



The following transitional Prudential Standard applies to Friendly Societies and is preserved by virtue of Regulation 33 of the Financial Sector Reform (Amendments and Transitional Provisions) Regulations 1999. This Prudential Standard was in force under section 28 of the Australian Financial Institutions Commission (AFIC) Code immediately before the transfer date.

## **6.4C PRUDENTIAL STANDARD (FRIENDLY SOCIETIES)**

### **GUARANTEES**

#### **Objective**

*To protect and promote the financial integrity and efficiency of the state-based financial institutions scheme and to ensure that members of friendly society benefit funds are adequately protected from the risks that a friendly society incurs in its operations. Towards this end, to ensure that a friendly society is not exposed to undue risk as a result of guarantees made by or on behalf of the friendly society.*

#### **General Background**

The provision of guarantees, sureties, indemnities and similar off-balance sheet facilities by a friendly society can generate additional income from a given asset base without the introduction of direct liabilities. A friendly society may also be obliged to provide guarantees or indemnities to access financial services for use by itself or its members. This off-balance sheet activity introduces contingent rather than direct liabilities, that can nevertheless create risks for a friendly society. The dangers are particularly acute if guarantees are extended without full analysis of the potential risks.

For the purposes of the Prudential Standards, guarantees, indemnities or similar commitments, provided by a friendly society on its own behalf to access services, will not generally be treated as direct credit substitutes. Guarantees provided to members of a benefit fund, a subsidiary or other venture associated with the friendly society, or given on behalf of members, are to be treated as direct credit substitutes.

Where a friendly society provides guarantees or other off-balance sheet facilities, it is, as part of its risk management strategy, to maintain policies with respect to the provision of such facilities, and is to be able to demonstrate appropriate systems to identify and manage the individual and aggregate risks involved. Further, off-balance sheet facilities that are direct credit substitutes are subject to Prudential Standard 6.2.

The introduction of this Prudential Standard may see a society in breach of some of its requirements. For example, a guarantee may be in place that is a direct credit substitute but not for a limited amount. Where this is the case a society is to contact its SSA to agree a strategy and timetable for achieving compliance.

### **Guarantees**

#### **6.4.3 Granting of Guarantees by a Society**

- 6.4.3.a Each friendly society is to have comprehensive written policies and procedures with respect to providing guarantees, indemnities or other off-balance sheet facilities; and is to satisfy its SSA that it has adequate systems and procedures for managing the risks involved.
- 6.4.3.b A society that issues an indemnity, guarantee or similar contingent liability is to ensure that the party relying on the facility is clearly aware of the specific fund or funds that back the obligation.

- 6.4.3.c AFIC may deem that certain types or classes of guarantees or other sureties are direct credit substitutes.
- 6.4.3.d A guarantee or other surety provided on behalf of a member is a direct credit substitute. Indemnities provided by a friendly society on its own behalf will not normally create direct credit substitutes.
- 6.4.3.e A guarantee that is a direct credit substitute:
- is to be for a limited amount; and
  - will be treated as a loan for the purpose of the capital requirements in Prudential Standard 6.2.
- An SSA may increase a friendly society's (or a specific fund's) capital requirement if, in the opinion of the SSA, the guarantee, or guarantees in aggregate, add significantly to the overall risk of the friendly society (or the specific fund).
- 6.4.3.f Where a friendly society provides a guarantee to a subsidiary or associate which substitutes for capital that would otherwise be required (eg under SIS legislation), then the maximum exposure under the guarantee will be treated as an Inadmissible Asset under Prudential Standard 6.2. Other guarantees provided to a subsidiary or associate will be treated as a direct credit substitute under 6.4.3.e. A society is to obtain approval from its SSA before providing a guarantee of, or on behalf of, a subsidiary or associate.
- 6.4.3.g The provision of a guarantee from the management fund of a friendly society to a benefit fund or its members is of significant prudential concern. A society should discuss the capital implications of any existing guarantees with its SSA. A society is to obtain approval from its SSA before providing such a guarantee.
- 6.4.3.h The provision of guarantees and indemnities may create contingent liabilities which are to be disclosed in the friendly society's financial statements to APRA in accordance with the applicable Australian Accounting Standards (as those standards applied in relation to reporting periods that began immediately before 1 January 2005).