2007-2008

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

FINANCIAL SYSTEM LEGISLATION AMENDMENT (FINANCIAL CLAIMS SCHEME AND OTHER MEASURES) BILL 2008

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	*Definition*
ADI	Authorised deposit-taking institution
ALRC	Australian Law Reform Commission
AML-CTF Act	*Anti-Money Laundering and Counter Terrorism Act 2006*
APRA	Australian Prudential Regulation Authority
APRA Act	*Australian Prudential Regulation Authority Act 1998*
ASIC	The Australian Securities and Investments Commission
Banking Act	*Banking Act 1959*
Commonwealth	Commonwealth of Australia
Corporations Act	*Corporations act 2001*
Davis Report	Study of Financial System Guarantees
EAFD	Early Access Facility for Depositors
FCS	Financial Claims Scheme
Federal Court	Federal Court of Australia
FSS Special Account	Financial System Stability Special Account
Government	The Australian Government
HIH	The HIH Group of Companies
IMF	International Monetary Fund
Insurance Act	*Insurance Act 1973*
ITAA	*Income tax Assessment Act 1997*
Legislative Instruments Act	*Legislative Instruments Act 2003*
Life Insurance Act	*Life Insurance Act 1995*
PCF	Policyholder Compensation Facility

Abbreviation	***Definition***
RBA	The Reserve Bank of Australia
Scheme	Financial Claims Scheme
SIS Act	*Superannuation Industry (Supervision) Act 1993*
Court	The Federal Court of Australia
TFN	Tax file number
The Inquiry	The 1997 Financial System Inquiry

General outline and financial impact

The Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Bill 2008 (the Bill) introduces measures to implement a Financial Claims Scheme (FCS), including a three-year 100 per cent guarantee of deposits in authorised deposit-taking institutions (ADIs), and other arrangements to deal with distressed or failing financial institutions.

Schedule 1 of the Bill amends the *Banking Act 1959*, the *Insurance Act 1973* and other Acts to establish an FCS, administered by the Australian Prudential Regulation Authority (APRA), to provide depositors in authorised deposit taking institutions a full guarantee of their depositors for a period of three years.

After three years the general provisions of the FCS will come into operation, limiting its operation to Australian denominated currency deposits. The Bill includes a mechanism to impose a cap on deposit coverage at that time. The Government has indicated that it will consider this issue at that stage.

In addition, the FCS provides compensation to eligible policyholders with claims against a failed general insurer in the event of a general insurer failure.

Schedule 1 also includes:

- appropriation arrangements for the FCS's administration and the advancing of funds to depositors and policyholders under the deposit guarantee and FCS; and

- arrangements for the recovery of funds advanced by the FCS and of administration costs through the sale of the closed institution's assets (see also recovery of funds via industry levies under the Financial Claims Scheme (ADIs) Levy Bill 2008 and Financial Claim Scheme (General Insurers) Levy Bill 2008).

Schedule 2 of the Bill amends the *Banking Act 1959* to establish arrangements to improve statutory management of ADIs and the recapitalisation of an ADI.

Schedule 3 of the Bill amends the *Insurance Act 1973* to establish arrangements to provide for the judicial management of general insurers and facilitate the recapitalisation of a general insurer.

Schedule 4 of the Bill amends the *Life Insurance Act 1995* to establish arrangements to improve judicial management of life insurers and facilitate the recapitalisation of a life insurer.

Schedule 5 of the Bill amends the *Financial Sector (Business Transfer and Group Restructure) Act 1999* to establish enhanced arrangements to facilitate the transfer of assets and liabilities between institutions.

Date of effect: Amendments in Section 1 to 3 apply from the date of Royal Assent. Schedules 2 to 5 apply from the day after Royal Assent. Provisions in Schedule 1 apply immediately after Schedules 2 to 5.

Proposal announced: The measures were announced in the Treasurer's Press Release No. 061 of 2 June 2008 and in the Prime Minister's Press Release of 12 October 2008.

Financial impact: Nil. Where the FCS or other arrangements are activated, there will be no net impact on taxpayers as the monies provided are subject to recovery.

Compliance cost impact: Low.

Chapter 1
Early access facility for depositors

Outline of chapter

1.1 Schedule 1 of the Bill implements the Early Access Facility for Depositors (EAFD) through legislative amendments to the *Banking Act 1959* (Banking Act). The purpose of the EAFD is to ensure that depositors in a failed authorised deposit-taking institution (ADI) have timely access to their deposit funds, which they would otherwise receive through the liquidation process under the depositor preference arrangements.

Context of amendments

1.2 Australia's crisis management arrangements have been subject to a number of assessments in recent years, including the *Study of Financial System Guarantees* (Davis Report), the International Monetary Fund's *Financial Sector Assessment Program*, and a review by the Council of Financial Regulators. These assessments have identified scope to enhance the existing arrangements for protecting depositors' interests in the event of the failure of an ADI.

1.3 More recently the ongoing dislocation in global financial markets has heightened the need for effective arrangements to deal with financial institutions in distress. The Financial Stability Forum's report on *Enhancing Market and Institutional Resilience* also encouraged jurisdictions to review and, where necessary, strengthen deposit insurance arrangements.

1.4 Currently, in the event of the failure of an ADI, depositors' claims are pursued in the liquidation process. The depositor preference arrangements give depositors a priority claim to assets over all other creditors in liquidation. However, no arrangements are in place to ensure that depositors have timely access to their funds in the event of the failure of an ADI. As a result it could take a number of months (or years) for the liquidation process to be completed and for depositors to receive any funds.

1.5 As deposit products are considered critical to participation in the economy, there is benefit in having formal, targeted and efficient

arrangements to ensure that depositors have timely access to their funds in the event of the failure of an ADI.

1.6 There is also benefit in formalising arrangements for responding to the failure of an ADI to provide clarity and certainty to depositors and other stakeholders in all ADIs.

1.7 The EAFD is targeted at meeting liquidity needs of depositors through an advance payment of funds that depositors would otherwise be able to receive from their ADI. The Bill establishes the parameters of the scheme and ensures depositors, particularly small retail depositors, are more likely to receive all of their deposits.

Summary of new law

1.8 The amendments establish the EAFD and provide the framework for determining and making payments to eligible depositors.

1.9 The Australian Prudential Regulation Authority (APRA) is the scheme administrator.

1.10 The depositor preference arrangements are adjusted to reflect the introduction of the scheme.

Comparison of key features of new law and current law

New law	***Current law***
Allows early access to deposits with an insolvent ADI	Depositors' claims are pursued in the liquidation process. The depositor preference provisions of Section 13A of the Banking Act give depositors a priority claim to assets over other creditors in liquidation.
APRA is responsible for administering the scheme	

New law	***Current law***
The EAFD will be activated via a Ministerial declaration which declares that an ADI has failed and appropriates an amount to pay depositors under the scheme.	
The concept of ***protected accounts*** is introduced for the purposes of defining eligible deposits for the scheme and preference arrangements in liquidation.	There is currently no definition of 'deposit' in the Banking Act.
Deposit balances in protected accounts will be calculated and aggregated for the purpose of determining amounts to be paid to depositors.	
There will be no cap on the amount to be paid to each depositor for the first three years of the scheme's operation. Following that the Government will review this position.	
APRA is able to meet a depositor's entitlement in various ways.	

New law	***Current law***
APRA and the RBA are not subject to reporting requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* in relation to any action they take for the purposes of meeting a depositor's entitlement under the scheme. The meeting of a depositor's entitlement is specifically excluded from the requirements of the restrictive trade practices provisions in Part IV of the *Trade Practices Act 1974.*	
A depositor's rights are automatically assigned to APRA for the amount of the depositor's entitlement under the scheme.	
A depositor can claim any remaining rights in liquidation.	
The liquidator may admit a depositor's remaining entitlement in liquidation without normal proof.	

New law	*Current law*
The order of priority for application of an ADI's assets against claims in liquidation reflects the introduction of the EAFD. Recovering the payments made to depositors with protected accounts have first priority, the costs of administering the scheme have second priority and remaining deposit liabilities of the ADI in Australia have third priority.	Currently, all deposits have equal priority in liquidation.
APRA is able to obtain information from an ADI or a liquidator necessary for administering the scheme.	

Detailed explanation of new law

1.11 Activation of the EAFD provides depositors in a failed ADI with more timely access to their funds than they would have under the normal liquidation process. APRA substitutes for those depositors as a creditor of the declared ADI in liquidation to the extent of their EAFD entitlements. ***[Schedule 1, item 15, section 16AB]***

1.12 The EAFD is administered by APRA. Administration of the scheme involves calculating and making payments to depositors. ***[Schedule 1, item 15, Section 16AC]***

1.13 The EAFD will be activated by a declaration by the Minister. This declaration will stipulate the failed ADI, the amounts available to make payments to depositors and the amounts to administer the EAFD. ***[Schedule 1, item 15, Section 16AD]***

1.14 APRA will need to provide the Minister with information necessary to activate the EAFD in a timely manner following the failure of an ADI. ***[Schedule 1, item 15, Section 16AC]***

1.15 In order that it can administer the Scheme and advise the Minister, APRA is provided with powers to obtain information.

1.16 APRA will have first priority in liquidation to the extent of the payments to depositors under the EAFD.

Activation of the EAFD

1.17 The EAFD can only be activated in relation to an ADI that has failed, because it is insolvent and is unlikely to be returned to solvency in a reasonable period of time, and APRA has applied for it to be wound up. In this respect, APRA is required to notify the Minister if it makes an application for an ADI to be wound up as soon as possible to ensure timely activation of the scheme ***[Schedule 1, item 14, subsection 14F(3) and item 15, section 16AD]***.

1.18 The circumstances in which APRA can apply for an ADI to be wound up are established in legislation. Section 14F of the Banking Act allows APRA to apply for an ADI to be wound up providing that a statutory manager is in control of an ADI's business and APRA considers it is insolvent. Allowing the scheme to be activated at this time ensures that there is sufficient certainty that an ADI will be wound up and that payments to depositors under the scheme are required.

1.19 The EAFD is to be activated at the discretion of the Government via a Ministerial declaration. An ADI specified in a declaration made by the Treasurer to activate the Scheme is a ***declared ADI*** ***[Schedule 1, item 6, subsection 5(1)]***. A declaration activates the scheme. ***[Schedule 1, item 15, section 16AD]***

1.20 A declaration outlines the total amount available to make payments to depositors of a declared ADI. For the first three years of the scheme, the amount that can be appropriated for the purposes of meeting depositors' entitlements is unlimited. After three years, the maximum that can be appropriated is $20 billion. The declaration must also outline the amount available for the administration costs for implementing the scheme up to a maximum of $100 million. ***[Schedule 1, item 15, section 16AD]***

1.21 Prior to making a declaration, the Minister may seek advice from APRA, ASIC or the RBA. This advice will assist the Minister in making a decision about whether to activate the Scheme and evaluating the expected costs of making payments to depositors and administering the scheme for the purpose of appropriating funds. However, the Minister's decision is not restricted in any way by the content of any information provided by the agencies. Further, it is not necessary that the Minister, before making a declaration, receive such advice from the agencies. Also, the non-provision of information does not prevent the Minister from making a declaration. ***[Schedule 1, item 15, section 16AE]***

1.22 Activating the EAFD via a single Ministerial declaration, which outlines the amounts to be made available to make payments to depositors and administer the scheme, will assist in its timely implementation.

1.23 The amount made available to make payments to depositors will be automatically credited to the Financial Claims Scheme Special Account upon activation of the Scheme. The ***Financial Claims Scheme Special Account*** is defined by reference to the APRA Act ***[Schedule 1, item 7, subsection 5(1)]***.

> Note: The operation and purpose of the Financial Claims Scheme Special Account is discussed in more detail at Chapter 3, Administration.

1.24 There is a $100 million limit on the amount that can be made available to administer the scheme. The amount made available for administration costs will be automatically credited to the APRA Special Account upon activation of the Scheme. The ***APRA Special Account*** is defined by reference to the APRA Act ***[Schedule 1, item 2, subsection 5(1)]***.

> Note: The operation and purpose of the APRA Special Account with regard to the Administration of the EAFD is discussed in more detail at Chapter 3, Administration.

1.25 Flexibility is provided in the legislation to make amendments to the declaration. However, in order to provide certainty to depositors, a declaration cannot be revoked.

1.26 This declaration is a legislative instrument. However, it is neither a disallowable instrument nor subject to sun-setting clauses under the *Legislative Instruments Act 2003*. It comes into effect on the day it is made ***[Schedule 1, item 15, subsections 16AD(6) and 16AD(7)]***. This ensures that the disallowance process does not create uncertainty around the operation of the Scheme and avoids any potential for the scheme to be activated and then be disallowed, which would cause significant disruption. ***[Schedule 1, item 15, section 16AD]***.

Eligible accounts

1.27 The types of deposits eligible for the EAFD are defined to clarify the scope of the Scheme. The concept of a ***protected account*** is introduced to describe the types of deposits eligible for the Scheme. It also describes the accounts eligible for priority in liquidation. ***[Schedule 1, item 11, subsection 5(1)]***

1.28 The scheme will cover products which are ***protected accounts***. There are three ways a product can be covered by the Scheme. First is that it is an account prescribed under Regulations. ***[Schedule 1, item 15, subparagraph 5(4)(a)]*** It is not intended that any products be prescribed at this stage.

1.29 Secondly, it can be an account that is kept under an agreement between the account holder and the ADI requiring the ADI to pay the account-holder on demand or at an agreed time the net credit balance. ***[Schedule 1, item 15, subparagraph 5(4)(b)]***

1.30 Thirdly, it can be a covered financial product that is kept under an agreement between the account holder and the ADI requiring the ADI to pay the account-holder on demand or at an agreed time the net credit balance. ***[Schedule 1, item 15, subparagraph 5(4)(b)]***

1.31 A covered financial product is one that is specified in a Ministerial declaration. This mechanism is intended to give effect to the Government's decision to provide a broad guarantee of deposits. The products specified in the Ministerial declaration will be covered by the 100 percent guarantee up until 12 October 2011. The deposits subject to the broad guarantee will also include deposits which fall within the concept of account. A covered financial product will no longer be a protected account and will no longer be part of the FCS if an application for winding up of the ADI under section 14F of the Banking Act is made after this date. The Bill also ensures that for the first three years of the scheme's operation, the scheme will apply to accounts kept in any currency.

1.32 Following 12 October 2011, regulations may be made outlining the coverage of the Scheme. In addition, after this date the Scheme will continue to cover an account that is kept under an agreement between the account holder and the ADI requiring the ADI to pay the account-holder on demand or at an agreed time the net credit balance.

1.33 Further detail on calculating amounts payable to depositors and payment methods are discussed below.

Calculation of amounts payable to depositors

1.34 To calculate the amounts payable to depositors, the Scheme Administrator will aggregate ***net credit balances*** ***[Schedule 1, item 8, subsection 5(1)]*** in protected accounts due to each ***account-holder***.

1.35 An account-holder can be an individual or an entity (such as a company) as defined by the *Income Tax Assessment Act 1997* (ITAA) ***[Schedule 1, item 1, subsection 5(1)]***. This means that an account-holder can be: an individual, a body corporate, a body politic, a partnership, any other unincorporated association or body of persons, a trust, a superannuation fund, or an approved deposit fund for the purposes of the ITAA.

1.36 The Scheme is not restricted to individuals and will apply to all account holders including businesses. This approach also ensures the facility can be implemented efficiently.

1.37 There may be transactions which have been authorised but not yet cleared at the time the ADI fails and the Scheme is activated. In recognition of this, a period of time will be allowed for clearance of funds. The period of time will be set in Regulations. In determining the length of time that will be allowed to clear funds, a balance needs to be struck between allowing the maximum amount of transactions to be cleared and ensuring that amounts owing to depositors under the scheme can be calculated and paid as quickly as possible. ***[Schedule 1, item 15, paragraphs 16AF(1)]***

1.38 A cheque drawn on the failed ADI and lodged with another ADI, but not cleared, before the first ADI fails is deemed under section 70A of the *Cheques Act 1986* to be dishonoured. In this case, the cheque will not reduce the entitlement under the Scheme of the depositor who drew the cheque (although he presumably will need to make in some other way the payment intended to be met through the cheque).

1.39 A cheque drawn on another institution and deposited with the failed ADI, but not cleared, before the failure would be subject to the normal clearance processes. Unless it fails to clear for some other reason (such as insufficient funds in the drawer's account), the cheque amount should be taken into account in determining the account-holder's entitlement under the Scheme. The clearance process for most cheques normally is completed within three business days, and in virtually every case is completed within five business days.

1.40 Interest that has accrued, but has not been credited, to a protected account at the time the scheme is activated via a Ministerial declaration, will be included in the balance of an account in calculating the amount due to the depositor by the failed ADI. ***[Schedule 1, item 15, paragraph 16AF(1)(b)]***

1.41 For the first three years of the scheme's operation there will be no cap on the payments made to depositors. That is, depositors will receive the full amount of their deposits. The Government has indicated that it will consider a cap on the scheme at that stage.

1.42 The Bill provides a facility to put in place a cap via Regulations. ***[Schedule 1, item 15, subsection 16AG(1)]***

1.43 If a situation arises where it is required, Regulations can be made to establish different caps for payments in relation to different types of accounts eligible for the EAFD. ***[Schedule 1, item 15, subsection 16AG(2)]***

1.44 If a cap is put in place, and a depositor has a number of accounts with the ADI, the Bill gives APRA the ability to determine which accounts should be considered first in making up the depositor's entitlement up to the capped amount. This allows APRA to determine the order in which accounts will be aggregated and the order in which accounts will be paid under the scheme where the total value of a depositor's accounts with a failed ADI exceeds any cap.

1.45 APRA could develop 'ordering rules', as part of the guidelines it develops as part of its role as Scheme Administrator, which could be placed on its website.

1.46 There are a number of factors which may influence the order in which protected accounts are aggregated for the purpose of calculating payments to be made under the EAFD. These factors include the size and the level of liquidity of the accounts involved. For instance, it would be desirable to aggregate accounts with small balances first, before accounts with large account balances, to minimise the number of very small claims that remain in the liquidation process. It would also be desirable to aggregate more liquid accounts first, such as transaction accounts, before less liquid accounts, such as term deposits, in light of the liquidity objective of the EAFD.

1.47 In relation to joint accounts (that is, where the account is in more than one name), the Bill provides that individual depositors are treated as separate depositors for the purposes of the EAFD. This means that the account will be split equally among the individual depositors. ***[Schedule 1, item 15, subsection 16AF(2)]***

1.48 The way in which a business account is treated will depend on the name(s) that the account is held in. If the account is held in the name of the business entity, then it will be treated as a single depositor. This is because APRA as the scheme administrator should not be expected to look through to the owners of the business at the time of the failure.

1.49 However, if the deposit account used by the business is held in individual names, akin to a typical joint account, then it will be treated as a joint account as outlined above.

1.50 APRA's declaration under section 16AG is not a legislative instrument.

Making payments to depositors

Method of payment

1.51 The Bill provides for how an account-holder's entitlement may be paid. This may be by paying an amount to an account holder in a single amount or by instalments. ***[Schedule 1, item 15, paragraph 16AH(1)(a)]***

1.52 An account holder may also be paid by applying an amount for the account holder's benefit by establishing an account into which payments will be made. ***[Schedule 1, item 15, paragraph 16AH(1)(b)]***

1.53 A combination of the methods in paragraphs (a) and (b) may also be used. ***[Schedule 1, item 15, paragraph 16AH(1)(c)]***

1.54 If APRA establishes an account on an account-holder's behalf for the purposes of meeting an entitlement, it may do so regardless of other laws that relate to opening accounts at an ADI and whether the depositor has consented to the account being established. ***[Schedule 1, item 15, subsections 16AH(3) and (4)]***

1.55 A Regulation making power may make provision for how an account holder's entitlement may be met. ***[Schedule 1, item 15, subsection 16AH(2)]***

1.56 The method of payment that APRA chooses to pay depositors will depend on the circumstances, taking into account factors including the type of accounts involved, costs, ability to minimise fraud, timeliness and logistics, as well as options that may be available in the light of innovation and technological changes that occur in this area over time. The method of payment could be by:

- cash, for example, via automatic teller machines;
- a cash substitute, for example, by cheque or debit card; or
- establishment of a like account at another ADI.

