

# **Life Insurance Act Regulations 1995 No. 141**

## **EXPLANATORY STATEMENT**

### **Statutory Rules 1995 No. 141**

Issued by Authority of the Treasurer

*Life Insurance Act 1995*

Life Insurance Act Regulations

Section 253 of the *Life Insurance Act 1995* (the Act) provides that the Governor-General may make regulations for the purposes of the Act.

The Act provides for the prudent management of life companies and for their supervision by the Insurance and Superannuation Commissioner.

The regulations are the core regulations considered essential to the operation of the Act on commencement. These regulations facilitate the proclamation of 1 July 1995 as the commencement date of the Act.

In accordance with the intention to provide a transitional period for the industry to progressively move towards the new financial reporting regime, some of the regulations are a reinstatement of the existing provisions under the regime of the *Life Insurance Act 1945*. This is intended to be only an interim measure and revised regulations will be promulgated over the next six months, allowing sufficient time for final development of the proposed regime and the proper consultation with industry.

The regulations have been developed in consultation with representatives of the life insurance industry.

The commencement date of the regulations is 1 July 1995.

Details of the regulations are attached.

## ATTACHMENT

### Details of the proposed Life Insurance Regulations

#### PART 1 PRELIMINARY

##### Regulation 1.01 - Citation

Regulation 1.01 provides that the regulations may be cited as the Life Insurance Regulations.

##### Regulation 1.02 - Commencement

Regulation 1.02 provides that the regulations commence on 1 July 1995, the date of proclamation of the *Life Insurance Act 1995* (the Act).

It is noted that only those regulations considered essential for the operation of the Act have been incorporated in this package. Further regulations will be made within the next 6 months.

##### Regulation 1.03 - Interpretation

Regulation 1.03 provides for the *Life Insurance Act 1995* to be referred to as the Act within the Regulations.

#### PART 2 - EXPLANATION OF KEY CONCEPTS

##### Regulation 2.01 - Contract to pay annuities - term prescribed

Regulation 2.01 provides that, in order to be considered a life policy within the definition of the Act, a term certain annuity (that is, an annuity for a term not dependent on human life) must be written for a term of greater than 10 years. Such policies can therefore only be written by a registered life company.

There is no intention, via this provision, to restrict registered life companies from providing shorter duration annuities, but rather to allow that providers other than life companies may provide such policies.

#### PART 3 - REGISTRATION OF LIFE COMPANIES

##### Regulation 3.01 - Application for registration as a life company

Where a company seeks registration as a life company, the information which must be provided in an application by the company is set out in regulation 3.01. The regulation requires that the application be in writing and signed by the principal executive officer and a director of the company.

The regulation refers to:

- (i) information to be provided in the application, the details of which are set out in Part A of Schedule 1 to the regulations; and
- (ii) documents to accompany the application, as set out in Part B of Schedule 1 to the regulations.

##### Regulation 3.02 - Time for giving of notice due to changes of circumstances

The information which is required to be provided by a company in an application for registration as a life company, is required to be notified on an ongoing basis, to the extent the circumstances of the company and the information ceases to be accurate (subsection 25(2) of the Act).

The time period within which a company must notify changes to the information is 14 days.

It is recognised that much of the information requested on application is received from the registered life company, in respect of later years of operation, through other reporting requirements under the Act, most particularly the financial returns and statistical returns.

Accordingly, to avoid administrative duplication for both life companies and the Insurance and Superannuation Commissioner, the Commissioner will issue a Circular which clarifies the particular information which must be notified for the purposes of subsection 25(2) of the Act.

#### PART 4 - STATUTORY FUNDS OF LIFE COMPANIES

##### Regulation 4.01 - Statutory funds - maximum amount of unsecured borrowing

The purpose of regulation 4.01 is to define the limit on the amount of unsecured borrowings which a statutory fund is permitted. That limit has been defined in terms of the free assets of the statutory fund, where free assets are those assets of the statutory fund in excess of the capital adequacy standard within the meaning of Division 2 of Part 5 of the Act.

Note, an actuarial standard defining the level of the capital adequacy standard comes into application on 1 July 1995.

