



BANK OF PAPUA NEW GUINEA

LIFE INSURANCE PRUDENTIAL STANDARD 1/2005

FINANCIAL REQUIREMENT FOR LIFE INSURANCE COMPANIES

Arrangement of Paragraphs

Part I Preliminary

- 1 Authorization
- 2 Application
- 3 Definitions

Part II Statement of Policy

- 1 Purpose
- 2 Scope
- 3 Responsibility

Part III Implementation and Specific Requirements

- 1 Minimum Financial Requirement
- 2 Approved guarantee
- 3 Composition of capital
- 4 Eligible assets
- 5 Assets
- 6 Excess assets

Part IV Corrective Measures

- 1 Remedial measures and sanctions
- 2 Audit certification

Part V Effective Date

- 1 Effective date

Part I: Preliminary

- 1 *Authorization:* The Bank of Papua New Guinea (the Bank) is authorized to issue prudential standards under Section 48 of the Life Insurance Act 2000 ('the Act') in relation to prudential matters to be complied with by licence holders, life insurance agents, shareholder controllers or indirect controllers.
- 2 *Application:* The Financial Requirement Standard applies in respect of each licence holder life insurance company at all times during all periods commencing on or after 9 of November 2003.
- 3 *Definitions:* Terminology used in this Standard, to the extent it is not specifically defined, takes the same meaning as that in the Act. The following definitions are specific to this Standard, and do not include all terminology from standards.

Financial Requirement: The financial requirement as specified in Schedule 3 of the Act and calculated in accordance with the Financial Requirement Standard, as prescribed by the Bank, in accordance with section 48, Part VII, of the Act.

Financial Requirement Standard: The prudential standard for the capital of the shareholders' fund as prescribed by the Bank, in accordance with section 48, Part VII, of the Act.

Part II: Statement of Policy

- 1 *Purpose:* This Standard is made in relation to the Financial Requirement for life insurance companies set down in section 16 and Schedule 3 of the Act. Section 16 establishes a continuing requirement to hold a minimum amount of capital, or where required by the Bank, to provide an approved guarantee in accordance with Schedule 3. Schedule 3 and the Regulation states that a life insurance company must hold a specific minimum amount of capital, currently set as four million kina (K4,000,000), and Part III of this standard specifies the composition of the capital.

This Financial Requirement is in addition to other financial requirements of the Act for the statutory funds of each life insurance company. That is, section 16 establishes a requirement to hold a minimum amount of capital outside the statutory funds of the company – in the case of a life company, in the shareholders' fund. This Standard considers this financial requirement.

The general intent of the Financial Requirement is to ensure, as far as practicable, that the financial position of a life company reflects an appropriate capital commitment, outside of the statutory funds of the company, to the life insurance business of the company. That is, that each life company operating in PNG is committed to the longer term operation and development of the life insurance market in this country.

The purpose of this Financial Requirement Standard is to prescribe the form in which the capital funds may be held to meet the minimum Financial

Requirement such that, under adverse operating circumstances, the company would be in a position to meet its trading commitments and adequately service its policy owners. This includes those circumstances where a life company has obligations in respect of any business it carries on that is not life insurance business.

- 2 *Scope:* The Financial Requirement Standard applies in respect of each licence holder life insurance company at all times during all periods commencing on or after 9 of November 2003.
- 3 *Responsibility:* It is the responsibility of the board of directors of each life insurance company to establish a system for monitoring and maintaining the Financial Requirement on a continuing basis.

If, after licensing of a life insurance company under the Act, a change of circumstances has the result that:

- any information included in the application for registration, including that for the Financial Requirement; or
- any information given to the Bank, or contained in a document given to the Bank, including that for the Financial requirement;

ceases to be accurate in relation to the company, the company must provide written notice to the Bank of the matters in relation to which the information is inaccurate and, accordingly, set out the true position that has now arisen.

As part of its annual lodgement of returns under Part X of the Act, each life insurance company is required under this Standard to lodge a certification from an approved auditor that the Financial Requirement has been maintained throughout the year and that the Financial Requirement Standard has been satisfied.

Part III: Implementation and Specific Requirements

- 1 *Minimum Financial Requirement:* At any time, the life company must have available, outside the statutory funds, a prescribed amount of capital, stated as four million kina (K4,000,000) , as specified in Schedule 3 of the Act and subject to approved transitional arrangements. This is referred to as the Financial Requirement.