1.57 There are some specific accounts that must be paid by APRA via the opening of an account. These will be specified in the Regulations for the purposes of subsection 16AH(5). It is proposed that the Regulations prescribe accounts such as Retirement Savings Accounts or Farm Management Deposits as a way of preserving certain tax treatments or other policy objectives such as retirement incomes policy. ***[Schedule 1, item 15, subsection 16AH(5)]***

Anti-Money Laundering Rules

1.58 Actions taken by APRA or the RBA for the purposes of meeting an account-holder's entitlement under the scheme may be taken to be the provision of designated services for the purposes of the *Anti-Money Laundering and Counter-Terrorism Act 2006* (AML-CTF Act). The Bill provides that the AML/CTF Act does not apply to the exercise of APRA's powers to pay out depositors under the scheme. This avoids any potential for the anti-money laundering requirements to unduly constrain APRA or RBA actions to meeting an account-holder's entitlement under the scheme, including through the imposition of reporting requirements. ***[Schedule 1, item 15, subsection 16AH(6)]***

1.59 Where APRA establishes, on behalf of an account holder who has an entitlement under the scheme, an account with an ADI for the purposes of wholly or partly meeting that entitlement, the ADI is not required to undertake the customer identification procedure that would otherwise be required under section 32 of the AML-CTF Act before commencing to provide a designated service to the customer. ***[Schedule 1, item 15, subsection 16AH(7)]***

Incorrect payments

1.60 The capacity to make payments in instalments ***[Schedule 1, item 15, subsection 16AH(1)]*** provides a convenient mechanism for any underpayments to be corrected.

1.61 The recovery by APRA of any overpayments can be provided for in Regulations. ***[Schedule 1, item 15, section 16AM]***.

1.62 It is expected that methods used to recover an overpayment might include:

- making it a debt due to APRA;
- withholding the amount of the overpayment from another payment that would otherwise have been paid to the same depositor under the scheme;
- withholding the amount of the overpayment from a payment that would have been made to the same depositor as a result of the liquidation process.

1.63 APRA would take into account factors such as timing relative to the liquidation process and the costs of recovering any amounts overpaid before determining whether to pursue recovering an overpayment and the appropriate method for doing so.

Administration

1.64 APRA may require a person to provide assistance in the performance of its functions and in the exercise of its powers. ***[Schedule 1, item 15, section 16AJ]***

1.65 Such assistance may be sought from an ADI whether or not it is a declared ADI, an administrator or a liquidator.

1.66 APRA requires certain information from a failed ADI (or an administrator or liquidator if one has been appointed) to be able identify, calculate and make payments to depositors under the EAFD. ***[Schedule 1, item 15, subsection 16AK(1)]*** Specifically, APRA requires information for purposes including:

- identify account-holders that may be eligible for a payment under the scheme;
- calculate the amounts payable to depositors; and
- make payments to or open accounts for eligible account-holders. ***[Schedule 1, item 15, subsection 16AK(4)]***

1.67 APRA can also obtain information from an ADI for preparatory purposes. For example, APRA may seek information to determine if an ADI would be able to provide information in a timely manner that APRA would require to administer the EAFD, if it were activated. APRA may also seek information to develop its own systems to be able to administer the EAFD if it were activated. ***[Schedule 1, item 15, paragraph 16AK(4)(g)]***

1.68 Information necessary to administer the EAFD may include personal information and tax file numbers. Access to and the use of personal information and tax file numbers is restricted by the *Privacy Act 1988* and the *Taxation Administration Act 1953*. An explicit exemption is provided so that APRA can obtain personal information, which includes 'information or an opinion (including information or an opinion forming part of a database), whether true or not, and whether recorded in a material form or not, about an individual whose identity is apparent, or can reasonably be ascertained, from the information or opinion'. ***[Schedule 1, item 10, subsection 5(1) and item 15, subsection 16AK(3)]***

1.69 Only APRA, an APRA member, an APRA staff member, a person (or officer or employee of such a person) to whom APRA has delegated the relevant power in relation to the FCS can obtain this information for the purposes of implementing the EAFD. This includes a person appointed, seconded or engaged by APRA to perform a role or

provide services under Part 4 of the APRA Act. ***[Schedule 1, item 15, subsection 16AK(2)]***

1.70 Given that this information is essential to the effective implementation of the Scheme, penalties apply if an ADI, relevant officer of the ADI or the liquidator do not comply with a request for information. ***[Schedule 1, item 16, section 16AL]***

1.71 A civil penalty may apply if an individual does not take all reasonable steps to comply with the request for information. However, if the contravention is dishonest, then a criminal penalty may apply. The two tiered approach reflects the circumstances in which the information is being sought, in particular, that APRA will be seeking information from a failed ADI. In this respect, there may be problems with the failed ADI's systems, records and staff. A civil penalty regime better suits the types of breaches to which they apply and standard of proof will more easily assist in compliance. ***[Schedule 1, item 15, section 16AL]***

1.72 The offences that apply to officers of an ADI or an ADI are continuous offences to encourage the provision of information necessary to implement the scheme in a timely manner. The offences are indictable offences due to the serious nature of non-compliance. As indictable offences this will ensure that any charge against a person will be a relevant fact when considering a persons ability to act on a request. ***[Schedule 1, item 15, section 16AL]***

1.73 A liquidator is subject to the regime for non-compliance under the Corporations Act. ***[Schedule 1, item 15, subsection 16AL(7)]***

Assignment of rights

1.74 The EAFD will bring forward the payment of some claims on protected accounts to which depositors would otherwise be entitled in the liquidation of a failed ADI.

1.75 To the extent that payments have been made to depositors under the scheme, their rights to claim these amounts in the liquidation will be transferred to APRA. ***[Schedule 1, item 15, section 16AI]*** This enables the Scheme Administrator to recover these amounts in liquidation to recoup the amount paid to depositors with protected accounts.

1.76 The assignment of rights to APRA takes place automatically upon activation of the scheme.

1.77 The assignment is limited to the amounts to which depositors are eligible for under the scheme. If a cap is imposed post 12 October 2011,

any right to claim above what a depositor is eligible for under the scheme remains with that depositor to be claimed in the liquidation process.

1.78 APRA is able to exercise or assign a right that it acquired upon the activation of the scheme.

Priority and claims in liquidation

1.79 The priorities of claims in liquidation of an ADI are adjusted to accommodate the introduction of the scheme. That is, the amounts paid out to depositors under the scheme receive first priority and the administration costs receive second priority. Other deposit liabilities of the ADI are ranked third, followed by the ADI's other liabilities. ***[Schedule 1, item 13, subsection 13A(3)]***

APRA's claims in liquidation

1.80 The costs of the scheme in terms of payments to depositors will in the first instance be recovered through the liquidation of the ADI.

1.81 The costs incurred by APRA in the administration of the EAFD are a debt due by the ADI to APRA. The debt is admissible to proof against the declared ADI in the winding up. ***[Schedule 1, item 15, section 16AO]***

Account-holders' claims in liquidation

1.82 Depositors cannot claim in the liquidation amounts they have been paid under the scheme because their rights to these amounts have been assigned to APRA. APRA can recover these amounts in the liquidation.

1.83 If a cap is imposed post 12 October 2011, some account-holders may have amounts in deposits in excess of what they were eligible for under the scheme. Any residual amounts in protected accounts will be recoverable in the liquidation and account-holders do not have to lodge a proof of debt for these claims. ***[Schedule 1, item 15, section 16AP and section 16AQ]***

1.84 This is designed to streamline the liquidation process and relieve most retail consumers from actively having to take steps to recover any remaining amounts in the liquidation process.

Claims and payments under liquidation

1.85 Where depositors have an account of a type specified in Regulations for the purposes of subsection 16AR(1), the liquidator must

pay the distribution to the depositor by opening an account of the same nature. ***[Schedule 1, item 15, subsection 16AR(2)]*** The liquidator can open an account on the account holder's behalf. ***[Schedule 1, item 15, subsections 16AR(3) and (4)]***

1.86 A liquidator can establish accounts for these purposes regardless of other laws that relate to opening accounts at an ADI and whether the depositor has consented to the account being established. ***[Schedule 1, item 15, subsection 16AR(4)]***

1.87 APRA is able to provide information to a liquidator for the purpose of assessing claims and determining and paying remaining amounts owed to account-holders in the liquidation process. It is also able to provide information to a liquidator to enable it to decide whether a distribution it is to make is attributable to an account of a particular type that requires the distribution to be made to an account of the same type. ***[Schedule 1, item 15, section 16AS]***

1.88 To allow payments to be made via the opening of accounts, APRA and the liquidator are given the power to pass on personal information to an ADI about the depositor. [Schedule 1, item 15, section 16AT] APRA has the ability to obtain the information it needs to pass to the liquidator. Reflecting the different requirements that might apply to different types of accounts, including if the special tax status of particular types of accounts is to be preserved, the Regulations may prescribe different information for disclosure in relation to different circumstances. ***[Schedule 1, item 15, Section 16AT]***

Exclusion from Trade Practices Act Requirements

1.89 The meeting of a depositor's entitlement under the EAFD is specifically excluded from the requirements of the restrictive trade practices provisions in Part IV of the *Trade Practices Act 1974*. This exclusion does not extend to account-holders' claims against the ADI in liquidation that remain after EAFD entitlements. ***[Schedule 1, item 15, section 16AU]***

Penalties

1.90 A civil penalty regime is introduced into the Banking Act. ***[Schedule 1, item B13, section 65B]***

1.91 The penalty regime in the Banking Act has not been updated for some time and currently only includes criminal penalties. A civil penalty is more appropriate than a criminal penalty in some circumstances. In addition, the introduction of a civil penalty regime improves consistency between corporations, financial sector and competition laws.

1.92 The regime introduced into the Banking Act is consistent with best practice Commonwealth model and many of the recommendations made by the Australian Law Reform Commission (ALRC) in the Principled Regulation Report.

1.93 A penalty unit is defined for the purposes of the Banking Act to make it clear that its meaning is the same as outlined in the *Crimes Act 1914*. ***[Schedule 1, item 9, subsection 5(1)]***

Chapter 2
Policyholder compensation facility

Outline of chapter

2.1 Schedule 1, Part 2 of the Bill amends the *Insurance Act 1973* (Insurance Act) to establish the Policyholder Compensation Facility (PCF).

2.2 The PCF provides eligible general insurance policyholders with timely access to funds owing as a result of an insurance claim in the event of a failure of a general insurer.

2.3 As part of the Financial Claims Scheme (FCS), the PCF complements, the Early Access Facility for Depositors (EAFD).

2.4 The PCF facilitates the efficient management of a general insurance failure.

2.5 The Australian Prudential Regulation Authority (APRA) will administer the PCF and will be responsible for ensuring that any payments are made in accordance with the legislation establishing the scheme and for arranging for the scheme's claims to be pursued in liquidation.

2.6 APRA's costs of administration will be recoverable through the scheme.

2.7 The PCF provides a mechanism that supports the 'retail end' of the general insurance market, covering individuals, small businesses and not-for-profit organisations. It is not intended that the PCF would provide compensation where an Australian general insurer provides cover on a cross-border basis to foreign persons or entities.

2.8 All risk mitigation products offered by general insurers, including the Australian branch of an authorised foreign general insurer, are covered by the PCF.

2.9 Insurance mandated by State and Territory governments (such as compulsory third party motor vehicle and workers' compensation insurance) is excluded from coverage by the PCF on the basis that protections already exist for these policyholders under State and

Territory law. In some cases States and Territories also impose levies to fund such schemes, as well as undertaking various levels of prudential supervision.

2.10 Consistent with the coverage of the HIH Claims Support Scheme, the following insurance related products will also be excluded:

- reinsurance;
- insurance provided by unauthorised foreign insurers (as defined in Regulation 4 of the *Insurance Regulations 2002*); and
- insurance-like products (for example, those products offered by discretionary mutual funds).

2.11 In contrast to the EADF, the PCF will rely primarily on focused eligibility criteria to protect against moral hazard. Access to benefits under the PCF will be limited to specific classes of policyholders:

- individuals who are Australian citizens or permanent residents or non-resident individuals who have insured against risks in Australia with an APRA-regulated general insurer;
- small businesses as set out in sub division 328-C of the *Income Tax Assessment Act 1997* (in broad terms a 'small business' for the purposes of this legislation is a business with annual aggregated turnover of less than $2 million);
- family trusts which own property for private and residential purposes or for a qualifying small business; and
- Australian-based non-profit organisations.

2.12 Because of the operation of these eligibility requirements, a number of policyholders, including the largest policyholders such as large corporations, will not be covered by the PCF. Those policyholders that do not meet the PCF eligibility requirements will be eligible to recover any funds owing to them in the normal course of the liquidation of the general insurer.

2.13 As a result of their exclusion from the PCF, these policyholders will continue to have strong incentives to monitor the health and stability of their general insurance company and assess the counterparty risk that might impact on the value of their insurance

coverage. The imperative of winning and keeping these clients will impose market discipline on general insurers and mitigate any moral hazard being created by the PCF.

2.14 In addition, the PCF will not compensate policyholders for the loss of unexpired premiums. This is consistent with the arrangements under the HIH Claims Support Scheme.

2.15 However, in the interests of administrative simplicity, claims up to $5,000 will not be subject to the eligibility criteria.

Context of amendments

2.16 Australia has had limited experience with financial institution failure despite exposure to international instability. When failures have occurred the response has been ad hoc.

2.17 While Australia's prudential regulatory framework includes arrangements to minimise the risk of failure and to assist in managing failures where they occur, there are currently no explicit, predetermined arrangements for assisting policyholders in the event a general insurer fails.

2.18 The failure of the HIH Group of Companies (HIH) in 2001 revealed significant gaps in the crisis management framework.

2.19 The failure cost the Australian Government (the Government) an estimated $861 million, with the Government likely to recover only 25 to 30 per cent in liquidation. The total cost of the HIH failure is around $5 billion.

2.20 The management of the HIH failure was complicated by the delay in establishing and commencing payments under the HIH Claims Support Scheme as well as by the complex eligibility criteria and entitlements which varied across different lines of insurance.

2.21 Schemes similar to that introduced by the Bill are common in developed economies.

2.22 Standing arrangements to assist policyholders have been considered in a number of forums since the HIH collapse, including the HIH Royal Commission report, a report on Financial System Guarantees in 2004, as well as by the Council of Financial Regulators and the International Monetary Fund (IMF).

2.23 The 1997 Financial System Inquiry ('the Inquiry') noted the need for specialised regulation of financial institutions due to the complexity of financial products, the nature of promises made and the adverse consequences to consumers where those promises were breached. Following the Inquiry and the HIH Royal Commission Report, the prudential regulatory framework was strengthened for general insurance.

Summary of new law

2.24 The amendments establish the PCF and provide the framework for activating the PCF, determining and making payments to eligible policyholders and recovering funds in liquidation where possible.

2.25 APRA is the PCF administrator.

Comparison of key features of new law and current law

New law	***Current law***
Provides for Government assistance to eligible policyholders in the event of a general insurer's failure.	Policyholders' claims against a failed insurer are pursued in the liquidation process.
APRA is responsible for administering the scheme	
The PCF will be activated via a Ministerial determination which will include an appropriation for up to $20 billion for payments to policyholders and $100 million for administration purposes.	Assistance for policyholders of a failed insurer has been ad hoc and there is no standing arrangement in current law.

New law	*Current law*
Policyholders will only be eligible for assistance if they are covered by a 'protected policy', meet the criteria set out in regulations, and are not excluded by a determination under the scheme legislation.	
Eligible policyholders will be paid the full amount of a claim for which the declared general insurer is liable.	
A policyholder's rights against the failed insurer are automatically assigned to APRA, to the extent that APRA pays out that liability under the PCF.	

Detailed explanation of new law

Administration of the PCF

2.26 APRA is the administrator of the PCF, should it be activated, and the Bill recognises the addition of this role to APRA's mandate by amending the Objects of the Insurance Act. ***[Schedule 1, Part 2, Item 19, Paragraph 2A(2)(f)]***

Activation of the PCF

2.27 The PCF is intended to ensure that eligible individuals, not for profit organisations and small businesses with valid insurance claims are protected in the event that their general insurer fails. APRA would pay those persons the amount they are entitled to before they would receive any payment in the winding up of the general insurer, and in return APRA would take those persons' places as creditors in the liquidation of the general insurer. ***[Schedule 1, Part 2, Item 27, Section 62ZW]***

2.28 As well as being responsible for making early payments to claimants under the PCF, APRA will assist the Minister in preparing for the activation of the scheme. ***[Schedule 1, Part 2, Item 27, Section 62ZX]***

2.29 The PCF will be activated by a Ministerial declaration which would relate to a specified general insurer or foreign general insurer. ***[Schedule 1, Part 2, Item 27, Section 62ZZC(1)]***

2.30 Before the Minister can make a declaration, the general insurer must be under judicial management under Division 1 of Part VB of the Insurance Act (see Part 1 of Schedule 3 of the Bill), and APRA must have advised the Minister that it believes the general insurer to be insolvent (or in the case of a foreign general insurer, APRA must have advised that it believes that it is unable to pay, from its Australian assets, all its Australian debts and liabilities other than pre-authorisation liabilities, when those debts become due and payable). ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(1) and 62ZZE]***

2.31 Because the PCF is intended to respond to specific circumstances around the failure of a particular insurer, the Ministerial declaration must specify a general insurer individually and may not specify insurers by reference to a class of general insurers.

2.32 In declaring that Division 3 should apply in relation to a specific general insurer, the Minister will be required to specify the amount to be credited to the Financial Claims Scheme Special Account.

2.33 At the time of declaration, the Minister will specify the amounts to be credited to both the Financial Claims Scheme Special Account and the APRA Special Account. The amounts credited will be based on an assessment by the Minister of the likely costs of, respectively, the policyholder entitlements to be met and the administration costs of the scheme. This assessment will be based upon, among other things, advice from APRA, ASIC and the Reserve Bank of Australia (RBA).

2.34 The amount to be credited to the Financial Claims Scheme Special Account must not be greater than $20,000,000,000. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(2)]***

2.35 The funds credited to the Financial Claims Scheme Special Account will only be available to meet entitlements to be paid out under Division 3.

2.36 The amount to be credited to the APRA Special Account must not be greater than $100,000,000. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(3)]***

2.37 Funds credited to the APRA Special Account will only be available to meet the costs of the administration of this Part in relation to a declared general insurer.

2.38 There is scope for the Minister to amend the declaration of a general insurer, but only in relation to the amounts specified to be credited to either the Financial Claims Scheme Special Account or the APRA Special Account or both. The Minister does not have the ability,

under the legislation, to amend the declaration with regard to the financial institution for which the Scheme is being invoked. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(4)]***

2.39 Although the amounts specified in the declaration may be altered, there is no scope for a Minister to revoke a declaration**.** ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(5)]***

2.40 A high level of certainty is necessary with respect to the 'triggering' of the PCF. Disallowance of the Minister's declaration, possibly many weeks after the commencement of PCF operation, would create substantial uncertainty to affected policyholders, the declared general insurer and its liquidator and APRA. Automatic sunsetting of the Minister's declaration may disrupt the conduct of litigation relating to insurance claims covered by the PCF, even if it occurs many years after the declaration. As a result, subsection 62ZZC(6) declares that section 42 (disallowance) and Part 6 (sunsetting) of the Legislative Instruments Act 2003 do not apply to the Minister's declaration or an amendment to it. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(6)]***

2.41 Because of the need for prompt action in response to a financial institution failure, and the need to ensure those with an entitlement under the PCF are paid without delay, the declaration of a general insurer or the amendment of such a declaration will take effect from the time they are made, rather than from the time they are registered on the Federal Register of Legislative Instruments. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZC(7)]***

2.42 The exclusion of a declaration under this Part from the effect of subsections 12(1) and 12(2) of the *Legislative Instruments Act 2003* is necessary to ensure that delays in the registration of an instrument in the Federal Registry of Legislative Instruments does not delay the provision of assistance to policyholders in the event of a general insurance collapse.