The test on unsecured borrowings is an 'at time of borrowing' test. Therefore at the time of borrowing, if the amount of borrowing is such as to result in a total of unsecured borrowings in the statutory fund of greater than fifty percent of the free assets of that fund, the borrowing is not permitted.

##### Inclusions in Unsecured Borrowings

It is noted that the Act specifically excludes bank overdrafts from the unsecured borrowings of the company (subsection 38(5) of the Act). It is the intention that subordinated debt (where the basis of subordination and terms of the debt meet the minimum requirements of the Commissioner) also be excluded from the unsecured borrowings of the statutory fund. In order to clarify this issue, the Commissioner will issue a Circular which clarifies the definition of unsecured borrowings for the purpose of section 38(4) of the Act.

#### PART 6 - FINANCIAL MANAGEMENT OF LIFE COMPANIES

##### Regulation 6.01 - Statement of actuaries pecuniary interests - prescribed form

The appointed actuary of the company is required under subsection 120(3) of the Act to disclose any pecuniary interests with the company. This regulation, by way of Form 1 of Schedule 4, sets out the form of the statement of pecuniary interests from the appointed actuary.

Interests required to be set out include securities, contracts and any type of remuneration and include interests held by persons such as a spouse, dependent child, business partner or other employer of the actuary, or a company of which the actuary is a director.

#### PART 9 - TRANSFERS AND AMALGAMATIONS OF LIFE INSURANCE BUSINESS

##### BACKGROUND

The intention of this part is to provide greater detail on the administrative processes to be followed by a life company prior to undertaking a transfer or amalgamation of life insurance business.

The regulations prescribe the processes for disclosure of information and documents in relation to the proposed transfer or amalgamation and set the sequence of events which that process should take, with prescribed timeframes on certain stages of the process.

The essential purpose of the regulations is to ensure that the policy owners affected by the proposed scheme for transfer or amalgamation (and the Commissioner) are given adequate information and sufficient notice, to make a proper evaluation of the proposal.

A diagrammatic representation of the sequence of events proposed by the regulations follows:

#### Regulation 9.01 - Copy of scheme for transfer or amalgamation etc. to be given to Commissioner

Regulation 9.01 provides that, before a company may publish a notice of intention to apply to the Court for confirmation of a scheme for transfer or amalgamation of life insurance business, prescribed information must have been provided to the Commissioner.

#### Regulation 9.02 - Notice of intention to apply for confirmation of scheme

The Commissioner must approve the notice of intention before it may be published. In approving the application, the Commissioner will consider the information provided under regulation 9.01. The purpose of the Commissioner approval is to ensure that the notice clearly informs of the process for confirmation and how affected policy owners may obtain further information and have their view heard.

The notice of intention must be published in the Gazette and certain Newspapers. The Commissioner will approve the newspapers in which the notice is proposed to be published. The purpose of the Commissioner approval is to ensure that the circulation of the published notice is sufficient to provide reasonable opportunity for all affected policy owners to view the notice of intention.

Subregulation 2 prescribes the minimum information which must be included in the notice. This information is:

- notice of the policy owner's entitlement to obtain a copy of the scheme for the transfer or amalgamation; and
- details of the address(es) from which a copy can be obtained.

Subregulation 3 provides that the notice of intention must be published prior to making the scheme available for public inspection.

Subregulation 4 prescribes that a copy of the scheme must be open for public inspection, during the times 9.00am to 5.00pm, for a period of at least 15 business days. The scheme is to be made available for public inspection at an office of the applicant company in each State or Territory in which there are affected policy owners. Where there is no office, the Commissioner may approve another location, to ensure that the material is reasonably accessible for inspection by all affected policy owners.

### Regulation 9.03 - Application for confirmation of the scheme

Before making application to the Court for confirmation of the scheme, regulation 9.03 requires that the following processes must have been completed:

- the scheme has been open for a public inspection for a period of no less than 15 business days;
- where the company is required to provide an approved summary of the scheme to all affected policy owners (in accordance with subsection 191(2) of the Act) that this has occurred; and
- at least 15 days have passed since provision of the approved scheme to affected policy owners - allowing sufficient time for policy owners to have reviewed the material.