The Financial Requirement is defined as a fixed dollar amount for all licence holder life insurance companies. The prescribed amount of the Requirement for a life company is not intended to be directly responsive to the risk profile of the operations of the shareholders' fund.

- 2 *Approved guarantee:* Where required by the Bank, a licence holder may be required to provide an approved guarantee of an amount not less than that specified in Schedule 3, specified as four million kina (K4,000,000) as at 9 November 2003, being a guarantee in respect of the applicant's duties as licence holder, where:

a 'guarantee' means:

- (a) any guarantee, indemnity, legally binding undertaking, letter of credit, acceptance or endorsement of a bill of exchange or promissory note or other legally binding obligation in favour of any person to secure to

enable the payment by any third party of any moneys or the performance or observance of any other obligation owed by the third party; or

- (b) any legally binding obligation to provide funds to a third party by the advance of moneys, the purchase of or subscription for securities (as defined in the Securities Act 1997); or
- (c) any legally binding obligation to ensure the solvency or financial condition of any third party; or
- (d) any put and/or call option whereby its grantor is legally obliged upon the exercise of the option to buy and/or sell

3 *Composition of capital:* For a life company limited by shares only, the Financial Requirement must be held as capital of the following form:

- paid-up share capital represented by ordinary shares; and/or
- paid-up share capital represented by irredeemable preference shares; and
- must be maintained in its shareholders' fund as excess assets, of which at least 50% must be held in the form of eligible assets.

These are inclusions in the Core Capital of the life insurance company. Core capital refers to the elements of permanent shareholders equity, retained earnings, and disclosed reserves that are created or maintained by appropriation of other surpluses.

4 *Eligible assets:* The eligible assets of a life company are the assets of the shareholders' fund other than certain assets invested in a related company. Any asset invested in a related company is only to be included in the eligible assets of the company where:

- the related company is a subsidiary of the life company and the asset is not reinvested with a company that is related to the life company (other than as a subsidiary); or
- the investment is a deposit with a bank.

Reinvestment of an asset includes reinvestment, whether direct or indirect, through one or more interposed bodies corporate, trusts or partnerships.

In order to qualify as an eligible asset for the purposes of meeting the Financial Requirement, an asset must be of tangible form and hence readily liquifiable. An asset invested in a related company should not be considered an eligible asset to the extent that the value of that asset includes a component of value in respect of a prudential capital requirement. An example of such an asset would be an investment in a related company that is a financial institution subject to minimum capital requirements. In determining the value to be taken for that asset, for eligible asset purposes, account should not be taken of any component of the value attributable to the required capital.

5 *Assets:* The assets of the shareholders' fund, for the purposes of this Standard are all assets of the life company other than the assets of the statutory funds of the company. The liabilities of the shareholders' fund, for the purposes of this Standard are all liabilities of the life company other than the liabilities of the

statutory funds of the company. Liabilities of the shareholders' fund, for this purpose, do not include liabilities in respect of share capital.

- 6 *Excess assets:* Excess assets exist to the extent the value of the assets of the shareholders' fund exceed the value of the liabilities of the shareholders' fund.

Part IV: Corrective Measures

- 1 *Remedial measures and sanctions:* If a licence holder breaches any provision of this prudential standard in a flagrant manner that results, or threatens to result, in an unsafe or unsound condition or fails to comply with the instructions and reporting requirements, the Bank may pursue appropriate corrective actions and sanctions such as by imposing conditions, or varying conditions, on the holders licence as provided by Section 22 of the Act.
- 2 *Audit certification:* Pursuant to Section 58 of the Act, licence holder life insurance companies are required to lodge a certification each year from an approved auditor that the Financial Requirement has been maintained throughout the year and that the Financial Requirement Standard has been satisfied. This certification is to be lodged as part of annual returns for each company under Part X of the Life Insurance Act.

Part V: Effective Date

- 1 *Effective date:* The effective date of this prudential standard shall be 1 January 2005.

Questions relating to this prudential standard should be addressed to:

The Manager,
The Financial Systems Supervision Department
Bank of Papua New Guinea
P.O Box 121
Port Moresby
N.C.D

Telephone: 675 322 7200
Facsimile: 675 321 4548

.....

L. Wilson Kamit, CBE
GOVERNOR