2.43 The timeliness of assistance under the PCF will be particularly relevant to policyholders who may be receiving payments under a salary continuance policy or similar arrangement, who would be reliant on continuing regular payments to provide funding for their day-to-day living expenses.

Advice and information for making a declaration

2.44 Prior to taking any decision about making a declaration in relation to a general insurer, the Minister may seek information relevant to making that decision from APRA, ASIC or the RBA.

2.45 A request for advice should be made in writing and can relate to any matter relevant to making a declaration, including matters that are relevant to the affairs of a general insurer. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZD(1)]***

2.46 APRA has an explicit power to advise the Minister on its belief of the solvency or otherwise of a general insurer. ***[Schedule 1, Part 2, Item 27, Section 62ZZE]***

2.47 Secrecy provisions in Part 6 of the *Australian Prudential Regulation Authority Act 1998*, section 127 of the *Australian Securities and Investments Commission Act 2001* and sections 79A and 79B of the *Reserve Bank Act 1959* should not be taken to prevent APRA, ASIC or Reserve Bank staff or members from providing information to the Minister as required by sections 62ZZD and 62ZZE. ***[Schedule 1, Part 2, Item 27, Sections 62ZZD and 62ZZE]***

2.48 Once a written request has been made by the Minister, agencies must respond as soon as is reasonably practical by providing the relevant advice to the Minister. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZD(2)]***

2.49 The purpose of the provision of information is to inform the Minister about the financial status of the general insurer in question, whether it is likely to be in a position to meet its liabilities and whether it is appropriate that the PCF be activated in relation to the general insurer in question.

2.50 While the Minister must take into account the advice or information that he or she receives, if any, the advice and information provided in no way limits what the Minister may take into account in making the decision. ***[Schedule 1, Part 2, Item 27, Section 62ZZD(3)]***

2.51 The failure of agencies to provide advice in a timely fashion in response to a request from the Minister should not in anyway limit his or her ability to make a declaration with regard to a general insurer.

Protected policies

2.52 The Bill creates a category of policy which is eligible for coverage under the PCF. These policies have been termed 'protected policies'.

2.53 A ***protected policy*** will be determined by reference to regulations which will set out those types of policies which will not be eligible for coverage under the PCF. ***[Schedule 1, Part 2, Item 26, definition of 'protected policy' in subsection 3(1)]***

2.54 This mechanism will ensure that the PCF is targeted to those individuals and businesses least able to assess risk and promote market discipline by those excluded from the scheme.

2.55 The flexibility of designating those policies which will not be considered 'protected policies' through regulation is important to allow for the scheme to be responsive to developments in the industry and in the public's usage of general insurance products.

2.56 In the initial stages of the PCF's implementation it is intended that mandated lines of insurance not be covered by the scheme where they are already protected through arrangements administered by the State and Territory Governments. This may mean the exclusion of compulsory third party motor vehicle insurance, workers' compensation and builders' warranty insurance in a number of States and Territories.

2.57 Although it is not proposed that the scheme would cover lines of insurance where duplicated protection is provided under State and Territory law, these lines of insurance could be brought into the scheme under an appropriate agreement with the States and Territories.

2.58 By providing that the scope of the term 'protected policy' can be altered by regulation, such changes will be able to occur in a timely manner.

2.59 It is intended that under the regulations, reinsurance and retrocession will be excluded from the definition of 'protected policy'.

2.60 Reinsurance and retrocession are not defined in the *Insurance Act 1973*. It is intended that reinsurance will be taken to mean a transaction whereby one insurance entity (the 'reinsurer') agrees to indemnify another insurance entity (the 'cedent') against all or part of the loss that the latter sustains under a policy or policies which it has issued. Retrocession will be taken to mean a transaction whereby one insurance entity (the 'retrocessionaire') agrees to indemnify another insurance entity (the 'reinsurer') against all or part of the loss that the latter sustains under a policy or policies of reinsurance that it has issued.

Lodging claims under the PCF

2.61 Under the PCF, claimants are required to apply for assistance, providing sufficient information for APRA to assess the claim against the PCF's eligibility criteria.

2.62 Section 62ZZB will give APRA the power to approve forms for the purposes of making applications to the PCF. ***[Schedule 1, Part 2, Item 27, Section 62ZZB]***

2.63 As outlined in Item 5 of Part 1 of Schedule 1 to the *Legislative Instruments Regulations 2004*, approval of a form is not a legislative instrument.

Entitlement to claim under the PCF

2.64 To be entitled to make a claim under the PCF a person must have a claim under an insurance policy issued by an insurer which has become a declared general insurer. This claim may arise because the policy in question provides cover to the person, or because the person is otherwise entitled to claim under the cover, for example, if that person has legal 'cut-through' rights to payment from the insurer such as those available under section 51 of the *Insurance Contracts Act 1984*. ***[Schedule 1, Part 2, Item 27, Section 62ZZF(1)]***

2.65 A time period during which a person is required to make a claim will be prescribed by regulations. ***[Schedule 1, Part 2, Item 27, Subparagraph 62ZZF(1)(b)(i)]***

2.66 For the purposes of determining the time period during which valid claims can be lodged under the PCF, APRA may specify a later day than the day on which the end of the period is prescribed by regulation. ***[Schedule 1, Part 2, Item 27, Subparagraph 62ZZF(1)(b)(ii)]***

2.67 Applicants will only be entitled to payment of claims under the PCF if they make a claim in the prescribed manner during the period which is prescribed in the regulations, or during the additional time specified by APRA. Persons whose claims are made outside this time period will not be eligible for coverage under the PCF.

2.68 Entitlement to the provision of assistance under the PCF is limited to policyholders who meet specified eligibility criteria.

2.69 It is intended that eligibility criteria be set so as to include those policyholders least able to effectively assess the prudential stability of the general insurers with whom they deal. Other policyholders will be eligible to recover claims in the normal course of liquidating the insurer.

2.70 In general terms, these groups would include individuals, small businesses, some family trusts and not-for-profit organisations.

2.71 To ensure that the PCF, whenever it might be activated, continues to cover appropriate classes of policyholders, the eligibility criteria will be specified in regulations. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZF(3)(b)]***

2.72 Initially these regulations will limit eligibility to:

- individuals who are Australian citizens or permanent residents or non-resident individuals who have insured against risks in Australia with an APRA-regulated general insurer;

- small businesses as defined in sub division 328-C of the *Income Tax Assessment Act 1997*;

- family trusts which own property for private and residential purposes or for a qualifying small business; and

- Australian-based not-for-profit organisations.

2.73 By setting eligibility criteria through regulation these criteria can be updated as needed to ensure that, as much as possible, they remain aligned with similar definitions of small business in other legislation and that they are consistent with eligibility criteria set for other relevant programs.

Fast-track for low value claims

2.74 To allow for the rapid assessment and payment of low-value claims, and to limit the likelihood that the cost of determining eligibility under the PCF will exceed the value of the claim in question, APRA will not be required to test the eligibility of claims where the amount of the liability in respect of the claim is less than $5,000. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZF(2)]***

2.75 In such cases, the claimant will be entitled to be paid, by APRA, an amount equal to the insurer's liability to the person in respect of the claim.

2.76 Claimants are not eligible for a payment unless APRA has determined that the insurer is liable to pay the claimant in respect of the claim, nor are they eligible if the claimant is a member of a class of policyholder or insured which has been excluded from the PCF by a determination of the Minister under section 62ZZ. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZF(1)(d)]***

2.77 APRA is responsible for determining both whether the declared general insurer has liability with respect to the person's claim as well as the amount of the claim and whether the claim should be paid out under the fast-track procedures, or whether it is necessary to test the claimant's eligibility with respect to the eligibility criteria.

2.78 The fast-track provisions are intended to streamline the process of paying claims. It is expected that in many cases a significant

proportion of the claims arising due to policies issued by the declared general insurer will fall below the $5,000 limit and be eligible for the fast-track.

Treatment of third parties

2.79 The only circumstances where third-parties, other than persons who are covered under a policy, are eligible to claim is where they would normally have a legal right to claim directly from an insurer although they are not the insured or the policyholder.

2.80 Such rights to claim are generally referred to as 'cut-through' rights. Section 51 of the *Insurance Contracts Act 1984* sets out the requirements for a person to have 'cut-through' rights.

2.81 APRA will be required to determine whether it is satisfied that the person applying to recover funds from the declared insurer meets the requirements of section 51 of the *Insurance Contracts Act 1984*. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZJ(4)(a)]***

2.82 This determination should be made in writing as soon as is reasonably practicable after the application is made.

2.83 APRA must also determine what the amount to be recovered, if any, is. ***[Schedule 1, Part 2, Item 27, 62ZZJ(4)(b)]***

2.84 If APRA determines that a person would be permitted to recover an amount from a general insurer under the provisions of the *Insurance Contracts Act 1984*, that is, that the person has a 'cut-through' right, then that person may be eligible for coverage under the PCF as a third-party. ***[Schedule 1, Part 2, Item 27, Section 62ZZG(1)]***

2.85 A person who belongs to a class of persons which has been excluded from coverage under a determination by the Minister, under section 62ZZ, is not eligible to recover an amount under the scheme as a third party.

2.86 The fast-track process also applies to claims made by third parties, that is, where the recoverable amount is determined by APRA to be less than $5,000, the person is entitled to be paid without meeting the eligibility criteria established in the regulations. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZG(2)]***

2.87 However, where the recoverable amount is determined by APRA to be $5,000 or more, eligibility criteria, prescribed by regulation, will apply. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZG(3)]***

2.88 It is intended that the eligibility criteria prescribed by regulation for the purposes of subsection 62ZZG(3) will correspond to those established for subsection 62ZZF(3).

2.89 By setting eligibility criteria through regulation these criteria can be updated as needed to ensure that, as much as possible, they remain aligned with similar definitions of small business in other legislation and that they are consistent with eligibility criteria set for other relevant programs.

2.90 The intent of the eligibility criteria is to target the assistance provided by the PCF to those groups most likely to be in greatest hardship.

Determining claims under the PCF

2.91 In the event of a general insurer's failure there are likely to be certain classes of policyholders or insureds with a greater knowledge of and/or involvement in the events leading to the failure.

2.92 These policyholders would be in a very different position from the general body of policyholders who are unlikely to be well placed to determine the counterparty risks they are taking on by doing business with the insurer.

2.93 Section 62ZZ will allow the Minister to exclude by determination certain classes of policyholders and insureds from the scheme. ***[Schedule 1, Part 2, Item 27, Section 62ZZ]***

2.94 It is intended that this power allow the Minister to exclude from benefiting from the scheme those persons with direct knowledge of or involvement in the events leading to the failure of the insurer, such as directors and officers of the failed insurer, their families and associates. Unlike the intended beneficiaries of the PCF, these policyholders are well placed to assess and avoid the counterparty risks of dealing with the general insurer.

2.95 This approach was also taken under the HIH Claims Support Scheme, which deemed as ineligible anyone who was, at any time in the three years prior to the collapse, a director or officer of HIH (as defined in the *Corporations Act 2001*) or in a position to influence or to provide advice to any of the directors or officers of any company in the group on any matter related to corporate governance.

2.96 The power given to the Minister by section 62ZZ is deliberately flexible to account for the wide range of possible circumstances surrounding a general insurance failure and the need to be

able to exclude the relevant classes of policyholders depending on these circumstances.

2.97 Detailing the various classes of policyholders to be excluded as part of the primary legislation, or in regulations to be proclaimed before the time of a failure, would present a real risk of either including or excluding classes of policyholders on a basis which is not relevant given the circumstances of the particular failure.

2.98 A similar ability to impose broad conditions on a grant of compensation for financial loss is available to the Minister in paragraph 233(1)(d) of the *Superannuation Industry (Supervision) Act 1993*.

2.99 There a risk that individuals with knowledge of an insurance company's financial situation, who expect the scheme to be activated could seek to exploit the PCF by taking actions primarily for the purposes of receiving a payment from the scheme through a third party.

2.100 To help prevent any intentional action specifically designed to lead to payment under the PCF, section 62ZY gives APRA the power to determine that a policy not be eligible for coverage under the scheme if it is reasonable to conclude, from the nature of the policy and/or the circumstances in which it is issued, that the policy was issued primarily to make the policyholder eligible for a payment under the PCF. ***[Schedule 1, Part 2, Item 27, Section 62ZY]***

2.101 Where a person makes a claim under the PCF, within the prescribed time period, relating to a protected policy issued by a general insurer which has been declared by the Minister, APRA will be responsible for determining whether the declared insurer has a liability to a claimant. APRA is also responsible for determining the amount of the liability, if any. ***[Schedule 1, Part 2, Item 27, Section 62ZZI]***

2.102 It is intended that APRA determines the insurer's liability under the insurance policy according to the terms and conditions of the contract of insurance, taking into account the limitations of the policy, any exclusions, any deductible amounts or excesses and any limits on the amount of the liability.

2.103 The determination APRA is required to make is in the nature of determining a contractual liability. APRA is not required to make a determination on compensation based on any other criteria, such as fairness or hardship.

2.104 Where APRA makes a determination of an insurer's liability under section 62ZZI, the determination is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003.*

2.105 Once a policyholder or insured person applies to APRA as the scheme administrator for assistance, using the form approved by APRA, APRA must determine in writing whether the person meets the eligibility criteria outlined in the regulations. ***[Schedule 1, Part 2, Item 27, Section 62ZZJ]***

2.106 APRA must make this written determination as soon after the lodgement of the application as is practicable.

2.107 In cases where the applicant is a third-party seeking to exercise 'cut-through' rights to be paid under a policy, APRA must determine in writing whether it is satisfied that section 51 of the *Insurance Contracts Act 1984* permits the person to recover an amount from the declared general insurer, and how much that amount is, if any.

2.108 Where APRA makes a determination of an insurer's liability under section 62ZZI, the determination is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003.*

2.109 Where APRA makes a written determination about a claimant's eligibility under the PCF, or whether they would be permitted to seek cut-through rights to payment, APRA must provide the applicant with a copy of the determination as soon as is practicable. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZJ(5)]***

Allowing extra time for claims

2.110 For the benefit of the creditors of the failed insurer, and in the interests of reducing the administration costs of the scheme, the period during which claims may be made against the scheme will be limited.

2.111 APRA will be able to specify in writing the date on which the period for making claims for assistance under the scheme will end. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZA(1)]***

2.112 The period during which applications will be accepted can be set for particular policies or for policies generally.

2.113 Where APRA makes an instrument under subsection 62ZZA(1) which relates to a single identified policy, the instrument will not be a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003.* ***[Schedule 1, Part 2, Item 27, Subsection 62ZZA(2)]***

2.114 However, instruments made by APRA under subsection 62ZZA(1) which do not specify a single identified policy would otherwise meet the meaning of section 5 of the *Legislative Instruments Act 2003*. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZA(3)]***

Notionally extended cover

2.115 In the event of a general insurance failure, with a failed company unable to meet its claims or write new policies, a degree of hardship will be caused to both those with claims on foot, or potential claims, and those whose cover is now in question, who will need to seek replacement cover.

2.116 If the decline and failure of the general insurer occurs rapidly, some policyholders may not be in a position to seek out replacement coverage immediately. If the failing general insurer cancels the policy in question, or the policy renewal falls due and the insurer does not renew the policy as expected, a range of persons who had fully intended to insure a certain risk may be left without coverage.

2.117 To provide protection in such cases, the PCF provides for notionally extended cover such that coverage will continue, under the terms of the policy, for a period of 28 days after the time the general insurer becomes a declared general insurer. ***[Schedule 1, Part 2, Item 27, Section 62ZZH]***

2.118 This notional coverage will be provided on the same terms as the coverage being provided by the policy that preceded it, with the same limits, exclusions, and deductible or excess amounts. The coverage will be deemed to be extended, even if the policy is cancelled within the 28-day grace period or the period of cover would otherwise have ended during the 28-day grace period.

2.119 This section does not extend the declared insurer's liability beyond its existing liability by forcing an alteration of the contract terms or by preventing the cancellation of the policy. The notional coverage provided by the section 62ZZH is only for an entitlement to be paid under the PCF.

Methods of payment

2.120 A person's entitlement under the PCF may be:

- paid by APRA to the person as a single amount or in instalments determined by APRA;

- applied, as a single amount or in instalments determined by APRA, for the person's benefit; or

- paid, in part, to the person by APRA with the remaining entitlement applied for the person's benefit.

2.121 Regulations may be prescribed specifying ways in which a person's entitlement under the PCF may be met. ***[Schedule 1, Part 2, Item 27, Section 62ZZK]***

Recovery in liquidation

2.122 As scheme administrator, APRA will initially seek to recover the costs of operating the PCF, both in terms of the payouts to claimants and the administration costs, through the liquidation of the declared general insurer.

2.123 To allow APRA to recover these funds, the rights of claimants against the declared insurer will be transferred to APRA. APRA will then stand in the shoes of the claimant in the liquidation process. ***[Schedule 1, Part 2, Item 27, Section 62ZZL]***

2.124 The transfer of rights will be taken to have occurred at the time at which APRA makes the last necessary determination related to the claimant's entitlement.

2.125 The legislation does not alter the priority in liquidation for a general insurer. APRA, as a creditor in the liquidation of a declared general insurer, will have the same priority as the claimant would have had if the transfer had not occurred.

2.126 Claimants, being eligible for a payment from the PCF equivalent to their entitlement to claim from the insurer, will have been fully compensated for the rights which are transferred to APRA.

2.127 Acting as scheme administrator will involve significant costs for APRA. These costs will be initially funded by an appropriation credited to the APRA Special Account under subsection 62ZZC(3).

2.128 APRA will then seek to recover these costs through the liquidation where possible.

2.129 Costs incurred by APRA in relation to the administration of the PCF in relation to a declared general insurer are to be taken as a debt due by the declared general insurer to APRA. ***[Schedule 1, Part 2, Item 27, Section 62ZZU]***

2.130 The debt will be admissible in the liquidation of the declared general insurer and will have the same priority in the winding up as a claim relating to amounts owed as a result of a contract of insurance with the declared general insurer.

Transfers of other rights

2.131 Although the rights a successful PCF claimant has against the declared general insurer become APRA's rights, allowing recovery in liquidation, other rights the claimant may have that are relevant to the claim are not transferred to APRA.

2.132 In particular, any rights an insured person may have against a third party in relation to causing the insured losses are not transferred to APRA.

2.133 Normally, such rights would be transferred to the insurer through subrogation, assignment or abandonment once the party had been paid the indemnified loss under their insurance contract.

2.134 Because the payment of the indemnified loss, in the case of a declared general insurer, would be made by the PCF rather than by the insurer, the operation of the PCF could disrupt the normal transfer of these rights. In some circumstances it could mean that a person would have been fully compensated for the loss through a payment from the PCF, but still have rights against a third party.