### Regulation 9.04 - Documents to be lodged with the Commissioner

This regulation prescribes the documents which the Commissioner requires to be provided after the transfer or amalgamation has occurred. The documents are to be provided by the 'receiving' company (that is the company to which business was transferred, or with whose business, other business was amalgamated).

The documents required are intended to confirm that the transfer or amalgamation occurred in accordance with the scheme as amended by the Court. The documents are:

- a statement of the nature and terms of the transfer or amalgamation;
- certified copies of:
  - the scheme
  - actuarial reports or other reports
  - the agreement or deed under which effected
  - Court order confirming the scheme
  - statement of assets and liabilities of each associated company; and
- a statutory declaration by the principal executive officer of payments in relation to the transfer or amalgamation.

Subregulations 2, 3 and 4 provide that these documents must be lodged within 30 days of the completion of the transfer or amalgamation. An extension of a further 30 days may be provided on written application to the Commissioner by the company.

## PART 10 - PROVISIONS RELATING TO POLICIES

### Regulation 10.01 - Assignment of life policy-prescribed form

For the purposes of transferring rights under a life policy, a memorandum of transfer must be completed, the form of which is prescribed in regulation 10.01, by way of Form 2 in Schedule 4.

### Regulation 10.02 - Notice of change of trustee of life policy

For the purpose of notifying a change of trustee of a life policy, the form of notice is prescribed in regulation 10.02 to be by way of statutory declaration.

#### Regulation 10.3 - Division 4 of Part 10 of the Act not to apply to certain life policies

Division 4 of Part 10 of the Act sets out the requirements for surrender values, paid-up policies and non forfeiture of policies. There are certain life policies for which the requirements of Division 4 of Part 10 of the Act are inappropriate. In the broad, policies with no investment element, where the policy owner has no expectation of a return on early termination of the policy, require no provisions in respect of surrender values, paidup policies or non-forfeiture of policies.

Therefore, regulation 10.03 sets out the kinds of policies which are excluded from the requirements of Division 4 of Part 10 of the Act as:

- annuity policies (where the term is dependent on human life, BUT not during the deferment period of a deferred annuity);
- risk policies (that is, policies against a contingency that may or may not happen). Excluded from this is pure endowment policies and policies which approach the traditional endowment or whole of life structures. These latter have been characterised as policies which require level premium payments, provide cover for long terms (greater than 10 years) and to advanced ages (greater than 70); and
- policies which are investment linked contracts.

#### Regulation 10.04 - Division- 4 of Part 10 of the Act to apply to certain policies with modification

The intention of this regulation is to prescribe modifications to the application of Division 4 of Part 10 of the Act in respect of particular kinds of policies, these being:

- family income benefit policies
- policies which include additional benefits
- policies with options
- ordinary policies that have been altered
- ordinary policies that have been increased
- special endowment policies
- paid up policies.

The regulation, by way of Schedule 3, provides greater description of the kinds of policies covered and for each kind, details the nature of the modification to Division 4 of Part 10 of the Act.

The calculation detail for the purposes of Division 4 of Part 10 of the Act will be prescribed in an actuarial standard. The actuarial standard titled "Actuarial Standard for Paid up Values and Surrender Values" has application from 1 July 1995.

The modifications in Schedule 3 reference the calculation processes detailed in that actuarial standard.

### Regulation 10.05 - Interest on overdue premiums - prescribed terms

The maximum rate of interest which a company may apply to overdue premiums on a life policy, for the purposes of section 210(3) of the Act, is prescribed by this regulation.

The maximum rate is defined by formula linked to the 10 year Treasury Bond rate as published by the Reserve Bank of Australia.

### Regulation 10.06 - Calculation of net claim value of policy

For the purposes of subsection 223(2) of the Act, this regulation defines the 'net claim value' of a policy.

This regulation provides that the net claim value under a policy would be determined as if a claim were being made against the policy in respect of a particular contingency the policy covered. The amount of the net claim value is the amount to which the insured would have been entitled under the terms of the policy on the happening of the contingency which is giving rise to the claim. In particular, any debt attaching to the policy would be deducted from the amount prior to payment.

