



# Prudential Practice Guide

## **LPG 700 – Friendly Society Benefit Funds**

September 2013

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## About this guide

1. *Prudential Standard LPS 700 Friendly Society Benefit Funds* (LPS 700) applies to life companies that are friendly societies registered under the *Life Insurance Act 1995* (the Life Act). It sets out requirements to ensure that the establishment, structure and operation of a friendly society's approved benefit funds are fair and equitable for its members.
2. This prudential practice guide (PPG) aims to assist friendly societies in complying with those requirements and, more generally, to provide guidance on APRA's view of sound practice in relation to the operation of friendly society approved benefit funds. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.
3. Not all the practices outlined in this PPG will be relevant for every friendly society and some aspects may vary depending upon the business operations and types of approved benefit funds of the friendly society.

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## Approved benefit funds

1. LPS 700 sets out requirements regarding the content and operation of approved benefit fund rules, the approval and amendment of a friendly society's benefit fund rules and any consequential amendments to the friendly society's constitution and the restructure and termination of benefit funds. Outlined below is guidance on addressing these requirements.

### General content of approved benefit fund rules

2. Subject to and for the purposes of the requirements of the Life Act, as modified, a friendly society must have approved benefit fund rules that adequately provide for, amongst other things, the matters outlined in paragraph 5 of LPS 700.
  3. In addressing these matters, APRA expects the following considerations to be taken into account:
    - (a) in relation to paragraph 5(g) of LPS 700, APRA envisages the approved benefit fund rules to include detail as to the criteria or qualifications for membership of the approved benefit fund;
    - (b) in relation to paragraph 5(h) of LPS 700, section 43 of the Life Act (as modified by section 16J of the Life Act) prevents a friendly society from making an investment of assets of an approved benefit fund unless the investment is of a kind provided for by the approved benefit fund rules and complies with any requirements in the prudential standards. Further, it would be prudent that the approved benefit fund rules include details of all the classes of investment in which assets of the approved benefit fund may be invested, as well as an indication of the extent of investment in each particular class. For example, the approved benefit fund rules may specify percentage bands for each investment class showing the minimum and maximum proportion the investment may represent as a percentage of total assets of the approved benefit fund. Approved benefit fund rules may also provide information on the general policy to be followed in determining the investments of the approved benefit fund;
- (c) further in relation to paragraph 5(h) of LPS 700, subsection 34(4A) of the Life Act (as inserted by the modifications made by section 16H of the Life Act) provides that a friendly society may invest assets of two or more approved benefit funds in a single investment if the approved benefit fund rules of each of those funds provide for such an investment and the investment complies with the applicable requirements of the prudential standards relating to assets of one fund being invested together with assets of another fund or funds. These requirements are set out in paragraphs 19 to 25 of LPS 700;
  - (d) in relation to paragraph 5(k) of LPS 700, in providing for taxation, it would be prudent for approved benefit fund rules to include details of the method of charging tax expense to the approved benefit fund and the effect of taxation on the calculation of benefit amounts;
  - (e) in relation to paragraph 5(m) of LPS 700, the *Life Insurance Regulations 1995* (Life Regulations) (made for the purposes of section 16ZC of the Life Act) provide for the substitution of Divisions 5 and 6 of Part 4 of the Life Act with a new section 56. This section, among other matters, provides for the distribution of surplus on the written advice of the Appointed Actuary. Paragraphs 11 to 13 of LPS 700 also refer to matters relating to surplus; and
  - (f) for the purposes of section 53 of the Life Act, LPS 700 sets out requirements for the termination of an approved benefit fund, including requirements for application of assets upon termination. As part of this process, consideration is given to the approved benefit fund rules for application of assets upon termination. APRA therefore expects a friendly society to consider the inclusion of rules for the application of assets on the termination of the approved benefit fund as part of its approved benefit fund rules.

### **Classification of approved benefit funds**

4. Paragraphs 6 to 10 of LPS 700 requires a friendly society to classify an approved benefit fund as either defined contribution or defined benefit, as defined in LPS 700.
5. The requirements for approved benefit fund rules to adequately provide for surplus allocation or distribution, as detailed in LPS 700, depend on whether an approved benefit fund is classified as defined benefit or defined contribution.
6. Examples of defined benefit funds include traditional risk products such as whole of life and endowment assurance, as well as modern risk products such as term insurance, life or term annuities or disability income. Examples of defined contribution funds include investment account, investment-linked and education funds.
7. An approved benefit fund may have both defined benefit and defined contribution elements. For example, traditional life insurance funds such as whole of life and endowment assurance funds may have been designed as traditional life insurance 'with profit' policies in which bonuses, reflecting, among other things, the investment performance of the assets, are added to the guaranteed defined benefits. Others such as funeral funds may take the form of either defined benefit or defined contribution funds.
8. LPS 700 provides for the friendly society to apply to APRA for a written determination of the classification of any approved benefit fund. APRA may make such a determination where APRA has reviewed the approved benefit fund rules and it is satisfied that a determination should be made.