2.135 To resolve this issue, the payment to an applicant of their entitlement under the PCF will be taken to be a payment from the general insurer under the protected policy for the purposes of these transfers of rights (subrogation, assignment or abandonment).
[Schedule 1, Part 2, Item 27, Section 62ZZM]

2.136 The intent is that rights available through subrogation, assignment or abandonment would be available to the insurer, which may be in liquidation, and that the liquidator could then pursue those rights as appropriate, with any successful recoveries adding to the funds available in the liquidation.

2.137 APRA would be a creditor in the liquidation and would benefit from these increase recoveries in proportion to its size relative to other creditors.

APRA to ensure it is aware of claims

2.138 APRA is to take all reasonable steps to ensure that it is aware of the making of a claim described in section 62ZZI within the required period specified by paragraph 62ZZF(1)(b). This will assist in ensuring that APRA's determination of claims occurs as quickly as possible. ***[Schedule 1, Part 2, Item 27, Section 62ZZN]***

Requiring assistance and obtaining information from general insurers

2.139 APRA may require assistance from the declared general insurer (or another general insurer) or the liquidator of the declared general insurer (or another liquidator) to perform its functions or exercise its powers in administering the PCF. APRA must make this request in writing. ***[Schedule 1, Part 2, Item 27, Section 62ZZO]***

2.140 APRA will require information from a declared general insurer (or another general insurer) or the liquidator of the declared general insurer (or another liquidator) so that it is able to assess the validity of claims and the extent of the coverage provided under protected policies. APRA must make this request in writing. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZP]***

2.141 Specifically, APRA requires information to:

- identify persons who may have a claim against the failed general insurer as a result of coverage by a protected policy;
- determine whether an applicant for assistance has an entitlement under the PCF;
- determine the amount of that entitlement; and
- meet a person's entitlement, either by payment to that person or otherwise.

2.142 APRA can also seek information for preparatory purposes. For example, APRA may seek information to determine whether a general insurer would be able to provide (in a timely way and in a useable format) the information APRA would need for it to be able to administer the PCF if it were activated in relation to that insurer. APRA may also seek information to develop its own systems to be able to administer the PCF if it were activated. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZP(4)(e)]***

2.143 In seeking to meet its obligations, APRA may obtain personal information. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZP(3)]***

2.144 The requested information can be required to be given to APRA, an APRA member, an APRA staff member who has relevant responsibilities, a person to whom APRA has delegated responsibilities under Part VC or a person who is an officer or employee of the person to whom responsibilities have been delegated. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZP(2)]***

2.145 Section 62ZZQ imposes substantial civil and criminal penalties on a general insurer that fails to comply with APRA's request for assistance or for information. The maximum fine for a general insurer is 200 penalty units. The maximum civil penalty for a general insurer is 10,000 penalty units. ***[Schedule 1, Part 2, Item 27, Subsections 62ZZQ(1) and (2)]***

2.146 Part 2.4 of the Criminal Code and clause 3 of Schedule 1 to the Insurance Act extend that criminal liability and civil liability, respectively, to persons who:

- aid, abet, counsel or procure a contravention of an offence or civil penalty provision;
- induce, whether by threats or promises or otherwise, a contravention of an offence or a civil penalty provision;
- conspire with others to effect a contravention of an offence or a civil penalty provision.

2.147 In addition, a person who is in any way, directly or indirectly, knowingly concerned in or party to, a contravention of a civil penalty provision is also deemed to have contravened that provision.

2.148 A person who attempts to commit an offence or procures the commission of an offence by an innocent agent also commits an offence.

2.149 Subsection 62ZZQ(4) also makes it an offence for an officer of a general insurer to fail to take reasonable steps to ensure the general insurer complies with APRA's requirements. The maximum fine is 50 penalty units. ***[Schedule 1, Part 2, Item 27, Subsections 62ZZQ(4)]***

2.150 These substantial criminal and civil penalties are required because assistance and information from general insurers is likely to be vital for the effective implementation of the PCF in a timely way.

2.151 The offences that apply to officers of a general insurer are continuous offences to encourage the provision of assistance and information necessary to implement the scheme in a timely way. The offences are indictable offences due to the serious nature of non-compliance and to ensure a link to 'fit and proper' and other requirements

that apply to auditors and officers in senior positions of prudentially regulated financial institutions.

2.152 A liquidator is subject to the regime for non-compliance under the Corporations Act if they fail to comply with APRA's requirements. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZQ(7)]***

Obtaining further information from PCF claimants

2.153 If APRA has insufficient information to make the determinations necessary in regard to a claim under the PCF, APRA may request that the claimant provide the necessary information to a specified person, and in a form specified by APRA and within a reasonable time. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZR(1)]***

2.154 Failure of a person to provide the information requested by APRA in the form requested may delay the processing of the person's claim. APRA need not make the determination relating to the claim until after the information requested has been provided. ***[Schedule 1, Part 2, Item 27, Paragraph 62ZZR(1)(b)]***

2.155 Persons requested to provide information in these circumstances can only be requested to provide the information to APRA, an APRA member, an APRA staff member who has responsibilities relating to the implementation of the PCF, a person to whom APRA has delegated functions under Part VC or an officer or employee of a person to whom functions have been delegated. ***[Schedule 1, Part 2, Item 62ZZR(2)]***

2.156 Given the nature of the determinations APRA is required to make, some of the information requested from claimants may be personal information. ***[Schedule 1, Part 2, Item 27, Subsection 62ZZR(3)]***

Recovery of Overpayments

2.157 Regulations may be made to provide for the recovery of overpayments made under the PCF. ***[Schedule 1, Part 2, Item 27, Section 62ZZS]***

APRA may delegate functions and powers

2.158 APRA may delegate its functions and powers under the Part VC. ***[Schedule 1, Part 2, Item 27, Section 62ZZT]***

Exemption from competition assessments

2.159 Actions in connection with Part VC, including:

- anything done in exercise of powers or performance of functions;
- anything done to enable or facilitate the exercise of those powers or the performance of those functions; and
- anything incidental to the above;

is exempt from *Trade Practices Act 1974* competition assessment. ***[Schedule 1, Part 2, Item 27, Section 62ZZV]***

2.160 This exemption is necessary because competition assessments may frustrate, unduly delay or create undue uncertainty in relation to the implementation of the PCF.

Civil penalties

2.161 Civil penalties may be enforced under Schedule 1 of the Insurance Act, which is made effective through section 129E. The burden of proof in proceedings for a civil penalty is on the balance of probabilities and there is no requirement to prove any fault elements in relation to the offending conduct. ***[Schedule 1, Part 2, Item 34, Section 129E]***

2.162 Within 6 years of a person contravening a civil penalty provision APRA may apply, on behalf of the Commonwealth, to the Court for an order that the person pay the Commonwealth a pecuniary penalty. ***[Schedule 1, Part 2, Item 35, Schedule 1, Subclause 1(1)]***

2.163 If the Court is satisfied that the person has contravened a civil penalty provision, the Court may order that person to pay to the Commonwealth for each contravention the pecuniary penalty that it considers appropriate. However, the Court may not order an amount to be paid that is greater than the 'relevant amount' specified for the provision. The 'relevant amount' is the maximum civil penalty that may be imposed, for example, 10,000 penalty units is the relevant amount specified in subsection 62ZZQ(1). ***[Schedule 1, Part 2, Item 35, Subclause 1(2)]***

2.164 In determining the pecuniary penalty, the Court must take into account the matters set out in paragraphs (a) to (d) in subclause 1(3). ***[Schedule 1, Part 2, Item 35, Subclause 1(3)]***

2.165 If a person's conduct contravenes more than one civil penalty clause and proceedings are instituted in relation to contravention of more

than one clause, then the person cannot be subject to more than one pecuniary penalty in relation to the same conduct. ***[Schedule 1, Part 2, Item 35, Subclause 1(4)]***

2.166 Contravening a civil penalty provision is not an offence. ***[Schedule 1, Part 2, Item 35, Clause 2]***

2.167 A person must not:

- aid, abet, counsel or procure a contravention of a civil penalty clause;
- induce, whether by threats or promises or otherwise, a contravention of a civil penalty clause;
- be in any way, directly or indirectly, knowingly concerned in or party to, a contravention of a civil penalty clause; or
- conspire with others to effect a contravention of a civil penalty provision. ***[Schedule 1, Part 2, Item 35, Subclause 3(1)]***

2.168 Schedule 1 applies to a person who contravenes the extended civil penalty provisions in subclause 3(1) as if that person had contravened the principal civil penalty provision. ***[Schedule 1, Part 2, Item 35, Subclause 3(2)]***

2.169 However, the relevant amount applicable to an individual (that is, a natural person) that contravenes a civil penalty provision is one fifth the relevant amount that would otherwise apply if the individual (that is, a natural person):

- contravenes a civil penalty provision because of the extended civil penalty provisions in subclause 3(1); and
- the principal penalty provision can only be contravened by a body corporate. ***[Schedule 1, Part 2, Item 35, Subclause 3(3)]***

2.170 Civil pecuniary penalties ordered to be paid by the Court are penalties payable to the Commonwealth and the Commonwealth may enforce the order as if it were a judgment of the Court. ***[Schedule 1, Part 2, Item 35, Clause 4]***

2.171 The Court is required to apply the rules of evidence and procedure for civil matters in proceedings for a civil penalty order. This means that the civil standard of proof, that is, the balance of probabilities, will apply. ***[Schedule 1, Part 2, Item 35, Clause 5]***

2.172 The Court must not make a civil penalty order against a person where the person has been convicted of a criminal offence for substantially the same conduct. ***[Schedule 1, Part 2, Item 35, Clause 6]***

2.173 Where proceedings for a civil penalty order and criminal proceedings are started against a person for substantially the same conduct the civil proceedings will be stayed. The civil proceedings will be dismissed if the person is convicted of the offence but may be resumed if the person is not convicted of the offence. ***[Schedule 1, Part 2, Item 35, Clause 7]***

2.174 The fact that a civil penalty order has been made against a person does not prevent criminal proceedings being started against the person for substantially the same conduct. ***[Schedule 1, Part 2, Item 35, Clause 8]***

2.175 Where criminal proceedings are commenced against a person who has already given evidence or produced documents in civil penalty proceedings arising from substantially the same conduct, that evidence inadmissible in the criminal proceedings. This does not apply to criminal proceedings relating to the falsity of the evidence in the civil proceedings. ***[Schedule 1, Part 2, Item 35, Clause 9]***

Consequential amendments

2.176 Definitions of 'APRA Special Account', 'civil penalty provision', 'declared general insurer', 'Financial Claims Special Account' 'penalty unit' and 'personal information' are inserted in subsection 3(1) of the Insurance Act. ***[Schedule 1, Part 2, Items 20 to 25]***

2.177 Consequential amendments are made to section 116A of the Insurance Act to apply that section's modified definition of assets and liabilities in Australia to the PCF. ***[Schedule 1, Part 2, Items 28 to 33]***

Chapter 3
Administration

Outline of chapter

3.1 Schedule 1, Part 3 of the Bill amends the APRA Act to provide APRA with the function of administering the Financial Claims Scheme (FCS) and establish financial and other arrangements to perform this function.

3.2 Schedule 1, Parts 4 and 5 of the Bill set out consequential, application and transitional provisions relating to the FCS.

Context of amendments

3.3 APRA's existing purpose, functions and powers (as specified in sections 8, 9 and 11 respectively of the APRA Act) have a prudential regulation focus. Similarly, under section 12 of the Banking Act, APRA has a duty to exercise its powers and functions under Division 2 of that Act for the protection of the depositors of the several ADIs and for the promotion of financial system stability in Australia.

3.4 As a result of its prudential regulation role, APRA is familiar with financial institutions and their systems and is well placed to do the necessary preparatory work and to test the scheme's implementation.

3.5 APRA's role is expanded to include administration of the scheme and development of the administrative practices and procedures to be applied in performing its regulatory role.

3.6 APRA's specific powers and responsibilities with regard to the EAFD and the PCF are established in the Banking Act and General Insurance Act.

3.7 The Bill also establishes the funding and accounting arrangements for administering and making payments under the FCS, and updates the requirements around APRA's annual reporting arrangements to reflect the existence of the FCS.

3.8 The arrangements include the use of the Financial Claims Scheme Special Account for funding payments to depositors of

policyholders benefiting from the scheme and the APRA Special Account for scheme administration costs.

Summary of new law

3.9 In addition to its previously existing functions, APRA is responsible for administering the FCS.

3.10 The Bill establishes Financial Claims Scheme Special Account and, subject to the Finance Minister's approval, allows APRA to borrow on behalf of the Commonwealth to help fund the amounts appropriated to meet depositor or policyholder entitlements on activation of the Financial Claims Scheme.

3.11 Amounts appropriated on activation of the scheme for its administration costs are handled through a separate APRA Special Account

3.12 APRA's annual reporting arrangements are updated to require it to include information on the operation of the scheme in relation to ADIs and general insurers.

Comparison of key features of new law and current law

New law	***Current law***
APRA's purpose is extended to include administration of the FCS.	APRA purpose relates to prudential regulation and retirement income standards.
Subject to the Finance Minister's approval, APRA is able to borrow on behalf of the Commonwealth to help fund the cost of FCS entitlements.	
Financial Claims Scheme Special Account is established to account for the funding of payments to depositors of policyholders under the FCS.	

New law	*Current law*
The costs of administering the FCS are accounted for in a separate APRA Special Account.	
APRA is required to include information about the operation of the FCS in its Annual Report.	

Detailed explanation of new law

APRA's functions and powers

3.13 APRA's existing purpose (as specified in section 8 of the APRA Act), functions (section 9 of the APRA Act) and powers (section 11 of the APRA Act) have a prudential regulation focus.

3.14 Under section 12 of the Banking Act, APRA has a duty to exercise its powers and functions under Division 2 of that Act for the protection of the depositors of the several ADIs and for the promotion of financial system stability in Australia. When undertaking its role as scheme administrator, APRA should have regard to these objectives and responsibilities.

3.15 The Bill extends APRA's purpose to include administering the financial claims scheme and developing the administrative practices and procedures to be applied in performing its regulatory role. ***[Schedule 1, item 38, subsection 8(1)]***

Funding arrangements

3.16 Payments to eligible depositors and policyholders under the FCS will initially be funded by the Commonwealth through an appropriation. These funds will be recovered in full through the liquidation of the failed institution, and, if necessary, by imposing a levy on the remaining firms within the relevant industry.

3.17 The legislation allows for the Treasurer to activate a maximum appropriation of up to $20 billion per failure. For the first three years the appropriation in relation to the EAFD will be unlimited.

3.18 Subject to the Finance Minister' approval ***[Schedule 1, item 49, Division 2, section 54E]***, APRA may borrow money on behalf of the Commonwealth. The amount borrowed must not exceed the amount

specified in the Ministerial determination activating the scheme. In turn, this amount cannot exceed $20 billion. ***[Schedule 1, item 15, section 16AD; item 26, section 62ZZC]***

Financial Claims Scheme Special Account

3.19 The Financial Claims Scheme Special Account is established as a Special Account for the purposes of the *Financial Management and Accountability Act 1997* ***[Schedule 1, item 49, section 54A]***. The Financial Claims Scheme Special Account is defined accordingly**.** ***[Schedule 1, item 37, subsection 3(1)]***

3.20 All amounts received by APRA, on behalf of the Commonwealth, via an appropriation and/ or under an approved borrowing arrangement to fund payments to depositors or policyholders must be credited to the Financial Claims Scheme Special Account. Amounts specified in the declaration activating the scheme, amounts borrowed and amounts appropriated for the purposes of the FCS can only be spent for the purposes of the Financial Claims Scheme Special Account. ***[Schedule 1, item 49, section 54B]***

3.21 The purpose of the Financial Claims Scheme Special Account is to make:

- payments to eligible depositors and policyholders under the Scheme; and
- repayments of any loans (the principle and interest) entered into using the borrowing power. ***[Schedule 1, item 50, section 54C]***

3.22 If a declaration by the Treasurer which activated the FCS is amended, this must be reflected in the amount credited to the Financial Claims Scheme Special Account. ***[Schedule 1, item 49, subsection 54B(2) and section 54D]***

APRA Special Account

3.23 The definition of the APRA Special Account is inserted and previous references to "the Account" are amended to refer to the relevant account(s) to reflect that there are two special accounts pertaining to APRA's functions. ***[Schedule 1, items 36, 40, 42, 43, 45]***

3.24 Amounts received under an appropriation for the costs of Scheme administration will be credited to the APRA Special Account. ***[Schedule 1, item 46, subsection 53(e)]***

3.25 For avoidance of doubt, it is made clear that any amounts for the purpose of the Financial Claims Scheme Special Account are not to be credited to the APRA Special Account. ***[Schedule 1, item 49, subsection 54B(2)]*** Further, any amounts standing to the credit of the APRA Special Account cannot be used for the purposes of the Financial Claims Scheme Special Account ***[Schedule 1, item 48, subsection 54(3)]***.

Special appropriations

3.26 Two standing special appropriations are authorised for the purpose of the FCS. These appropriations can be activated by a declaration by the Treasurer which will specify the maximum amounts to be appropriated.

3.27 The first standing special appropriation is for the purpose of making payments to depositors and policyholders. The maximum amount of this appropriation is $20 billion. For the first three years of the EAFD, the appropriation is unlimited. This amount is to be credited to the Financial Claims Scheme Special Account. ***[Schedule 1, item 49, section 54B]***

3.28 The second standing special appropriation is for the purposes of administering the scheme. The maximum amount of this appropriation is ($100 million). This amount is to be credited to the APRA Special Account. ***[Schedule 1, item 46, subsection 53(e)]***

3.29 The appropriation mechanism for the FCS will ensure that it can be established and make payments in an effective and timely manner once activated.

Borrowing power

3.30 APRA is authorised to borrow money, on behalf of the Commonwealth, for the purposes of making payments and administering the Financial Claims Scheme. ***[Schedule 1, item 49, section 54E]*** The borrowing power has the following features:

- borrowing is only authorised in circumstances where the Treasurer has activated the FCS and made a determination of the FCS payment costs in respect of that failure (that is, the money appropriated to APRA, for the purposes of making payments to depositors and policyholders, via the first special appropriation mechanism);

- the amount borrowed for a specific failure is limited to the total amount of the Treasurer's determination(s) of the cost of payments to be made under the scheme for that failure ***[Schedule 1, item 49, paragraph 54E(2)(a) and subsection 54E(3)]***; and

- the length of the loan agreement is limited to 12 months. ***[Schedule 1, item 49, paragraph 54E(2)(b)]***

3.31 The terms and conditions of any loan agreement are subject to the written approval of the Finance Minister prior to APRA entering into an agreement. ***[Schedule 1, item 49, subsection 54E(1)]***

- The Finance Minister has the ability to delegate this power. ***[Schedule 1, item 49, subsection 54E(5)]***

Financial Claims Scheme levies

3.32 Any money raised through an industry levy under the *Financial Claims Scheme (ADIs) Levy Act 2008* and *Financial Claims Scheme (General Insurers) Levy Act 2008*, are payable to the Commonwealth and must not be credited to the Financial Claims Scheme Special Account or the APRA Special Account. ***[Schedule 1, item 41, subsection 50(6); item 44, paragraph 53(d)]***

Amounts received in liquidation

3.33 Any amounts recovered by the scheme administrator from liquidation are to be returned to consolidated revenue and must not be credited to the APRA Special Account or the Financial Claims Scheme Special Account

Annual report

3.34 APRA is required to include information about the operation of the FCS in relation to ADIs and general insurers in its annual report. ***[Schedule 1, items 50, 51, section 59]***

Application and transitional provisions

3.35 The responsible Minister under the *Banking Act 1959* is permitted to make a declaration in relation to an ADI or general insurer subject to the satisfaction of commencement and condition requirements. ***[Schedule 1, item 15, section 64AD; item 26, section 62ZZC]***

3.36 A transitional period of 18 months is provided for disclosure requirements under the *Corporations Act 2001*, for matters related to the operation of the FCS. ***[Schedule 1, item 62]***

Consequential amendments

3.37 Consequential amendments required for the administration of the FCS include:

- Amending the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act) for decisions made by APRA in relation to the payment from the FCS. ***[Schedule 1, Part 4, item 53, paragraphs (hc) and (hd)]***

- Amending the *Corporations Act 2001* to include a reference to APRA for the purposes of the powers of Companies Auditors and Liquidators Disciplinary Board in relation to auditors and liquidators. ***[Schedule 1, Part 4, item 54, subsection 1292(2)]***

- Amending the *Financial Institutions Supervisory Levies Collection Act 1998* to provide for APRA's collection of industry levies under the Financial Claims Scheme (ADIs) Levy Act 2008 and *Financial Claims Scheme (General Insurers) Levy Act 2008*. ***[Schedule 1, Part 4, items 55, 56, 57, Parts 2, 3 and 3A]*** For constitutional reasons, each levy requires its own Act. The levy collection mechanism is similar to those already in place for the various financial institution supervisory levies that essentially funds APRA's prudential supervision operations and the Financial Assistance Levy relating to the superannuation sector.