## PART 11 - MISCELLANEOUS

### Regulation 11.01 - Fee for inspection or copying of documents

The financial and annual statistical returns provided by life companies to the Commissioner is public information. Regulation 11.01 prescribes a fee for the inspection or copying of those documents.

Subregulation 1 prescribes a fee of \$10 to inspect a financial statement or annual statistical return.

Subregulation 2 prescribes a copying fee, in respect of such documents, of \$1 per page. A maximum fee of \$60 is prescribed by subregulation 3 for copying all documents of a company in respect of a financial year.

### Regulation 11.02 - Definition of "financial sector supervisory agency"

This regulation defines the financial sector supervisory agencies to whom information or documents may be disclosed, where that disclosure is for the purposes of the performance of the functions or the exercise of the powers of that agency (under subsection 251(4) of the Act).

### Regulation 11.03 - Definition of "law enforcement agency"

This regulation defines the law enforcement agencies to whom information or documents may be disclosed (under subsection 251(5) of the Act).

## PART 12 - HOW THIS ACT AFFECTS EXISTING LIFE COMPANIES ETC.

### BACKGROUND

Division 5 and 6 of Part 4 of the Act provide the mechanisms for allocation and distribution of operating profit of the life company. The basis provided is intended to operate within the new financial reporting regime being developed for life companies. In accordance with the timing of introduction of that new reporting regime, the operation of Divisions 5 and 6, are modified by

regulation, to re-introduce the basis for surplus distribution as it applied under the *Life Insurance Act 1945*.

Most particularly, the structure in the Act defines a two stage process of:

1. ALLOCATION of operating profit to 5 specific purpose pools; and
2. DISTRIBUTION of those pools in accordance with provisions of the Act.

Once money is allocated to a pool, it belongs to that pool and can only be distributed according to the provisions specified for that pool. The pools are intended to operate like a running account, being credited upon allocation and debited upon distribution. To commence operations under this structure, it is necessary for life companies to determine the 'starting amount' of each of the defined pools, at the commencement date. The basis for determining the starting amount will be prescribed in Commissioner's rules.

It is important to note that under the modification of Divisions 5 and 6:

1. The concept of ALLOCATION has been removed. Only the DISTRIBUTION phase remains in the process.
2. The concept of pools, while maintained, is only a vehicle to facilitate the operation of section 62 of the Act (the distribution provision). Accordingly only 3 pools are maintained instead of the 5 under the Act.
3. The definition of the pools has been altered to refer to a portion of the SURPLUS, where surplus emerges as the excess of assets over liabilities at the valuation date.
4. The 'pools' are not run as accounts but rather recalculated at each valuation. The concepts of crediting and debiting are removed. The need to define a starting amount is removed.

The modification provision is, in accordance with section 261 of the Act, only to apply in respect of financial years of the company commencing before 1 January 1996.

In respect of subsequent financial years, when Divisions 5 and 6 of Part 4 of the Act come into full operation, the operations of these Divisions during the interim period of this modification provision will have NO impact on the balance of the pools, the starting amounts' or any other aspect of Division 5 and 6.

#### Regulation 12.01 - Modification of Division 5 and 6 of Part 4 of the Act in their application to existing life companies

This regulation, together with Schedule 3, modifies the operation of Division 5 and 6 of Part 4 of the Act in respect of financial periods of a life company commencing before 1 January 1996. The purpose of the modification is to re-instate the surplus distribution provisions as they existed under the *Life Insurance Act 1945* (section 50).

To assist in the interpretation of these modification provisions, attached as Appendix 1 to this explanatory memorandum, is a reworked version of Divisions 5 and 6 of the Act, taking into account the modification provisions.

#### PART 13 - DICTIONARY

##### Regulation 13.01 - Definition of "eligible assets" - dictionary

The eligible assets of the company (as referred to in section 21 of the Act) are defined in regulation 13.01 to include assets invested in a related company where:

- that related company is a subsidiary of the company, and
- those assets are not reinvested, in any way, with another related company which is not a subsidiary.

The purpose of the latter provision is to ensure the 'control' of the assets being included as eligible assets remains with the company.

Further the regulation provides that bank deposits are included as eligible assets.

