less the revaluation included in the General Purpose Financial Statements should be reported at this item.

FORM C3 – RECONCILIATION TO RETAINED PROFITS AT THE END OF THE PERIOD IN GENERAL PURPOSE FINANCIAL STATEMENTS

Accumulated adjustment for assets held at different values in the general purpose financial statements	Where there are assets in the management funds which are not reported at Fair Value through the Income Statement in the General Purpose Financial Statements, revaluations of these assets to determine Life Act Operating Profit will differ from revaluations of these assets as reported in the General Purpose Financial Statements. The accumulated revaluation at Fair Value (and any associated changes in the values of tax assets and liabilities) less accumulated revaluations included in the General Purpose Financial Statements should be reported at this item.
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### FORM C6 – MANAGEMENT FUND BALANCE SHEETS

The distinction between current assets and non-current assets, and between current liabilities and non-current liabilities, has been removed to simplify reporting. As a consequence, Forms C7 - Non-Current Assets, C8 - Current Liabilities, C11 - Note 4 – Other Non-Current Assets and C13 - Note 6 – Other Non-Current Liabilities, have been deleted. Non-current assets have been incorporated into Form C6 - Assets, and Form C10 - Note 3 – Other Assets. Current liabilities have been incorporated into Form C9 - Liabilities while details of other non-current liabilities are included in Form C12 - Note 5 – Other Liabilities.

Item	Comment
Seed Capital to Benefit funds	Seed capital must be reported separately from other loans
Investment Property	“Investment” added for clarification. Now excludes owner-occupied property.
Property, Plant and Equipment	“Property” added for clarification – this item includes owner-occupied property

### DECLARATION, STATEMENT AND REPORT ATTACHED TO REGULATORY FINANCIAL STATEMENTS

The declarations, statements and reports attached to regulatory financial statements are distinct from those attached to the general purpose financial statements, and need to be made having regard to any difference between the two statements.

However, they should not be regarded in any way as contradictory, since they are made in different contexts. In particular, the directors’ statement that the income

statement truly represents the financial performance, and that the balance sheet truly represents the financial position, are made in the context of the of the Act and these Rules – i.e. that they truly represent the amounts to be reported in accordance with the Act and the Rules. This should not therefore contradict any statement made in relation to a different financial performance or financial position as reported in the general purpose financial statements.

## **Implementation**

These new prudential rules will apply for reporting periods ending on or after 31 May 2006, i.e. corresponding to the first full financial reporting periods for which IFRS applies to a friendly society.

However, to maintain an orderly changeover to IFRS based data collection for APRA and for the industry as a whole APRA is extending the deadline for the first data collections under the revised forms by six weeks for friendly societies which have a financial year ending on 31 May or 30 June. The relevant deadlines for the data collections will therefore be within 19 weeks of the end of the reporting period to which they relate.

### **Regulatory Impact Statement (RIS)**

The Office of Regulation Review has advised that a RIS is not required. These revisions to the friendly society returns were covered in the RIS, APRA1 2005-47(1):7520, that was prepared and tabled with the legislative instrument, Record of Resolutions of the Life Insurance Actuarial Standards Board: Actuarial Standards, 5 December 2005. This deals with the changes arising from IFRS generally and, specifically, with the changes to the actuarial standards made by the Life Insurance Actuarial Standards Board in December 2005.