- Amending the *Income Tax Assessment Act 1936* ***[Schedule 1, Part 4 item 58, subsection 202(q)]*** and *Taxation Administration Act 1953* ***[Schedule 1, Part 4, item 60, subsection 8WB(1A)]*** to account for the use of tax file numbers in the administration of the FCS. A separate chapter of this Explanatory Memorandum addresses these amendments.

- Amending the *Reserve Bank Act 1959* to allow the disclosure of information relevant to the Minister's decision in relation to the declaration activating the financial claims scheme in relation to a general insurer. ***[Schedule 1, Part 4, item 59, subsection 79A(2)]***

3.38 The amendment of the ADJR Act exempts from review under the ADJR Act decisions made by APRA, as administrator of the FCS, in relation to: the dollar amounts of individual entitlements of depositors under the FCS; and decisions as to whether a person has a valid claim against an insurer under the FCS as it relates to insurance.

3.39 This helps ensure that the scheme can be administered in a seamless and timely way. If depositors were able to challenge the decision of APRA about individual entitlements and amounts received, there is the potential to delay finalisation of payments to all depositors which could significantly complicate the management of the failure.

3.40 Similarly, the FCS is designed to ensure that eligible insurance claims are paid in a normal timeframe, rather than in the liquidation stage which is considerably more drawn out. As such, any mechanism which reviews APRA's decision to pay claims in a normal timeframe would seem to undermine the point of the FCS.

3.41 Curtailment of ADJR Act review rights does not in itself prevent a policyholder from pursuing what they believe is owed to them through the liquidation process.

Chapter 4
Use of tax file numbers

Outline of chapter

4.1 Part 4 of Schedule 1 to this Bill amends the taxation law to provide for the usage of tax file numbers (TFNs) to facilitate the administration of the Financial Claims Scheme (FCS).

Context of amendments

4.2 The Australian Prudential Regulation Authority (APRA) as administrator of the FCS needs to identify depositors in a failed authorised deposit-taking institution (ADI) to ensure that early access payments to depositors do not exceed the maximum amount per depositor. The TFN is a unique identifier that has been used by various government agencies to facilitate the administration of legislation.

Summary of new law

4.3 The Bill amends the *Banking Act 1959* to provide for the use of TFNs under the FCS to assist in identifying depositors in a failed ADI. The Bill also amends section 202 of the *Income Tax Assessment Act 1936* (ITAA 1936) to expand the objects of the TFN system to include the recording, use and disclosure of TFNs to facilitate the FCS. In addition, the Bill amends subsection 8WB(1A) of the *Taxation Administration Act 1953* (TAA 1953) to provide that an offence is not committed where a person records, uses or discloses TFNs for the purposes of the FCS.

Detailed explanation of new law

4.4 APRA is the administrator of the FCS and arranges for depositors in a failed ADI to have early access to their funds subject to a prescribed limit. In order for APRA to ensure that early access payments to depositors do not exceed the maximum prescribed limit per depositor under the FCS, TFNs and other personal information provided by

depositors to the failed ADI will be used to assist in identifying depositors.

4.5 Where depositors have quoted their TFN to an ADI that has become subject to the FCS, the Bill amends the *Banking Act 1959* to permit the TFN to be used for the purposes of administering the FCS. The TFN would be used in conjunction with other information, including personal information held by the ADI in order to identify total deposits held by depositors with that ADI. ***[Schedule 1, item 15, subsection 16AK(3) of the Banking Act 1959]***

4.6 The ADI would be able to disclose this information to APRA for the purposes of the administration of the FCS. It could also disclose it to any other recipients authorised by APRA to perform duties as part of the FCS.

4.7 In order to facilitate those purposes, the Bill amends the ITAA 1936 to permit the use of the TFN for the purposes of the FCS. ***[Schedule 1, item 58, paragraph 202(q) of the Income Tax Assessment Act 1936]***

Consequential amendments

4.8 A number of consequential amendments are required to prevent the recording, usage and disclosure of TFNs pursuant to paragraph 202(q) of the ITAA 1936 being treated as an offence against the secrecy provision in subsection 8WB(1) of the TAA 1953. The Bill contains amendments to subsection 8WB(1A) of the TAA 1953 to exclude from the offence provision, usage of the TFN in relation to the FCS. ***[Schedule 1, item 60,paragraphs 8WB(1A)(a) and (b)]***

Chapter 5
Other measures: banking

Outline of chapter

5.1 Schedule 2 of the Bill amends the *Banking Act 1959* (Banking Act) primarily to expand and enhance the duties, powers and functions of ADI statutory managers.

Context of amendments

5.2 APRA already has the power to become or appoint a statutory manager of an ADI under the Banking Act. A statutory manager replaces the board of the institution and has all the powers and functions of the board of directors of the distressed ADI.

5.3 At present, the underlying rationale in the appointment of ADI statutory managers is for them to act in the interests of depositors. When performing their functions for a financial institution, statutory managers should also have regard to the need for financial system stability, because of the economic significance of these institutions and the potential effects of their failure on economic and social stability.

5.4 The powers in the Banking Act for managing a distressed ADI are generally drafted as high-level principles, intended to allow APRA and a statutory manager to act in the interests of the ADI's depositors. However, the Corporations Act, Australian Securities Exchange (ASX) listing rules and the company's constitution currently limit a statutory manager's ability to deal with the share capital of an ADI. Restrictions on the statutory manager's powers may frustrate options for the resolution of financial institution distress.

5.5 Ministers have inherent powers to enter into contracts or arrangements, but the present need to obtain an appropriation prior to making payments under such arrangements may inhibit the Government's ability to act quickly in some circumstances.

Summary of new law

5.6 If an administrator of an ADI believes that a proposed course of action is likely to have a detrimental effect on financial system stability in Australia, the administrator must notify APRA and obtain APRA's consent before acting, unless it is not reasonably practicable to do so.

5.7 Terms in contracts including those made under the law of a foreign country that are enforceable in Australia relating to the appointment of a statutory manager or the use of APRA's directions powers are not grounds for a contract or a counterparty to deny obligations, accelerate debt or close out on any transaction under that contract.

5.8 In order to facilitate earlier and more effective intervention where necessary, the circumstances for commencement of statutory management or investigation have been broadened to include where APRA considers that in the absence of external support: the ADI *may* become unable to meet its obligations; the ADI *may* suspend payment; or, it is likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of depositors or financial system stability in Australia.

5.9 A statutory manager has powers to facilitate a recapitalisation through: issuing new shares or rights to acquire shares; selling those shares or rights; cancelling existing shares or rights; or varying or restricting rights attached to shares. A statutory manager also has powers to amend governance arrangements of an ADI. These powers override any potential restrictions in the Corporations Act, contracts, listing rules and company constitutions.

5.10 A person who proposes to appoint an external administrator to an ADI must give prior notice to APRA. A liquidator of an ADI that proposes to apply to Court in relation matters arising under the winding up must give prior notice to APRA.

5.11 The Minister may, with the written approval of the Finance Minister, authorise the making of contracts or arrangements for the main purposes of the Banking Act – that is, to protect the interests of depositors and financial system stability in Australia. Amounts up to a cap can be appropriated for making payments under such contracts or arrangements under the Banking Act, Insurance Act and Life Insurance Act.

Comparison of key features of new law and current law

New law	*Current law*
Current condition broadened to include where APRA considers that in the absence of external support: the ADI *may* become unable to meet its obligations; the ADI *may* suspend payment; or, it is likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of depositors or financial system stability in Australia.	APRA may appoint or become a statutory manager including where it considers that the ADI is *likely* to become unable to meet is obligations or that it is *about* to suspend payment.
Current powers broadened such that a statutory manager may recapitalise a financial institution by issuing new shares, selling shares, cancelling existing shares or varying or restricting rights attached to shares. A statutory manager may alter the governance arrangements of an ADI.	A statutory manager has the powers and functions of the board of directors of the ADI (collectively and individually), including the board's powers of delegation. A statutory manager may sell or dispose of the business of an ADI in whole or in part.
Current duties extended such that if a statutory manager of an ADI has reasonable cause to believe that a proposed course of action is likely to have a detrimental effect on financial system stability in Australia, they must notify APRA and obtain APRA's written consent before acting, unless it is not reasonably practicable to do so.	In taking on the powers and function of the members of the board of directors of an ADI, a statutory manager who is not APRA is under a primary duty to act in the interests of depositors, but may have a residual or secondary duty to act in the interests of the company as a whole, including shareholders.
The Minister may, with the approval of the Finance Minister, authorise the making of contracts or arrangements for the main purposes of the Banking Act. Amounts up to a cap can be appropriated for making associated payments.	Ministers have inherent powers to enter into contracts or arrangements on behalf of the Commonwealth. However, in order to be able to make payments under such arrangements an appropriation authority is required.

Detailed explanation of new law

Duties of administrator of ADI's business

5.12 An administrator of an ADI's business must advise APRA if they have reasonable cause to believe that the exercise of a function or

power by them is likely to have a detrimental effect on financial system stability in Australia. ***[Schedule 2, Item 14, Section 14DAA(1)]***

5.13 An administrator will not be able to exercise a function or power that may have a detrimental effect without receiving APRA's consent. This consent must be in writing, to ensure it is clear whether APRA has consented.

5.14 These additional duties are qualified to take into account circumstances where it may not be reasonably practicable for an administrator to meet its obligations, particularly if an action is urgent. However, there is an expectation that the administrator will advise APRA as early as possible of the action. ***[Schedule 2, Item 14 Section 14DAA(2)]***

5.15 Subsection 8(2) of the *Australian Prudential Regulation Authority Act 1998* provides that one of APRA's purposes in performing and exercising its functions and powers is to promote financial system stability in Australia. Further, subsection 12(1) of the Banking Act requires APRA to exercise its powers and functions for the protection of the depositors of the several ADI's and for the promotion of financial system stability in Australia.

5.16 The general requirement for APRA's prior consent to a proposed course of action will help avoid actions that may have a detrimental impact on financial system stability.

5.17 An administrator's failure to comply with these requirements will not invalidate their performance of a function or exercise of a power. ***[Schedule 2, Item 14, Subsection 14DAA(3)]***

5.18 The above requirements apply to administrators appointed on or after commencement. ***[Schedule 2, Item 15]***

No ending of contracts on directions or appointment of ADI statutory managers

5.19 ADIs are parties to contracts that allow them to participate in markets and access systems that are necessary for their operations. These contractual arrangements could include clauses that allow a counterparty to terminate the contract and demand immediate payment of amounts owed under the contract in circumstances, such as where a statutory manager is appointed or APRA issues directions to the institution.

5.20 For example, the Australian Payments Clearing Association regulations deem the appointment of a statutory manager an insolvency event, while the International Swaps and Derivatives Association master

agreement contains clauses that make the appointment of a statutory manager a defaulting event.

5.21 The operation of such contractual provisions would significantly affect an already weak ADI.

5.22 The Banking Act already specifies in sections 11CD and 15C that the appointment of a statutory manager or use of APRA's directions powers is not grounds for the counterparty to deny any obligations, accelerate any debt or close out on any transaction under a contract. The relevant provisions are silent on whether they apply to contracts governed by Australian law or the law of a foreign country.

5.23 The provisions are amended to make clear that they apply to whether the contract is governed by Australian law (including the law of a State or Territory) or the law of a foreign country, or part of a foreign country. The use of APRA's directions powers or the appointment of a statutory manager to an ADI is not grounds for the contract or the counterparty to the contract to deny obligations, accelerate any debt or close out on any transaction under a contract. ***[Schedule 2, Items 4, 5, and 18, Sections 11CD and 15C]***

5.24 Similar provisions to the above are also included where a statutory manager exercises recapitalisation powers (see below). ***[Schedule 2, Item 12, Sections 14AC]***

5.25 These amendments apply to contracts made after commencement. ***[Schedule 2, Items 6, 13 and 19]***

5.26 Currently, under section 15B of the Banking Act, appointing a statutory manager ceases all legal proceedings against the ADI, or in relation to the ADI's property, except where the APRA or Court has consented otherwise. It also prevents any person commencing new proceedings unless APRA or Court consents. An amendment to this section will clarify that this moratorium does not apply to criminal proceedings or civil penalty proceedings. This ensures that law enforcement can continue during statutory management, and is similar to the exemption for criminal proceedings and prescribed proceedings under section 440 of the Corporations Act. ***[Schedule 2, Items 17, Subsection 15B(1A)]***

Commencement of ADI statutory management

5.27 Under subsection 13A(1) of the Banking Act, subject to certain conditions, APRA may investigate the affairs of an ADI, take control of an ADI's business or appoint a person or administrator to perform these roles. An entity that takes control of an ADI under the section — either

APRA or an administrator appointed by APRA — is referred to as an ADI statutory manager.

5.28 Existing paragraph 13A(1)(b) of the Banking Act, which allows for statutory management or investigation where APRA considers that the ADI is *likely* to become unable to meet is obligations or that it is *about* to suspend payment, may be interpreted narrowly to imply that statutory management or investigation can only commence just prior to an imminent failure.

5.29 As interventions at an earlier stage may be more effective in some circumstances, paragraph 13A(1)(b) is amended in order to broaden the range of circumstances where a statutory manager or investigator can be appointed by APRA (or where APRA can commence performing these roles itself).

5.30 Paragraph 13A(1)(b) is amended so that APRA may act where it considers that in the absence of external support: the ADI *may* become unable to meet its obligations; the ADI *may* suspend payment; or, it is likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of depositors or financial system stability in Australia. ***[Schedule 2, Item 7, Paragraph 13A(1)(b)]***

5.31 Excluding external support from the condition is necessary in order to ensure statutory managers can be appointed despite the existence of arrangements such as the Government's guarantee of deposits under Schedule 1 Part 1 of the Banking Act.

5.32 The concept of external support can be clarified by regulations that specify a form of support for an ADI that that is not to be considered to be external support for the purposes of paragraph 13A(1)(b). ***[Schedule 2, Item 8, Subsection 13A(1A)]*** Initially it is envisioned that the regulations would exclude forms of support that are entered into in the normal course of business and industry support contracts certified by APRA under section 11CB of the Banking Act.

5.33 APRA must give the ADI notice that an ADI statutory manager will take, or is taking, control of the business. This is intended to allow APRA to specify a time at which statutory management commences in the notice. Statutory management commences at the time specified, or if no time is specified, at the time the notice is given. ***[Schedule 2, Item 9, Section 13BA]***

5.34 The requirement to give notice applies to decisions to take control of an ADI's business made after commencement. ***[Schedule 2, Item 10]***

5.35 APRA continues to have regulatory powers in relation to the ADI, which ensures the ADI is subject to ongoing prudential regulatory scrutiny while it is under statutory management. The provisions of the Banking Act and the *Financial Sector (Collection of Data) Act 2001* continue to apply. ***[Schedule 2, Item 18, Section 15D]***

5.36 This means the ADI under statutory management is still required to comply, as far as possible, with the prudential framework including capital adequacy and reporting requirements. APRA however also already has powers that could be used to exempt a specified person from specific requirements of the Banking Act. This power may be used to exempt the ADI from some prudential requirements, such as capital adequacy requirements, while the statutory manager is in control of the entity and is considering an appropriate course of action.

Powers of ADI statutory managers to facilitate recapitalisation

5.37 The recapitalisation of a financial institution is an internationally recognised method of resolving a failure and restoring the institution's health. Capital provided to a distressed institution provides a cushion to support any losses and it enhances its ability to operate competitively in the market. Importantly, it does not impose a repayment obligation on an already weak institution.

5.38 An ADI statutory manager may facilitate a recapitalisation through: issuing new shares or rights to acquire shares; selling those shares or rights; cancelling existing shares or rights; or varying or restricting rights attached to shares. The statutory manager could also reduce the company's share capital by cancelling any paid-up share capital that is not represented by available assets. ***[Schedule 2, Item 12, Section 14AA]***

5.39 As an example, a statutory manager could facilitate a capital injection into an ADI by issuing new shares and selling them to a new investor. Under this example the new investor would gain a stake in the company and pre-existing shareholders would have their stake in the company diluted but would retain their shares in the ADI.

5.40 In conjunction with the above, it would also be possible to cancel existing shareholders' shares, which for example could be used to facilitate a new investor taking 100 per cent control of an ADI.

5.41 The recapitalisation powers are intended to be strong and flexible, in order to allow a statutory manager to respond quickly and decisively to a range of circumstances.

5.42 Prior to undertaking an action to recapitalise the ADI, the statutory manager is required to obtain an independent valuation report, which sets out the expert's opinion of the fair value of the shares and rights affected. The statutory manager is required to consider the report, and may find the contents useful when considering fair valuations, but is not compelled to follow the recommendations of the report when determining the terms of a recapitalisation action. ***[Schedule 2, Item 12, Section 14AB]***

5.43 Existing section 69E of the Banking Act ensures that any action that would result in an acquisition of property from a person otherwise than on just terms would remain valid, with the Commonwealth liable to pay compensation of a reasonable amount as agreed with the person. Many potential recapitalisation actions however, are unlikely to result in an 'acquisition of property'. An example would be where existing shareholders' stakes in the company are diluted by the statutory manager issuing and selling new shares in the company.

5.44 The requirement applying to the expert valuation report, in relation to issuing, selling or cancelling shares, is similar to those of compulsory share acquisitions under the Corporations Act. Where the expert valuation report is required to give the fair value of rights attached to shares, the legislation does not prescribe how the valuation may be conducted, so as to provide flexibility to the expert valuer. This reflects the fact that there may be many types of rights attached to shares, and different valuation methods would be appropriate for different types of rights.