### **Seed capital**

9. Approved benefit funds must meet the requirements of *Prudential Standard LPS 110 Capital Adequacy* and *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital*. Subject to the requirements set out in paragraphs 14 and 15 of LPS 700, a friendly society may inject management fund capital into a new or existing approved benefit fund. However, APRA expects that seed capital is not regularly transferred from the management fund to a particular approved benefit fund.
10. The repayment of seed capital does not constitute an allocation or distribution of surplus under section 56 of the Life Act.

### **Provision of financial benefits**

11. Subject to the exclusions set out in paragraph 18 of LPS 700, if a friendly society wishes to provide financial benefits to a member as a result of financial contributions made by the member, APRA expects that an approved benefit fund is maintained both to accept the contributions and to pay the financial benefit.

### **Joint investments of approved benefit funds**

12. Paragraphs 19 to 25 of LPS 700 are made for the purposes of subsection 34(4A) as inserted by subsection 16H(4A) of the Life Act. This subsection provides that a friendly society may invest assets of two or more approved benefit funds in a single investment provided that the rules of each benefit fund allow for such an investment and that the investment complies with the prudential standards.
13. A health insurance benefit fund regulated under the *National Health Act 1953* is not an approved benefit fund for the purposes of the Life Act. A health insurance benefit fund cannot, therefore, contribute to a joint investment between the health fund and one or more approved benefit funds or the management fund.

14. LPS 700 specifies various accounting procedures for the maintenance and administration of joint investments. The overall aim of these procedures is to maintain accountability and transparency between the joint investment and the contributing approved benefit funds. These procedures are necessary in order that the principle enunciated in subsection 34(3) as modified by subsection 16H(3) of the Life Act is met; that a friendly society must keep the assets of each approved benefit fund distinct and separate from:
  - the assets of any other approved benefit fund; and
  - any other assets of the friendly society.
15. Paragraph 21 of LPS 700 requires that any joint investments must be able to be readily liquified. The reason for this is so that each contributing approved benefit fund is able to redeem its investment in an expeditious manner with no undue effect on other contributing approved benefit funds. For example, a number of approved benefit funds investing in a single property would not be an appropriate joint investment, whereas a joint investment in listed shares, government securities, bank or commercial bills would be appropriate as a ready secondary market exists for such investments.
16. Paragraph 21 of LPS 700 also requires that the operation of a joint investment must not result in the asset exposures of a contributing approved benefit fund being directly affected by the investment decisions of another contributing approved benefit fund. This precludes, for example, management of joint investments by way of an internal unitised pool of joint investments; as transactions between the pool and a given contributing approved benefit fund would directly alter the proportion of the different pooled assets attributable to each other contributing approved benefit fund participating in the pool.
17. A friendly society may use the services of a custodian in relation to a joint investment, provided that the joint investment is invested in the name of the friendly society.
18. Section 45 of the Life Act, as modified by the Life Regulations, provides that a friendly society must not transfer an asset from one approved benefit fund to another approved benefit fund, except in the situation where the asset is transferred at fair value or in accordance with Divisions 3, 4 or 5 of Part 4 of the Life Act. The operation of a joint investment is not permitted to be used in a way that would contravene section 45 of the Life Act such as loans created between contributing approved benefit funds.
19. LPS 700 specifies prescribed time periods within which the benefit fund accounts must be reconciled with the investment register. In the main, APRA expects that the reconciliation process is performed at least every seven days or, where applicable, at other such time as permitted by APRA. APRA may permit a less frequent reconciliation where APRA is satisfied that the friendly society's joint investment is relatively stable with insufficient transactions to warrant weekly reconciliation. However, where the investment relates to unitised contracts or the society conducts a mark to market exercise, a more frequent reconciliation than every seven days may be required.

### **Single bank account for approved benefit funds**

20. Paragraphs 26 to 32 of LPS 700 are made for the purposes of subsection 34(4) of the Life Act, as modified by subsection 16H(4). This subsection permits a friendly society to use a single bank account, building society account or credit union account as the single 'bank account' if it is maintained in accordance with LPS 700. A health insurance benefit fund regulated under the *National Health Act 1953* is not an approved benefit fund for the purposes of the Life Act.