Regulation 13.02 - Definition of "superannuation policy - dictionary

Superannuation policy is defined to include particular kinds of policies as identified in regulation 13.02.

## APPENDIX 1

### REGULATIONS - SCHEDULE 3

#### Part 4 - Divisions 5 & 6

##### *Division 5-Allocation of profit and losses and capital payments*

###### Interpretation

56.(1) In this Division:

"Australian fund" has the same meaning as in Part 6;

"Australian/overseas fund" has the same meaning as in Part 6;

"Australian participating business" means participating business carried on in Australia;

"overseas fund" has the same meaning as in Part 6;

"overseas participating business" means participating business carried on outside Australia.

(2) The categories of business of a statutory fund for the purposes of this Division are the categories of business into which the classes of life insurance business to which the fund relates are divided by section 75 or 76.

###### Statutory funds - Surplus

58.(1) The life insurance business of a statutory fund has a surplus at the date of an investigation if that investigation shows that the balance of the revenue account exceeds the net liabilities of the company in respect of that business at that time. The amount of surplus is the amount by which the balance of the revenue account exceeds net liabilities.

(2) In subsection (1):

"balance of revenue account", in relation to the life insurance business of a statutory fund, means the balance of the revenue account of the fund in respect of that business, determined in accordance with Part A of the Schedule to the Commissioner's rules made for the purpose of section 82(5) of the Act;

"investigation" means an investigation of the financial condition of a life company made under:

(a) section 113; or

(b) if the results of the investigation are made public - section 115;

"net liabilities", in relation to the life insurance business of a statutory fund, means the net liabilities of the fund in respect of that business, determined in accordance with Part E of the Schedule to the Commissioner's rules made for the purposes of section 117(2) of the Act.

##### *Division 6-Distribution of retained profit and shareholders' capital*

###### Interpretation

61.(1) In this Part:

"Australian policy owners' retained profits", in relation to a statutory fund at the date of investigation, means eighty percent or a greater percentage specified in the articles of association of the company to which the fund relates, of the total surplus of the fund under section 58 that is derived from Australian participating business;"

"date of investigation" means the date of an investigation made under section 58;

"shareholders' retained profits (Australian participating)", in relation to a statutory fund at the date of investigation, means the total surplus of the fund under section 58 that:

(a) is derived from Australian participating business; and

(b) is not Australian policy owners' retained profits.

"shareholders' retained profits (other)", in relation to a statutory fund at the date of investigation, means the total surplus of the fund under section 58 that is not derived from Australian participating business.

#### Distribution of retained profits

62.(1) The distribution of retained profits of a statutory fund must be in accordance with the following rules:

(a) Australian policy owners' retained profits may only be distributed to owners of Australian policies that provide for participating benefits;

(d) shareholders' retained profits (Australian participating) and shareholders' retained profits (other) may be:

(i) transferred to shareholders' funds; or

(ii) transferred to another statutory fund of the company; or

(iii) distributed to owners of policies that provide for participating benefits.

(e) shareholders' retained profits (other) may be distributed to owners of overseas policies that provide for participating benefits, in a manner consistent with the articles of association of the company.

(2) A distribution of retained profits of a statutory fund may only be made after the directors of the company have received the appointed actuary's written advice as to the likely consequences of the proposed distribution.

(3) A distribution of retained profits of a statutory fund must not be made if.

(a) the distribution would have the result that the solvency standard would not be satisfied in relation to the fund; or

(b) the distribution would involve a contravention of a direction given by the Commissioner under section 68; or

(c) in the case of a distribution of shareholders' retained profits (Australian participating), the distribution would involve a contravention of Commissioner's rules made for the purposes of subsection (5).

(4) Except with the approval of the Commissioner, a distribution of shareholders' retained profits (Australian participating) or shareholders' retained profits (other) must not be made if..

(a) the distribution would have the result that the capital adequacy standard would not be satisfied in relation to the fund; or

(b) the distribution would involve a contravention of a direction given by the Commissioner under section 73.

(5) Commissioner's rules may prohibit the distribution of shareholders' retained profits (Australian participating) unless the distribution is in accordance with specified requirements relating to the distribution of Australian policy owners' retained profits.