5.45 Whether the valuation report concerns issuing, selling or cancelling shares, or restricting or varying share rights, the Minister can give written notice to the expert valuer about valuation assumptions to be used in the report. The provisions specify that the instruments are not legislative instruments in order to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. ***[Schedule 2, Item 12, Subsections 14AB(4) and (6)]***

5.46 The statutory manager is also required to comply with further procedural requirements, such as notifying all affected shareholders. ***[Schedule 2, Item 12, Subsection 14AA(2)]***

5.47 The statutory manager may seek, from APRA, an exemption from the valuation report requirements. APRA may give this exemption if the APRA considers that taking the time needed to obtain and consider a valuation report would be detrimental to depositors' interests and the stability of the financial system. ***[Schedule 2, Item 12, Subsections 14AB(1) and (8)]***

5.48 An exemption made by APRA from the valuation requirement is not a legislative instrument. This provision is included to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. ***[Schedule 2, Item 12, Subsection 14AB(8)]***

5.49 In the interests of a timely recapitalisation, this power overrides any Corporations Act requirements, markets listing rules, any contractual arrangements and any provision in the entity's constitution. This means that members will not be able to seek members' remedies under the Corporations Act or seek a court injunction to delay the recapitalisation. Recapitalisation may also be effected even if the company constitution prohibits issuing a specified class of shares or prohibits a share issue unless certain 'entrenched' requirements are satisfied. ***[Schedule 2, Item 12, Subsection 14AA(4)]***

5.50 A recapitalisation transaction cannot be used to trigger default or protective clauses under a contract with the financial institution, so that the contract or the other party to the contract cannot deny contractual obligations, accelerate debts or close out transactions merely because the statutory manager has implemented a recapitalisation (see also earlier section above, on no ending of contractual obligations). ***[Schedule 2, Item 12, Section 14AC]*** This change applies only to contracts made after commencement. The recapitalisation powers themselves apply to statutory managers appointed before, on or after commencement of the schedule. ***[Schedule 2, Item 13]***

5.51 Acquisitions of shares in an ADI as a direct result of the use of the recapitalisation powers or acquisition of assets in a sale or disposal of the business in whole or in part by a statutory manager are authorised for the purposes of subsection 51(1) of the *Trade Practices Act 1974*. ***[Schedule 2, Item 20, Section 16AA]***

5.52 This exemption is intended to ensure that the transactions can occur quickly and give certainty to acquiring parties without formal competition review processes which may take some time. The Australian Competition and Consumer Commission (ACCC) can be consulted on the competition implications of such transaction under various other potential approval mechanisms, for example, the Treasurer's national interest decision under the *Financial Sector (Shareholdings) Act 1998*.

5.53 The automatic authorisation applies to acquisitions occurring after commencement. ***[Schedule 2, Item 21]***

Powers of ADI statutory managers to alter governance arrangements

5.54 An ADI statutory manager may alter the ADI's constitution, rules or other arrangements for governance where it may assist the statutory manager to perform its functions, duties and powers and it promotes the protection of the depositors of the ADI and financial system stability in Australia. ***[Schedule 2, Item 11]***

5.55 This provides the statutory manager with plenary flexibility, as the clauses in the company's constitution or its governance arrangements may hinder a quick and decisive resolution of the failing ADI's affairs. An example of when governance arrangements could be altered is as part of, or following, a decision to recapitalise an institution.

5.56 As per statutory managers' powers for facilitating recapitalisation, the power to alter governance arrangements overrides any Corporations Act requirements, markets listing rules, any contractual arrangements and any provision in the entity's constitution. As above, the powers apply to statutory managers appointed before on or after commencement of the schedule.

Notice to APRA of external administration of ADI

5.57 A person who proposes to appoint an external administrator to a ADI must give prior notice to APRA. APRA can be heard at these applications. This requirement ensures that APRA has timely notice of these applications and can respond appropriately where necessary. For example, APRA may wish to oppose the appointment of an external administrator under Chapter 5 of the Corporations Act or may instead choose to appoint a statutory manager to the ADI. ***[Schedule 2, Item 22 Section 62B]***

5.58 A person who applies for the appointment of an external administrator to an ADI without first notifying APRA commits a strict liability offence of up to 60 penalty units. ***[Schedule 2, Item 22 Section 62B]***

5.59 This is a strict liability offence, as it may be difficult to show that the person's omission to notify APRA in this circumstance was intentional. This provision provides maximum incentive for such persons to ensure APRA is notified prior to an application for an external administrator to be appointed to an ADI.

5.60 The definition of external administrator is moved from subsection 15A(5) to subsection 5(1), in order to apply it to the entire Act. ***[Schedule 2, Items 1 and 16]***

5.61 Where the liquidator of an ADI proposes to apply to Court in relation matters arising under the winding up of the ADI, it must give prior notice to APRA and APRA can be heard on the application. This provision is modelled on section 183 of the Life Insurance Act and ensures that APRA may make submissions on issues that affect the entity's depositors, or the stability of the financial system in Australia, where it is appropriate to do so. ***[Schedule 2, Item 22 Section 62C]***

Minister's power to authorise contracts or arrangements to protect depositors or financial stability

5.62 Ministers have inherent powers to enter into contracts or arrangements on behalf of the Commonwealth. However, in order to be able to make payments in accordance with Commonwealth's obligations under such contracts or arrangements an appropriation authority is required prior to drawing money from Consolidated Revenue. A special appropriation mechanism is introduced into the Banking Act in order to allow such authority to be obtained in a timely manner if required.

5.63 The Minister may, with the written approval of the Finance Minister, authorise the making of contracts or arrangements for the main purposes of the Banking Act – that is, to protect the interests of depositors and financial system stability in Australia. ***[Schedule 2, Item 23, Section 70C]***

5.64 This does not limit any other powers of the Minister to enter into contracts or arrangements.

5.65 The Minister must specify an amount in the authorisation to be credited to the Financial System Stability Special Account (the FSS Special Account).

5.66 The balance of the FSS Special Account attributable to such authorisations — total amounts credited under these authorisations but not yet expended for the purpose of meeting payments under authorised contracts or arrangements — must be less than $20,000,000,000 at any time. The amount specified can be amended but not revoked.

5.67 If the Minister has authorised a contract or arrangement, the Minister is also provided with a borrowing power, subject to the written approval of the Finance Minister. ***[Schedule 2, Item 23, Section 70D]***

5.68 The Minister may borrow on behalf of the Commonwealth for up to 24 months for amounts totalling not more than $20,000,000,000 at any time. The borrowing power is intended as a contingency measure in order to ensure that the Commonwealth could obtain sufficient liquidity to meet obligations under contracts or arrangements if payments were required at very short notice. If cash was available at the time from

Consolidated Revenue it is not envisioned that the use of the borrowing power would be required.

5.69 Similar provisions for authorising a contract or arrangement and associated borrowing are included in the Insurance Act ***[Schedule3, Item 26, Sections 131A and 131B]*** and Life Insurance Act. ***[Schedule 4, Item 34, Sections 251A and 251B]***

5.70 The FSS Special Account is established in the Banking Act in order to provide an appropriation authority for payments under contracts and arrangements authorised under the Banking Act, Insurance Act and Life Insurance Act. ***[Schedule 2, Item 23, Sections 70E to 70H]***

5.71 A special account is a ledger entry which records the right to draw money from the Consolidated Revenue Fund up to the balance of the account. The balance of a special account is increased by specifying amounts that are credited to the account, and such amounts can only be debited for the prescribed purposes of the account.

5.72 Amounts specified in authorisations in relation to contracts or arrangements authorised in the Banking Act, Insurance Act and Life Insurance Act provisions are credited to the FSS Special Account. Any amounts that are borrowed in connection with such authorisations are also credited to the FSS Special Account.

5.73 The balance of the FSS Special Account can only be spent on the purposes of the account. The main purpose of the account is making payments under contracts and arrangements authorised by the Minister. Repaying borrowings and meeting the expenses of administering the account are also prescribed as purposes of the account.

5.74 Finance Minister and Financial System Stability Special Account are defined in section 5(1). ***[Schedule 2, Items 2 and 3]***

Chapter 6
Other measures: general insurance

Outline of chapter

6.1 Schedule 3 of the Bill amends the *Insurance Act 1973* (Insurance Act) to establish a framework for the judicial management of certain general insurers, including foreign general insurers.

Context of amendments

6.2 The Insurance Act does not currently allow for the judicial management of general insurers. General insurers can be externally administered under the *Corporations Act 2001*, which requires the company to be administered in the interests of creditors or members. There is no framework that allows general insurers to be externally administered in the interests of policyholders and financial system stability in Australia.

6.3 The inability to apply to the Federal Court of Australia (the Court) for the appointment of a judicial manager to manage a general insurer is a gap in the Australian Prudential Regulation Authority's (APRA) powers to respond in circumstances where the affairs of the general insurer may warrant intervention.

6.4 Schedule 3 establishes a framework that enables general insurers to be judicially managed in the interests of policyholders and the stability of the financial system. The framework is broadly modelled on the judicial management arrangements in the *Life Insurance Act 1995*.

Summary of new law

6.5 APRA or a general insurer may apply to the Court for the appointment of a judicial manager.

6.6 The Court may appoint a judicial manager if the insurance business of the insurer has been investigated by APRA and the Court is satisfied that it is in the policyholders' interests. Alternatively, the Court can appoint a judicial manager if it is satisfied that the insurer (in the case

of a foreign general insurer, its insurance business in Australia) is insolvent, has failed to comply with prudential standards or an APRA direction, or that the financial position or management of the general insurer may be unsatisfactory.

6.7 Once appointed, the judicial manager is required to report to the Court and recommend a course of action. The judicial manager has the power of the board to manage the general insurer, and must do so in accordance with the Court's oversight and instructions.

6.8 The judicial manager must recommend to the Court that: the business is transferred to another insurer; the insurer carry on after a period of judicial management; the insurer be recapitalised; the insurer be wound up; or some other course of action. The Court may then make appropriate orders.

Comparison of key features of new law and current law

New law	*Current law*
A judicial manager can be appointed to a general insurer in certain circumstances, including where it is in the policyholders' interests. The judicial manager can recommend a course of action, including transfer of business, recapitalisation, or the winding up of the distressed general insurer.	There is no judicial management framework in place for general insurers. External administration of general insurers is currently contained within Chapter 5 of the Corporations Act, an arrangement that is not primarily concerned with policyholders' interests or financial system stability.

Detailed explanation of new law

6.9 The effect of schedule 3 of the Bill is outlined below. Where appropriate, any special or modified application to foreign general insurers is discussed. A 'foreign general insurer' is defined in section 3 of the Insurance Act as a body corporate that:

(a) is a foreign corporation within the meaning of paragraph 51(xx) of the Constitution; and

(b) is authorised to carry on insurance business in a foreign country; and

(c) is authorised under section 12 to carry on insurance business in Australia.

6.10 Where a general insurer is established in Australia as a stand-alone insurer or as a subsidiary of either an Australian or international general insurance group, it is an Australia-registered corporation that is subject to the full scope of the Corporations Act and relevant parts of the Insurance Act. Such an insurer will be subject to all the judicial management provisions.

Appointment of judicial manager and termination of judicial management

6.11 Schedule 3 establishes the framework for the judicial management of general insurers in certain circumstances. A general insurer that is authorised under the Insurance Act, including a foreign general insurer, may be placed under judicial management.

6.12 Part VB provides a framework for the judicial management of general insurers. However, it does not preclude persons from exercising their rights under the Corporations Act or other legislation, unless this is inconsistent with the judicial management framework. ***[Schedule 3, item 5, subsection 3(1) and item 11, section 62Q]***

6.13 The object clause in the Insurance Act is amended so that it includes a reference to judicial management of general insurers whose circumstances are unsatisfactory. These appointments are made to ensure the stability of the financial system in Australia and to protect the interests of policyholders. ***[Schedule 3, item 1, subsection 2A(2)]***

6.14 The concepts of policyholders' interests and financial system stability in Australia are broad and may be applied flexibility to assist APRA and the judicial manager to perform their functions and duties under the Insurance Act.

6.15 The general insurer or APRA may apply for the appointment of a judicial manager. However, a general insurer is required to give APRA at least one month's notice of its intention to apply. Both the general insurer and APRA will have the right to be heard at an application hearing. ***[Schedule 3, item 11, section 62K]***

6.16 A judicial manager may be appointed by the Court where APRA has conducted an investigation of the general insurer under Part V of the Insurance Act, and the Court is satisfied that it is in the interests of policyholders that a judicial manager is appointed. ***[Schedule 3, item 11, section 62L]***

6.17 Alternately, if the Court is satisfied that one or more of the following circumstances exist, and the time required to conduct or complete an investigation would be detrimental to policyholders' interests:

- The general insurer has become, or is likely to become, unable to pay its policy or other liabilities;
- in the case of a foreign general insurer, the entity has become, or is likely to become, unable to meet, from its assets in Australia, its liabilities in Australia other than pre-authorisation insurance liabilities as they fall due; ***[Schedule 3, item 6, subsection 3(1)]***
- the general insurer has failed to comply with a prudential standard;
- the general insurer has failed to comply with an APRA direction; or
- the management or financial position of the general insurer is unsatisfactory;

then a judicial manager can be appointed. ***[Schedule 3, item 11, section 62M]***

6.18 The Court may order the appointment of a judicial manager if the Court considers that at least one of the grounds for appointment is satisfied. ***[Schedule 3, item 11, section 62L and 62M]***

6.19 If the Court orders the appointment of a judicial manager, the order may specify that judicial management is taken to commence on a particular day and at a particular time. If the court does not so specify, judicial management is taken to commence when the order is made. This provision provides certainty as to commencement, and it also determines when the general insurer must cease making payments or issuing policies (a general insurer may not issue new policies after a judicial manager is appointed, unless it has the Court's consent). ***[Schedule 3, item 11, section 62N and subsection 62T(2)]***

6.20 If the Court orders the appointment of a judicial manager, it must also appoint a person to be the judicial manager. There are no restrictions on who can be appointed a judicial manager. The Court may set the remuneration and terms of appointment for the judicial manager. ***[Schedule 3, item 11, section 62R and 62S,]***

6.21 The Court may cancel the appointment of a particular judicial manager and appoint another person. ***[Schedule 3, item 11, section 62R]***

6.22 A judicial manager appointed by the Court displaces the incumbent management of the company. This provision is identical in its term to the equivalent provision in the Life Insurance Act, and ensures that the directors and the board of management cease to have control of the general insurer from the time the judicial manager is appointed. This

operates similarly to the appointment of an external administrator of a company under the Corporations Act. ***[Schedule 3, item 11, section 62T]***

6.23 Division 1 of Part VB, concerning judicial management, only applies to the foreign general insurer's business within Australia. ***[Schedule 3, item 11, subsection 62T(3) and section 62ZO]***

6.24 Foreign general insurers are required to comply with the Insurance Act and prudential standards. The foreign general insurer's assets in Australia and liabilities in Australia are affected by section 116A and the prudential standards. Section 116 of the Insurance Act requires all general insurers' assets in Australia to be applied to its liabilities in Australia on liquidation.

6.25 The test for appointing a judicial manager under subparagraph 62M(a)(ii) uses these concepts. Where a Court is satisfied that a foreign general insurer is likely to be unable to meet, from its assets in Australia, its liabilities in Australia (other than pre-authorisation liabilities) as they fall due, the Court will be able to order the appointment of a judicial manager. This test creates an artificial entity for the purposes of determining the solvency of a foreign general insurer's Australian operations. ***[Schedule 3, item 11, subsection 62M(a)(ii)]***

6.26 The appointment of a judicial manager affects other persons in relation to the general insurer. In particular, it affects external administrators that are, or will potentially be, appointed to the general insurer; persons who have, or are proposing to commence proceedings against the general insurer; and some persons who have entered contracts with the general insurer.

External administration

6.27 The following amendments ensure that a judicial manager appointed by the Federal Court takes precedence over other forms of company external administration, where it is considered necessary to protect policyholders' interests and/or ensure financial system stability.

6.28 Judicial management overrides any other form of external administration of the general insurer, as defined under Chapter 5 of the Corporations Act. ***[Schedule 3, item 11, section 62U and Schedule 3, items 27 to 31]***

6.29 A person who proposes to appoint an external administrator to a general insurer must give prior notice to APRA. APRA can be heard at an application hearing. This requirement ensures that APRA has timely notice of these applications and can respond where necessary. For example, APRA may wish to oppose the appointment of an external administrator under Chapter 5 of the Corporations Act on the grounds that

it has applied for, or intends to apply for, the appointment of a judicial manager. ***[Schedule 3, item 11, section 62ZQ]***

6.30 A person who applies for the appointment of an external administrator without first notifying APRA commits a strict liability offence. The maximum penalty for the offence is 60 penalty units. ***[Schedule 3, item 11, subsection 62ZQ(4)]***

6.31 This is a strict liability offence, as it may be difficult to show that the person's omission to notify APRA in this circumstance was intentional. This provision provides maximum incentive for such persons to ensure APRA is notified prior to an application for an external administrator to be appointed to a general insurer.

6.32 While a judicial manager is appointed to the entity, all other forms of external administration are terminated and no other external administrator can be appointed. A purported appointment of another form of external administration, in contravention of this provision, is invalid. This ensures, for example, that creditors of the company cannot enforce a lien or charge over company property by appointing a receiver or other external administrator. ***[Schedule 3, item 11, section 62U]***

6.33 However, the Insurance Act does not override other aspects of the Corporations Act. Absent the appointment of a judicial manager, creditors, ASIC and other persons may still exercise their rights under the Corporations Act to appoint other types of external administrators. Subject to the moratorium on all proceedings whilst a judicial manager is appointed, members, creditors and ASIC may also exercise their rights to wind up a general insurer (within the bounds of section 116, with requires all general insurers' assets in Australia to be first applied to its liabilities in Australia on liquidation). ***[Schedule 3, item 11, section 62ZP]***

Proceedings

6.34 Appointing a judicial manager ceases all legal proceedings against the general insurer, or in relation to the general insurer's property, except where the judicial manager or Court has consented otherwise. It also prevents any person commencing new proceedings unless the judicial manager or Court consents. ***[Schedule 3, item 11, section 62P]***

6.35 This provision is similar to the moratorium during external administration under section 440 of the Corporations Act, and ensures that the judicial manager has adequate powers to protect company assets. For example, creditors of the general insurer would not be able to use court proceedings to enforce a debt.

6.36 In some circumstances, the judicial manager may consent to proceedings being brought against the general insurer, because it may assist to clarify the general insurer's liability to a class of insureds. Doing so may save time and money for all parties. Such situations would be similar to external administrators who permit 'representative proceedings' to be brought, in order to determine whether the company owes liability to a party or parties.

6.37 This moratorium does not apply to criminal proceedings or civil penalty proceedings. This ensures that law enforcement can continue during judicial management, and is similar to the exemption for criminal proceedings and prescribed proceedings under section 440 of the Corporations Act. ***[Schedule 3, item 11, subsection 62P(2)]***

6.38 The judicial manager is not liable to anyone for refusing to consent to a person commencing or continuing proceedings against the general insurer. This provision gives the judicial manager protection against claims for damages or other losses suffered by creditors, shareholders or other persons as a result of this refusal.

Contractual obligations

6.39 A contract with the general insurer cannot be terminated, or contractual obligations owed to the general insurer avoided, on the grounds that a judicial manager has been appointed. Where contractual clauses provide for specified events as grounds to terminate or vary the contract, this provision would override those clauses.

6.40 Without such provisions, the appointment of a judicial manager is likely to be an 'event of default' or other 'specific event' under many commercial contracts. These 'events' may have a number of consequences that are detrimental to the continuing operations of the general insurer. Such events may entitle the other party to the contract to cease meeting their contractual obligations, such as performing business services. If the contract is a loan or a type of debt, such events may allow the creditor to ask for immediate payment of the amount outstanding under the loan, and may have additional penalty clauses attached. If the contract relates to other transactions or trades, such events may entitle the other party to close out these transactions and ask for immediate settlement of any outstanding accounts. ***[Schedule 3, items 12-15 and 11, section 62V]***

6.41 These provisions protect the financial position of the general insurer and policyholder interests until the judicial manager has had time to make an assessment as to an appropriate course of action. These provisions also ensure the judicial manager can allow the general insurer to continue trading if it is appropriate.

6.42 These provisions override any other form of external administration of a foreign general insurer. This would include receivers and receiver-controllers appointed over company assets. They also protect the foreign general insurer from proceedings against the company, and ensure that contractual obligations continue to be met by other parties.

6.43 The scope of these provisions is limited because a judicial manager would only have management of the Australian operations of the foreign general insurer. Therefore, the protections given under these provisions would only apply to the part of the foreign general insurer's operations that is under the judicial manager's control.

6.44 Where proceedings or contractual obligations relate to a part of the business that is in the general insurer's country of registration or another country, the protection given by these provisions would not be available.