21. LPS 700 specifies various accounting procedures for the maintenance and administration of a single bank account. The overall aim of such procedures is to maintain accountability and transparency between the bank account and the affected approved benefit funds and to ensure that the principle enunciated in subsection 34(3) of the Life Act, as modified by subsection 16H(3) and referred to in paragraph 14 of this PPG is met.
22. LPS 700 specifies prescribed time periods within which the transactions of the bank account must be allocated to and reconciled with the benefit fund accounts. In the main, APRA expects that the reconciliation process is performed at least every seven days or, where applicable, at such other time, as permitted by APRA. APRA may permit a less frequent reconciliation where APRA is satisfied that the friendly society's single bank account is relatively stable with insufficient transactions to warrant weekly reconciliation. However, where the bank account relates to unitised contracts or the society conducts a mark to market exercise, a more frequent reconciliation than every seven days may be required.
23. Section 45 of the Life Act, as modified by the Life Regulations, provides that a society must not transfer an asset from one approved benefit fund to another approved benefit fund, except in the situation where the asset is transferred at fair value or in accordance with Divisions 3, 4 or 5 of Part 4 of the Life Act. The operation of the single bank account must not contravene section 45 of the Life Act such that one approved benefit fund operates an overdraft. Accordingly, all approved benefit fund accounts must be in funds at all times. For example, if one approved benefit fund was in funds with the bank account and another was in overdraft, the effect is that an unspecified asset would have been transferred from the latter fund to the former fund and the latter fund would have borrowed cash from the former which would not be acceptable under section 45 of the Life Act.

#### **Adequate adoption of benefit fund rules or amendments of approved benefit fund rules**

24. Under paragraphs 16L(3)(c) and 16Q(3)(c) of the Life Act, before APRA approves benefit fund rules or amendments of approved benefit fund rules, it must be satisfied that the rules or amendments have been adequately adopted.
25. Subsection 16B(2) of the Life Act provides for adequate adoption of benefit fund rules. LPS 700 sets out the required method of adoption of benefit fund rules or amendments of approved benefit fund rules in order that they may be considered as having been adequately adopted for the purposes of subsection 16B(2) of the Life Act.
26. For a new benefit fund, where the benefit fund rules have not yet been approved, the appropriate method of adoption may be either by resolution of the Board of directors of the friendly society or by a special resolution of the members of the friendly society (or a class of members as determined by APRA) in accordance with the requirements of the *Corporations Act 2001* (the Corporations Act) at the discretion of the friendly society. A resolution by the Board of directors would be the usual method of adoption, as the benefit fund would not normally have any members. However, LPS 700 does not preclude the friendly society from seeking the approval of the other members of the friendly society.
27. For an amendment to the approved benefit fund rules of an existing approved benefit fund, the appropriate method of adoption may be either by a special resolution of the members of the friendly society (or a class of members as determined by APRA) in accordance with the requirements of the Corporations Act or by resolution of the Board of directors of the friendly society. Subject to APRA approval, a resolution by the Board of directors may be appropriate in certain circumstances as set out in LPS 700.

28. In addition to the requirements in LPS 700, in accordance with paragraph 16B(2)(b) of the Life Act, new benefit fund rules or amendments to approved benefit fund rules will only be considered to be adequately adopted if APRA considers that the method of adoption adequately takes into account the interests of members.
29. If a friendly society applies to APRA for approval of a proposed amendment of its approved benefit fund rules in relation to a restructure of benefit funds pursuant to section 52 of the Life Act or a termination of a benefit fund pursuant to section 53 of the Life Act, the society may, under subparagraph 34(b) of LPS 700, adopt the amendments by a resolution of the Board of directors. In this case, it is considered that resolution by the Board of directors will not prejudice the rights of members of the benefit fund provided the requirements of paragraphs 53 to 73 of LPS 700 or paragraphs 74 to 89 of LPS 700 (as applicable) are complied with.
30. Under section 16U of the Life Act, APRA may approve amendments to a friendly society's constitution that are consequential upon the approval or amendment of its approved benefit fund rules. This enables a friendly society to undertake a single process to amend its approved benefit fund rules and related parts of its constitution, rather than having to also pursue the Corporations Act requirements to amend its constitution in relation to minor consequential matters. Under subsection 16U(3) of the Life Act, APRA may approve the consequential amendments if satisfied that the amendments are consequential on the proposed benefit fund rules or the amendment of approved benefit fund rules and do not also deal with other matters. The application for consequential amendments must be in accordance with LPS 700.
31. Section 16U of the Life Act will only be used by APRA to approve minor changes to a company's constitution that flow from new or amended benefit fund rules, for example, this approval process may be appropriate where the addition of a new benefit fund to the company's constitution requires renumbering or additional cross-references to other parts of the constitution.
32. APRA may consult with the Australian Securities and Investments Commission in considering whether to approve consequential amendments.