APRA's powers in relation to the general insurer and judicial manager

6.45 The provisions of the Insurance Act and the *Financial Sector (Collection of Data) Act 2001* continue to apply to a general insurer under judicial management. This means the general insurer under judicial management is still required to comply with the prudential framework including capital adequacy, audit and actuarial requirements. APRA may, however, exempt a specified person from specific requirements of the Insurance Act (section 7) modify the application of particular prudential standards (section 32) or issue a direction to the general insurer in certain circumstances (section 104). ***[Schedule 3, item 11, section 62W]***

6.46 The general insurer under judicial management is required to submit returns under the *Financial Sector (Collection of Data) Act 2001*. This maintains a key element of APRA's supervisory process.

6.47 APRA may also request information from the judicial manager at any stage of judicial management. The request for information must relate to the conduct of judicial management or the financial circumstances of the entity, including whether it is solvent. APRA may require information to be given within a specified, reasonable, time and the judicial manager must comply with the request. ***[Schedule 3, item 11, section 62ZD]***

6.48 APRA can apply to the Court for the Court to give directions to the judicial manager. APRA is required to give prior notice to the judicial manager, and the judicial manager can be heard. ***[Schedule 3, item 11, section 62ZC]***

6.49 This is in addition to APRA's power to make submissions in any proceedings relating to judicial management.

Powers and obligations of the judicial manager

6.50 The management of the general insurer vests in the judicial manager, which gives the judicial manager all the powers of the board of directors and management of the general insurer. This gives the judicial manager the flexibility to continue trading and issuing policies (subject to Court approval) if doing so would assist the general insurer's future viability and protect existing policyholders. The judicial manager has powers to take various actions in the name of the general insurer, and has additional powers necessary to effectively perform its functions. These powers include disposing of assets, obtaining credit, bringing and defending legal proceedings and proving in bankruptcy. The Court may also direct the judicial manager to exercise any other powers. ***[Schedule 3, item 11, section 62Y and subsection 62T(2)]***

6.51 Once appointed, the judicial manager is subject to the Court's control and is required to manage the general insurer economically and efficiently. ***[Schedule 3, item 11, sections 62X and 62ZG]***

6.52 The judicial manager may apply to the court for instructions concerning the management of the general insurer. Before the judicial manager makes the application, it is required to give notice to APRA and APRA can be heard on the application. ***[Schedule 3, item 11, subsection 62X(3) to (5)]***

6.53 The judicial manager has the power to disclaim onerous property, under Division 7A of Part 5.6 of the Corporations Act. This essentially gives the power that a liquidator has under the Corporations Act to the judicial manager to disclaim onerous property of the general insurer. It can disclaim property that consists of land burdened with onerous covenants, shares, property that is unsaleable or may give rise to a liability or onerous obligation or a contract. ***[Schedule 3, item 11, section 62ZH]***

6.54 The judicial manager is not liable for anything done in good faith, while performing their functions. This protects the judicial manager and ensures that they can effectively perform their functions and duties in relation to the entity without the fear of future liability. ***[Schedule 3, item 11, section 62ZM]***

Report by the judicial manager and Court orders

6.55 The judicial manager has the obligation to report to the Court as soon as possible and recommend a course of action. A course of action

ordered by the Court is binding on all persons. The recommended course of action may include: transfer of business of the general insurer; continuing to carry on insurance business after a period of judicial management; recapitalise the general insurer; wind up the general insurer; or any other course of action considered desirable.

Reporting to court

6.56 Once appointed, the judicial manager is required to compile a report for the Court on the financial circumstances of the entity. In the report, the judicial manager must recommend a course of action for the general insurer with a view to acting in the general interests of the policyholders while promoting financial system stability in Australia. This procedure is modelled on the reporting procedure established by Part 8 of the Life Insurance Act. ***[Schedule 3, item 11, section 62ZI,]***

6.57 The judicial manager may make one or more reports to the court, where it is necessary to do so. ***[Schedule 3, item 11, subsection 62ZI(4)]***

6.58 After filing the report with the Court, the judicial manager is required to give a copy of the report to APRA. APRA may be heard on applications by the judicial manager to give effect to recommendations in the report. APRA, as the prudential regulator, is therefore informed of the progress of judicial management and is able to support, oppose or suggest modifications to the report recommendations. ***[Schedule 3, item 11, subsection 62ZI(6)]***

6.59 In the report, the judicial manager must recommend a course of action for the general insurer, or different courses of action for different parts of the general insurer's business. The recommendations are not limited by legislation, but may include: the transfer of business of the general insurer to another general insurer; allow the general insurer to carry on business after period of judicial management; wind up the general insurer; or take such other course of action as the judicial manager considers desirable (which might include altering the company constitution rules, or other arrangements for governance). ***[Schedule 3, item 11, subsection 62ZI(2)]***

6.60 The broad scope of these recommendations ensures that the judicial manager can recommend action that is appropriate for the circumstances of the general insurer so as to protect the policyholders' interests while promoting financial system stability in Australia.

6.61 One of the recommendations that can be made by the judicial manager is to change the company's constitution, rules or other arrangements for governance, where it may assist the judicial manager to perform its functions and duties as a judicial manager.

6.62 This possible recommendation provides the judicial manager with flexibility, as the clauses in the company's constitution or its governance arrangements may hinder a quick and decisive resolution of the failing general insurer's affairs.

6.63 When the judicial manager applies to the Court, the Court may give any order that it considers advantageous to the general interests of policyholders, while promoting financial system stability in Australia. The Court may vary the recommended action or make any other orders it considers appropriate. The Court's order is binding despite the Corporations Act, the company's constitution, any contract to which the general insurer is a party, or the listing rules of a financial market. ***[Schedule 3, item 11, section 62ZJ]***

Recapitalisation

6.64 The recapitalisation of a financial institution is an internationally recognised method of addressing a distressed institution and restoring the institution's financial health. Capital provided to a distressed institution provides a cushion to support any losses and it enhances its ability to operate competitively in the market. Importantly, it does not impose a repayment obligation on an already weak institution.

6.65 A judicial manager may facilitate a recapitalisation: through issuing new shares or rights to acquire shares; selling those shares or rights; cancelling existing shares or rights; or varying or restricting rights attached to shares. The judicial manager could also reduce the company's share capital by cancelling any paid-up share capital that is not represented by available assets. ***[Schedule 3, item 11, section 62Z]***

6.66 As an example, a judicial manager could facilitate a capital injection into a general insurer by issuing new shares and selling them to a new investor. Under this example the new investor would gain a stake in the company and pre-existing shareholders would have their stake in the company diluted but would retain their shares in the company.

6.67 As an alternative to the above, it would also be possible to cancel existing shareholders' shares, which, for example, could be used to facilitate a new investor taking 100 per cent control of a general insurer.

6.68 The recapitalisation powers are intended to be strong and flexible in order to allow a judicial manager to respond quickly and decisively to a range of circumstances.

6.69 A judicial manager of a foreign general insurer would not be able to issue new shares in the entity, or write down or cancel existing shares, where the senior management of the Australian branch does not

have such powers. All other powers and recommendations are open to the judicial manager.

6.70 Prior to undertaking an action to recapitalise the general insurer, the judicial manager is required to obtain an independent valuation report which sets out the expert's opinion of the fair value for each of the shares and rights, or the fair value of the rights affected. The judicial manager is required to consider the report, and may draw on its content, but is not compelled to follow the recommendations of the report when determining the terms of a recapitalisation action. ***[Schedule 3, item 11, subsection 62ZA(2)]***

6.71 Section 127A ensures that any action that would result in an acquisition of property from a person otherwise than on just terms would remain valid, with the Commonwealth liable to pay compensation of a reasonable amount as agreed with the person. Many potential recapitalisation actions however, are unlikely to result in an 'acquisition of property'. An example would be where existing shareholders' stakes in the company are diluted by the statutory manager issuing and selling new shares in the company. ***[Schedule 3, Item 25, section 127A]***

6.72 The requirements applying to the expert valuation report, in relation to issuing, selling or cancelling shares, are similar to those of compulsory share acquisitions under the Corporations Act. Where the expert valuation report is required to give the fair value of rights attached to shares, the legislation does not prescribe how the valuation may be conducted so as to provide flexibility to the expert valuer. This reflects the fact that there may be many types of rights attached to shares and different valuation methods would be appropriate for different types of rights. ***[Schedule 3, item 11, section 62ZA]***

6.73 Where the valuation report concerns issuing, selling or cancelling shares, or restricting or varying share rights, the Minister can give written notice to the expert valuer about the valuation assumptions to be used in the report (these provisions specify that the instruments are not legislative instruments in order to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act). ***[Schedule 3, item 11, subsections 62ZA(4) and (6)]***

6.74 The judicial manager is also required to comply with further procedural requirements, such as notifying all affected shareholders. ***[Schedule 3, item 11, section 62Z(2)]***

6.75 APRA may determine that there is to be an exemption from the valuation requirement. APRA may give this exemption if it considers that it is in the interests of policyholders, and where applicable, the stability of the financial system, for recapitalisation to be completed before the valuation report is completed, as the time needed to complete a valuation

report would be detrimental to policyholders' interests or the stability of the financial system. ***[Schedule 3, item 11, subsections 62ZA(1) and (8)]***

6.76 An exemption made by APRA from the valuation requirement is not a legislative instrument (this provision is included to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act). ***[Schedule 3, item 11, subsections 62ZA(8) and (10)]***

6.77 In the interests of a timely recapitalisation, this power overrides any Corporations Act requirements, markets listing rules, any contractual arrangements and any provision in the entity's constitution. This means that members will not be able to seek members' remedies under the Corporations Act or seek a court injunction under that Act to delay the recapitalisation. This means that recapitalisation may occur even if the company constitution prohibits issuing a specified class of shares or prohibits a share issue unless certain 'entrenched' requirements are satisfied. The judicial manager may also amend the company constitution, rules or other governance arrangements to carry out recapitalisation. ***[Schedule 3, items 11, subsection 62Z(4)]***

6.78 A recapitalisation transaction cannot be used to trigger default or protective clauses under a contract with the general insurer, so that the other party to the contract cannot deny contractual obligations, accelerate debt payments or close out transactions merely because the judicial manager has implemented a recapitalisation. This limitation only applies to contracts made after the commencement of the section. ***[Schedule 3, item 11, section 62ZB and item 12]***

6.79 The recapitalisation mechanism above ensures the judicial manager has power to carry out the transaction effectively and quickly. At the same time, it protects the interests of those affected by the transaction, particularly the entity's shareholders.

Business transfer

6.80 If the court orders that the general insurer's business be transferred to another entity, the judicial manager is required to formulate a transfer scheme under Division 3A of Part III of the Insurance Act. The Court must approve a transfer under Division 3A. Approval may also be required for a transfer under the *Insurance Acquisitions and Takeovers Act 1991*. ***[Schedule 3, items 7-8 and 11, section 62ZK]***

Exemption from competition assessments

6.81 A range of actions taken by the judicial manager are exempt from competition assessment under the *Trade Practices Act 1974*. This is

because a competition assessment may frustrate, unduly delay or create undue uncertainty in relation to action that promotes the interests of policyholders and financial system stability in Australia. Such an exemption ensures that the judicial manager and APRA have maximum flexibility when considering ways to rehabilitate a distressed general insurer. ***[Schedule 3, item 11, section 62ZN]***

Ending judicial management

6.82 Judicial management continues until it is cancelled by the Court or the general insurer is wound up. The judicial manager, APRA and any other interested person may apply to Court for the cancellation of judicial management. Where the judicial manager or another interested person applies for the cancellation, they must give prior notice to APRA and APRA can be heard on the application. ***[Schedule 3, item 11, sections 62ZE and 62ZF]***

6.83 If the Court cancels the appointment of the judicial manager and does not appoint another judicial manager under section 62R, the management of the entity will vest in the board of directors or other governing body. ***[Schedule 3, item 11, sections 62R and 62ZF(5)]***

6.84 The judicial manager can resign the appointment as judicial manager for any reason, however they must do this by filing their resignation with the Court. ***[Schedule 3, item 11, section 62ZL]***

External administration and winding up

External administration

6.85 Under the Corporations Act, a person who makes an application to a Court to appoint an external administrator must give APRA written notice of the application. ***[Schedule 3, item 11, section 62ZQ and item 2, subsection 3(1)]***

Winding up

6.86 APRA is able to apply to Court to wind up a general insurer under the Insurance Act rather than under Chapter 5 of the Corporations Act, after an investigation into the insurer's affairs. The Insurance Act provisions allow the Court to wind up the general insurer if this is in the policyholders' interests. This provision is modelled on section 181 of the Life Insurance Act. ***[Schedule 3, item 11, section 62ZU and items 27 to 31]***

6.87 If an order to wind up a general insurer is made under the Insurance Act, the winding up process is conducted in accordance with Corporations Act winding up provisions. ***[Schedule 3, item 11, section 62ZV]***

6.88 APRA will also have an additional role during the wind up of a general insurer. Where the liquidator of a general insurer proposes to apply to court in relation to a winding up, they must give prior notice to APRA and APRA can be heard on the application. This provision is modelled on section 183 of the Life Insurance Act and ensures that APRA may make submissions on issues that affect the entity's policyholders, or the stability of the financial system in Australia, where it is appropriate to do so. This power relates to winding up initiated under the Corporations Act as well as winding up initiated under the Insurance Act. ***[Schedule 3, item 11, section 62ZR]***

6.89 APRA can also apply to the Court for directions in relation to any matter in the winding up of the general insurer. This ensures that APRA may make submissions on issues that affect the entity's policyholders, or the stability of the financial system in Australia, where it is appropriate to do so. This power relates to winding up initiated under the Corporations Act as well as winding up initiated under the Insurance Act. ***[Schedule 3, item 11, section 62ZS]***

6.90 In addition, APRA can request information from the liquidator concerning the liquidation of the entity. This ensures that APRA has access to information that may be relevant to protecting the interests of the entity's policyholders. Where APRA is administering the Financial Claims Scheme in respect of the general insurer, APRA will also be able to access information that would assist its functions as scheme administrator. ***[Schedule 3, item 11, section 62ZT]***

Compensation for acquisition of property

6.91 Section 127A is inserted into the Insurance Act and provides that if the operation of the Act results in an acquisition of property by the Commonwealth on unjust terms, the Commonwealth is liable to pay compensation. This schedule provides a mechanism to determine the compensation payable. ***[Schedule 3, Item 25, section 127A]***

Minister's power to authorise contracts or arrangements to protect policyholders or to promote financial stability

6.92 Ministers have inherent powers to enter into contracts or arrangements on behalf of the Commonwealth. However, in order to be able to make payments in accordance with the Commonwealth's obligations under such contracts or arrangements an appropriation

authority is required. A special appropriation mechanism is introduced into the Banking Act in order to allow such authority to be obtained in a timely manner if required.

6.93 The Minister may, with the written approval of the Finance Minister, authorise the making of contracts or arrangements for the purposes of protecting the interests of policyholders and financial system stability in Australia. ***[Schedule 3, item 3, subsection 3(1) and item 26, section 131A]***

6.94 This does not limit any other powers of the Minister to enter into contracts or arrangements.

6.95 The Minister must specify an amount in the authorisation to be credited to the Financial System Stability Special Account (the FSS Special Account). ***[Schedule 3, item 4, subsection 3(1)]***

6.96 The FSS Special Account is established in the Banking Act in order to provide an appropriation authority for payments under contracts and arrangements authorised under the Banking Act, the Insurance Act and the Life Insurance Act. ***[Schedule 2 item 23, sections 70E to 70H]***

6.97 The balance of the FSS Special Account attributable to such authorisations – total amounts credited under these authorisations but not yet expended for the purpose of meeting payments under authorised contracts or arrangements – must be less than $10,000,000,000 at any time. The amount specified can be amended but not revoked.

6.98 If the Minister has authorised a contract or arrangement, the Minister is also provided with a borrowing power, subject to the written approval of the Finance Minister. ***[Schedule 3, item 26, section 131B]***

6.99 The Minister may borrow on behalf of the Commonwealth for up to 24 months for amounts totalling not more than $10,000,000,000 at any time. The borrowing power is intended as a contingency measure in order to ensure that the Commonwealth could obtain sufficient liquidity to meet obligations under contracts or arrangements if payments were required at very short notice. If cash was available at the time from consolidated revenue it is not envisioned that the use of the borrowing power would be required.

6.100 Similar provisions for authorising a contract or arrangement and associated borrowing are to be included in the Banking Act and Life Insurance Act. ***[Schedule 2, item 23, sections 70C and 70D, and schedule 4, item 34, sections 251A and 251B]***

6.101 The authorisation by the Minister regarding the making of contracts or arrangements takes effect from the time it is made. The exclusion of an authorisation under this Part from the effect of subsections 12(1) and 12(2) of the *Legislative Instruments Act 2003* is necessary to ensure that delays in the registration do not unduly delay an authorisation which is ultimately done in the interests of policyholders or financial system stability in Australia.

Pre-authorisation liabilities; assets and liabilities in Australia

6.102 Sections 28 and 116 of the Insurance Act are being amended to distinguish between a general insurer's liabilities before and after becoming authorised (under section 12 of the Act) to carry on insurance business in Australia. Note that the amendment to section 116 is applied retrospectively. However, the retrospective application of this amendment does not amount to an acquisition of a property right on unjust terms and would be beneficial to policyholders with current policies that have purchased insurance from the general insurer after it was authorised should it be wound up. ***[Schedule 3, items 6, 9, 10, 16 and 17]***

6.103 Section 116A of the Insurance is being amended to apply its modified definitions of 'assets in Australia' and 'liabilities in Australia' to the judicial management regime in Part VB. This will ensure that the consideration of assets and liabilities in determining a general insurer's solvency for the purposes of the judicial management regime will be consistent with the existing provisions of the Insurance Act. ***[Schedule 3, items 18-24]***

Application and transitional provisions

6.104 These provisions apply to transactions or contracts entered into, or Court applications lodged, after the commencement of these provisions. ***[Schedule 3, items 12 – 15, and section 2A of Insurance Act 1973]***

Chapter 7
Other measures: life insurance

Outline of chapter

7.1 Schedule 4 of the Bill amends the *Life Insurance Act 1995* (Life Insurance Act) to strengthen the judicial management framework in line with the amendments to the *Insurance Act 1973*.

Context of amendments

7.2 The Life Insurance Act already contains an adequate judicial management framework. However, key amendments would ensure the judicial manager has power and flexibility to manage a failing life insurer, implement the arrangements or changes necessary to enable the company to become financially viable again and promote financial system stability in Australia.

Summary of new law

7.3 This schedule gives the judicial manager of a life insurer the key additional power to facilitate the recapitalisation of a life insurance company.

7.4 The amendments also ensure that judicial management has priority over all other forms of external administration under the Corporations Act.

Comparison of key features of new law and current law

New law	*Current law*
Judicial managers of life insurers will have additional powers to recapitalise the company, as well as change its constitution, rules or other governance arrangements. Where a judicial manager is appointed, it overrides other forms of external administration under Chapter 5 of the Corporations Act.	Judicial managers lack the power to recapitalise a life insurer or alter its governance arrangements. Judicial managers do not have explicit authority that supersedes other external administrators.

Detailed explanation of new law

Financial system stability in Australia

7.5 The object clause in the Life Insurance Act is amended so that it includes a reference to judicial management of a life insurer whose circumstances are unsatisfactory. These appointments are made to ensure the stability of the financial system in Australia and to protect the interests of policyholders. ***[Schedule 4, item 1, subsection 3(2)(d) and item 15, subsection 175(1)(a)]***

Judicial management and other external administration

7.6 The following amendments ensure that a judicial manager appointed by the Federal Court takes precedence over other forms of company external administration, where it is considered necessary to protect policyholders' interests and/or ensure financial system stability.