### **Approval of consequential amendments of a friendly society's constitution on initiative of APRA**

33. Section 16V of the Life Act applies where APRA considers that the constitution of a company is deficient because, as a result of the adoption or amendment of approved benefit fund rules, the constitution is inconsistent with those rules. Subsection 16V(2) of the Life Act allows APRA to give a company a written notice requiring the company to submit for approval consequential amendments (in accordance with the requirements set out in LPS 700) to rectify deficiencies in its constitution.
34. APRA will only approve an application for consequential amendments on the initiative of APRA if it is satisfied that the amendments rectify the inconsistency or deficiency. If APRA refuses to approve proposed consequential amendments instigated on the initiative of APRA or the friendly society fails to submit the consequential amendments, APRA may, by notice, determine consequential amendments to rectify the inconsistency or deficiency.

## Notice to members

35. In certain circumstances notice is required to be given to members of the friendly society:
- after APRA approval of approved benefit fund rules in accordance with paragraph 38 of LPS 700;
  - after APRA approval of amendments of approved benefit fund rules in accordance with paragraph 41 of LPS 700;
  - after APRA approval of amendments of approved benefit fund rules as required by APRA in accordance with paragraph 44 of LPS 700;
  - after APRA approval of consequential amendments of a friendly society's constitution on initiative of the friendly society in accordance with paragraph 47 of LPS 700; or
  - after APRA approval of consequential amendments of a friendly society's constitution on initiative of APRA in accordance with paragraph 50 of LPS 700.
36. Where notice to members as referred to in paragraph 35 is required to be given, under paragraph 51 of LPS 700, the friendly society must give a written notice to its members, no later than the day on which notice is given of the next general meeting of the friendly society stating the date on which the new benefit fund rule or the change to the benefit fund rule or society constitution, as the case may be, came into force and giving the text or a summary of the new benefit fund rule or of the change to the benefit fund rule or friendly society's constitution as the case may be.
37. Subject to APRA's prior approval, under paragraph 52 of LPS 700, a friendly society may give notice to relevant members by virtue of advertisements published in newspapers circulating generally in the area of each State or Territory in which the friendly society operates. APRA may approve this option where, for example, the change is relatively minor and the expense to the society in individually notifying all relevant members is considered excessive.

## Restructure of approved benefit funds

38. Under section 52 of the Life Act, a friendly society may apply to APRA to restructure its statutory funds by making one or more policies that are referable to a statutory fund or funds become referable to another statutory fund or funds of the friendly society. LPS 700 sets out the requirements for such a restructure including requirements for making the application (specifically the information to be included with the application to APRA), criteria for APRA to approve or refuse the application, how the restructure takes place, notification of interested persons and information to be lodged with APRA following the restructure.
39. An application for a restructure by a friendly society must be lodged with APRA at least 90 days before the proposed date of restructure. The purpose of this requirement is to allow sufficient time for APRA to assess an application before a restructure is planned to take place. However, under certain circumstances a shorter timeframe may be appropriate and APRA may determine, in consultation with the friendly society, that a period less than 90 days before the proposed date of restructure is appropriate for lodgement of the application and accompanying documents.
40. The time at which the restructure takes effect for a friendly society, is when the benefit fund rules or amendments to benefit fund rules have been approved by APRA and have come into force under sections 16N and 16T of the Life Act.
41. APRA may exempt, in accordance with paragraph 71 of LPS 700, the friendly society providing notification to the approved benefit fund members after the restructure has taken effect. For example, APRA may grant an exemption from the requirement to notify the members of a particular approved benefit fund if the members of that fund have already been provided details of the restructure under paragraph 59 of LPS 700 and the members have approved the restructure in accordance with subparagraph 58(a) of LPS 700.

42. The requirements outlined in Schedule 1 to Form 5 in LPS 700 set out the information required to be lodged with an application for a restructure. This information is designed to satisfy APRA that the rights and interests of members and policy owners involved in the restructure are not disadvantaged. It is intended that APRA receive detailed information regarding the appropriate treatment of assets and liabilities involved in the restructure.

### **Termination of approved benefit funds**

43. Section 53 of the Life Act provides, *inter alia*, that prudential standards may provide for the termination of one or more of the statutory funds (which term, in accordance with section 16G of the Life Act, includes an approved benefit fund of a friendly society) of life companies. Section 53 and LPS 700 do not, however, apply to terminations that may take place as a consequence of a restructure of statutory funds pursuant to section 52 of the Life Act and prudential standards made for the purposes of that section. Such terminations would only be of statutory funds which no longer contain assets or liabilities and to which policies are no longer referable.

44. LPS 700 sets out, consistent with subsection 53(2) of the Life Act, the requirements for termination of an approved benefit fund including:

- requirements for making the application (specifically the information to be included with the application to APRA);
- how the termination takes place, including a requirement for member or Board approval of relevant proposed amendments to approved benefit fund rules or the constitution of the society;
- the order of distribution of assets of the approved benefit fund;
- notification of members; and
- information to be lodged with APRA following the termination.



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