7.7 Judicial management overrides any other form of external administration of the life insurer, as defined under Chapter 5 of the Corporations Act. ***[Schedule 4, item 11, section 165A and items 2 and 35]***

7.8 If the Court orders the appointment of a judicial manager, the order may specify that judicial management is taken to commence on a particular day and at a particular time. If the court does not so specify, judicial management is taken to commence when the order is made. This provision provides certainty as to commencement. ***[Schedule 4, items 3-5 and 9-10]***

7.9 There is no explicit requirement on who can be a judicial manager. ***[Schedule 4, items 8 and 38]***

7.10 A person who proposes to appoint an external administrator to a life insurer must give prior notice to APRA. APRA can be heard at an application hearing. This requirement ensures that APRA has timely notice of these applications and can respond where necessary. For example, APRA may wish to oppose the appointment of an external administrator under Chapter 5 of the Corporations Act on the grounds that it has applied for, or intends to apply for, the appointment of a judicial manager. ***[Schedule 4, item 25, section 179C]***

7.11 A person who applies for the appointment of an external administrator without first notifying APRA commits a strict liability offence. The maximum penalty for the offence is 60 penalty units. ***[Schedule 4, item 25, subsection 179C(4)]***

7.12 This is a strict liability offence, as it may be difficult to show that the person's omission to notify APRA in this circumstance was intentional. This provision provides maximum incentive for such persons to ensure APRA is notified prior to an application for an external administrator to be appointed to a life insurer.

7.13 While a judicial manager is appointed to the entity, all other forms of external administration are terminated and no other external administrator can be appointed. A purported appointment of another form of external administration, in contravention of this provision, is invalid. This ensures, for example, that creditors of the company cannot enforce a lien or charge over company property by appointing a receiver or other external administrator. ***[Schedule 4, item 11, section 165A]***

7.14 However, the Life Insurance Act does not override other aspects of the Corporations Act. Absent the appointment of a judicial manager, creditors, ASIC and other persons may still exercise their rights under the Corporations Act to appoint other types of external administrators. Subject to the moratorium on proceedings whilst a judicial manager is appointed, members, creditors and ASIC may also exercise their rights to wind up a life insurer. ***[Schedule 4, item 25, section 179B]***

7.15 Where the liquidator of a life insurer proposes to apply to court in relation to a winding up, they must give prior notice to APRA. ***[Schedule 4, item 26, subsection 183(1)]***

7.16 APRA can currently request information from the liquidator concerning the liquidation of the entity under section 185. This ensures that APRA has access to information that may be relevant to protecting the interests of the entity's policyholders. An additional note will clarify that action can be taken against the liquidator who does not comply with such a request. ***[Schedule 4, item 27]***

Contractual obligations

7.17 A contract with the life insurer cannot be terminated, or contractual obligations owed to the life insurer avoided, on the grounds that a judicial manager has been appointed. Where contractual clauses provide for specified events as grounds to terminate or vary the contract, this provision would override those clauses.

7.18 Without such provisions, the appointment of a judicial manager is likely to be an 'event of default' or other 'specific event' under many commercial contracts. These 'events' may have a number of consequences that are detrimental to the continuing operations of the life insurer. Such events may entitle the other party to the contract to cease meeting their contractual obligations, such as performing business services. If the contract is a loan or a type of debt, such events may allow the creditor to ask for immediate payment of the amount outstanding under the loan, and may have additional penalty clauses attached. If the contract relates to other transactions or trades, such events may entitle the other party to close out these transactions and ask for immediate settlement of any outstanding accounts. This applies to contracts made after the commencement of this section. ***[Schedule 4, item 11, section 165B and item 12]***

7.19 These provisions protect the financial position of the life insurer and policyholder interests until the judicial manager has had time to make an assessment as to an appropriate course of action. These provisions also ensure the judicial manager can allow the life insurer to continue trading if it is appropriate.

7.20 Similarly to the situation outlined above, a contract with the life insurer cannot be terminated, or contractual obligations owed to the life insurer avoided, on the grounds that the life insurer has been subject to an APRA direction under section 230B. ***[Schedule 4, item 31, subsection 230C(1) and items 32 and 33]***

Stay of proceedings

7.21 Currently, under section 160 of the Life Insurance Act, appointing a judicial manager ceases all legal proceedings against the life insurer, or in relation to the life insurer's property, except where the judicial manager or Court has consented otherwise. It also prevents any person commencing new proceedings unless the judicial manager or Court consents.

7.22 An amendment to this section will clarify that this moratorium does not apply to criminal proceedings or civil penalty proceedings. This ensures that law enforcement can continue during judicial management,

and is similar to the exemption for criminal proceedings and prescribed proceedings under section 440 of the Corporations Act. ***[Schedule 4, items 6 and 7]***

Recapitalisation

7.23 The recapitalisation of a financial institution is an internationally recognised method of addressing a distressed institution and restoring the institution's financial health. Capital provided to a distressed institution provides a cushion to support any losses and it enhances its ability to operate competitively in the market. Importantly, it does not impose a repayment obligation on an already weak institution.

7.24 A judicial manager may facilitate a recapitalisation: through issuing new shares or rights to acquire shares; selling those shares or rights; cancelling existing shares or rights; or varying or restricting rights attached to shares. The judicial manager could also reduce the company's share capital by cancelling any paid-up share capital that is not represented by available assets. ***[Schedule 4, item 13, section 168A]***

7.25 As an example, a judicial manager could facilitate a capital injection into a life insurer by issuing new shares and selling them to a new investor. Under this example the new investor would gain a stake in the company and pre-existing shareholders would have their stake in the company diluted but would retain their shares in the company.

7.26 As an alternative to the above, it would also be possible to cancel existing shareholders' shares, which, for example, could be used to facilitate a new investor taking 100 per cent control of a life insurer.

7.27 The recapitalisation powers are intended to be strong and flexible in order to allow a judicial manager to respond quickly and decisively to a range of circumstances.

7.28 Prior to undertaking an action to recapitalise the life insurer, the judicial manager is required to obtain an independent valuation report which sets out the expert's opinion of the fair value for each of the shares and rights, or the fair value of the rights affected. The judicial manager is required to consider the report, and may draw on its content, but is not compelled to follow the recommendations of the report when determining the terms of a recapitalisation action. ***[Schedule 4, item 13, subsection 168B and items 15-22]***

7.29 The requirements applying to the expert valuation report, in relation to issuing, selling or cancelling shares, are similar to those of compulsory share acquisitions under the Corporations Act. Where the expert valuation report is required to give the fair value of rights attached

to shares, the legislation does not prescribe how the valuation may be conducted so as to provide flexibility to the expert valuer. This reflects the fact that there may be many types of rights attached to shares and different valuation methods would be appropriate for different types of rights. ***[Schedule 4, item 13, section 168B]***

7.30 Where the valuation report concerns issuing, selling or cancelling shares, or restricting or varying share rights, the Minister can give written notice to the expert valuer about the valuation assumptions to be used in the report (these provisions specify that the instruments are not legislative instruments in order to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act). ***[Schedule 4, item 13, subsections 168B(4) and (6)]***

7.31 The judicial manager is also required to comply with further procedural requirements, such as notifying all affected shareholders. ***[Schedule 4, item 13, section 168A(2)]***

7.32 APRA may determine that there is to be an exemption from the valuation requirement. APRA may give this exemption if it considers that it is in the interests of policyholders, and where applicable, the stability of the financial system, for recapitalisation to be completed before the valuation report is completed, as the time needed to complete a valuation report would be detrimental to policyholders' interests or the stability of the financial system. ***[Schedule 4, item 13, subsections 168B(1) and (8)]***

7.33 An exemption made by APRA from the valuation requirement is not a legislative instrument (this provision is included to assist readers, as the instrument is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act). ***[Schedule 4, item 13, subsections 168B(8) and (10)]***

7.34 In the interests of a timely recapitalisation, this power overrides any Corporations Act requirements, markets listing rules, any contractual arrangements and any provision in the entity's constitution. This means that members will not be able to seek members' remedies under the Corporations Act or seek a court injunction under that Act to delay the recapitalisation. This means that recapitalisation may occur even if the company constitution prohibits issuing a specified class of shares or prohibits a share issue unless certain 'entrenched' requirements are satisfied. The judicial manager may also amend the company constitution, rules or other governance arrangements to carry out recapitalisation. ***[Schedule 4, items 13, subsection 168A(4)]***

7.35 A recapitalisation transaction cannot be used to trigger default or protective clauses under a contract with the life insurer, so that the other party to the contract cannot deny contractual obligations, accelerate debt

payments or close out transactions merely because the judicial manager has implemented a recapitalisation. This limitation only applies to contracts made after the commencement of the section. ***[Schedule 4, item 13, section 168C and item 14]***

The recapitalisation mechanism above ensures the judicial manager has power to carry out the transaction effectively and quickly. At the same time, it protects the interests of those affected by the transaction, particularly the entity's shareholders.

Business transfer

7.36 Prior to a Court confirming a transfer of life insurance business scheme, the Court must have regard to the interests of policyholders, and if a report relevant to all or part of the scheme has been filed with the Court under section 175, the contents of the report. ***[Schedule 4, items 28-30]***

Exemption from competition assessments

7.37 A range of actions taken by the judicial manager are exempt from competition assessment under the *Trade Practices Act 1974*. This is because a competition assessment may frustrate, unduly delay or create undue uncertainty in relation to action that promotes the interests of policyholders and financial system stability in Australia. Such an exemption ensures that the judicial manager and APRA have maximum flexibility when considering ways to rehabilitate a distressed life insurer. ***[Schedule 4, item 23, section 179A]***

7.38 This applies to acquisitions occurring on or after commencement of this provision. ***[Schedule 4, item 24]***

Minister's power to authorise contracts or arrangements to protect policyholders or financial stability

7.39 Ministers have inherent powers to enter into contracts or arrangements on behalf of the Commonwealth. However, in order to be able to make payments in accordance with the Commonwealth's obligations under such contracts or arrangements an appropriation authority is required. A special appropriation mechanism is introduced into the Banking Act in order to allow such authority to be obtained in a timely manner if required.

7.40 The Minister may, with the written approval of the Finance Minister, authorise the making of contracts or arrangements for the

purposes of protecting the interests of policyholders and financial system stability in Australia. ***[Schedule 4, item 34, section 251A and item 36]***

7.41 This does not limit any other powers of the Minister to enter into contracts or arrangements.

7.42 The Minister must specify an amount in the authorisation to be credited to the Financial System Stability Special Account (the FSS Special Account). ***[Schedule 4, item 37]***

7.43 The FSS Special Account is established in the Banking Act in order to provide an appropriation authority for payments under contracts and arrangements authorised under the Banking Act, the Insurance Act and the Life Insurance Act. ***[Schedule 2 item 23, sections 70E to 70H]***

7.44 The balance of the FSS Special Account attributable to such authorisations — total amounts credited under these authorisations but not yet expended for the purpose of meeting payments under authorised contracts or arrangements — must be less than $10,000,000,000 at any time. The amount specified can be amended but not revoked.

7.45 If the Minister has authorised a contract or arrangement, the Minister is also provided with a borrowing power, subject to the written approval of the Finance Minister. ***[Schedule 4, item 34, section 251B]***

7.46 The Minister may borrow on behalf of the Commonwealth for up to 24 months for amounts totalling not more than $10,000,000,000 at any time. The borrowing power is intended as a contingency measure in order to ensure that the Commonwealth could obtain sufficient liquidity to meet obligations under contracts or arrangements if payments were required at very short notice. If cash was available at the time from consolidated revenue it is not envisioned that the use of the borrowing power would be required.

7.47 Similar provisions for authorising a contract or arrangement and associated borrowing are to be included in the Banking Act and Insurance Act. ***[Schedule 2, item 23, sections 70C and 70D, and schedule 3, item 26, sections 131A and 131B]***

7.48 The authorisation by the Minister regarding the making of contracts or arrangements takes effect from the time it is made. The exclusion of an authorisation under this Part from the effect of subsections 12(1) and 12(2) of the *Legislative Instruments Act 2003* is necessary to ensure that delays in the registration do not unduly delay an authorisation which is ultimately done in the interests of policyholders or financial system stability in Australia.

Chapter 8
Other measures: transfers of business

Outline of chapter

8.1 Schedule 5 of the Bill amends the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Business Transfer Act) in order to provide for greater flexibility and certainty when arranging for a compulsory transfer of business from a distressed ADI.

Context of amendments

8.2 Part 4 of the Business Transfer Act contains compulsory transfer of business powers that could be used to transfer business from a distressed ADI to a healthy ADI that was willing to receive (purchase) the business. However, present restrictions may impact on the use of these powers to manage a distressed ADI.

8.3 Part 4 also provides for compulsory transfers of business between life insurers.

8.4 The Act also provides for voluntary transfers of business and restructures of ADI corporate groups, however no changes are proposed to these provisions as they are less likely to be used in the resolution of a distressed ADI.

Summary of new law

8.5 Amendments to the Business Transfer Act will broaden the compulsory transfer of business powers to allow transfers from an ADI to a non-ADI entity and to allow further transfers of associated business functions from an entity related to an ADI that is also transferring business. These changes could be used to facilitate transfers of business to a bridge bank or asset management company if such entities were ever established. The flexibility to break up an institution in this way could also be used to facilitate the sale of parts of a distressed institution to one or multiple buyers.

8.6 Further amendments to the Act also provide greater reassurance that compulsory transfers of business could be used effectively should they need to be applied to a distressed ADI. These include: clarifying that the Commonwealth is liable for any challenges for acquisition of property otherwise than on just terms in order to provide certainty for the institution agreeing to receive business under the Act; and allowing greater flexibility in the circumstances when the compulsory transfer provisions can be used by allowing for a Ministerial determination that a transfer should occur.

Comparison of key features of new law and current law

New law	*Current law*
No change.	Compulsory transfers of business can be made from a life insurer to another life insurer.
The following types of compulsory transfers of business can be made: • from an ADI to another ADI; • from an ADI to a non-ADI (in relation to non-banking business); and • in connection with one of the above, associated transfers from an entity related to the original transferring ADI to a body that is, or is related to, the original receiving body.	Compulsory transfers of business can be made from an ADI to another ADI that agrees to receive business. Transfers cannot only relate to non-banking business.

Detailed explanation of new law

Changes to types and preconditions for effecting compulsory transfers of business

8.7 Existing section 25 of the Business Transfers Act allows APRA to make a compulsory transfer determination between two regulated bodies of the same type – that is, from an ADI to an ADI or from a life insurance company to another life insurance company.

8.8 There are no substantial changes to the operation of compulsory transfers between life insurance companies. Parts of the framework for making such transfers have been re-enacted to separate them from the changes made to ADI arrangements. ***[Schedule 5, Item 7, subsection 25(1C)]***

8.9 Arrangements for transfers from one ADI to another largely remain unchanged but are now set out separately from the life insurance provisions and from new transfer types. ***[Schedule 5, Item 7, Subsection 25(1)]***

8.10 The main difference for ADI to ADI transfers is to introduce an ability for the Minister to declare in writing that a transfer of business should occur from a specified ADI. ***[Schedule 5, Item 13, Section 25A]*** This mechanism is designed to give greater flexibility to authorities as to when a compulsory transfer can be undertaken. This recognises that it is difficult to predict all circumstances when a compulsory transfer of business may be useful in facilitating an appropriate resolution option.

8.11 If such a determination is made APRA no longer needs to be satisfied that another condition in new section 25(1)(a) is met before making a compulsory transfer determination (although other conditions in section 25, including that APRA has considered the interests of depositors and considers that the transfer is appropriate, must still be satisfied).

8.12 New powers are introduced to enable a transfer from an ADI to a non-ADI entity. ***[Schedule 5, Item 7, Subsection 25(1A)]*** In practice such transfers can only be of unregulated business as non-ADI entities are not authorised by APRA to undertake banking business, including deposit-taking activities. Non-ADI entities receiving business could be a private business willing to purchase a non banking part of the ADIs business. Transfers could be made to an asset management company set up for the purpose of receiving such business.

8.13 Transfers can be made from an ADI to a non-ADI for the same reasons as a transfer to an ADI (as set out in paragraph 25(1)(a)) or alternatively if APRA has already made a partial transfer from the transferring ADI to an ADI of regulated business. The latter arrangement allows an ADI to be broken up into banking and non-banking entities, or could allow greater flexibility in how a receiving group of companies structures business received under a compulsory transfer.

8.14 If APRA is making, or has made within a reasonable period, a compulsory transfer from an ADI to an ADI or non-ADI, APRA may also make a determination that there is to be a compulsory transfer from a body that is related to the ADI (that is not an ADI, life insurer or general insurer) to another body that is the original receiving body or is related to the original receiving body. ***[Schedule 5, Item 7, Subsection 25(1B)]***

8.15 The purpose of allowing such related transfers is to allow for the transfer of important business functions that may be required for the operation of the ADI, but are performed by another entity within its corporate group. Such functions could be transferred along with the

ADI's business in order to allow preserve the continued effective operation of the ADI's business functions.

8.16 Items 1 to 6 and 8 to 11 are consequential to the above restructuring of section 25 or of the broadening of transferring and receiving bodies that can be involved in a compulsory transfer. ***[Schedule 5, Items 1 to 6 and 8 to 11]***

8.17 Amendments made to section 8, 24 and 25 apply to the making of determinations on, or after commencement. ***[Schedule 5, Item 19]***

8.18 Determinations made by APRA under section 25 or declarations made by the Minister under section 25A are not legislative instruments. The provisions specify that the instruments are not legislative instruments in order to assist readers, as they are not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. ***[Schedule 5, Item 12 and Item 13 Section 25A(2)]***

Compulsory transfers not grounds for denying obligation

8.19 A compulsory transfer of business or actions related to effecting a compulsory transfer of business cannot be used to trigger default or protective clauses under a contract with the financial institution, so that the contract or the other party to the contract cannot deny contractual obligations, accelerate debts or close out transactions merely because the statutory manager has implemented a recapitalisation (see also similar provisions in Schedule 2, on no ending of contractual obligations). ***[Schedule 5, Item 14]***

8.20 This change applies only to contracts made after commencement. ***[Schedule 5, Item 19]***

Interaction with the Trade Practices Act

8.21 A compulsory transfer of business or anything done to enable or facilitate a compulsory transfer of business are authorised for the purposes of subsection 51(1) of the *Trade Practices Act 1974*. ***[Schedule 5, Items 15 to 17]***

8.22 This exemption is intended to ensure that the transfer can occur quickly and give certainty to acquiring parties without formal competition review processes which may take some time. The Australian Competition and Consumer Commission (ACCC) must be consulted on the competition implications of a compulsory transfer under paragraph 26(2)(a) of the Business Transfer Act and can be consulted under various other potential approval mechanisms, for example, the

Treasurer's national interest decision under the *Financial Sector (Shareholdings) Act 1998*.

8.23 The automatic authorisation applies to transfers occurring after commencement. ***[Schedule 5, Item 19]***

Compensation for the acquisition of property

8.24 Existing section 44 of the Business Transfer Act ensures that any action that would result in an acquisition of property from a person otherwise than on just terms would remain valid, with the receiving body liable to pay compensation of a reasonable amount as agreed with the person.

8.25 Amendments to section 44 are made to clarify that the Commonwealth is liable for any challenges for acquisition of property otherwise than on just terms under a compulsory transfer. This is intended to provide certainty for the institution agreeing to receive business from a transferring body. Receiving bodies remain liable for compensation for acquisitions of property otherwise than on just terms arising from a voluntary transfers of business or restructure under parts 3 or 4A of the Act. ***[Schedule 5, Item 18]***

8.26 This change applies to acquisitions of property occurring on or after commencement. ***[Schedule 5, Item 19]***

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Item 34, Sections 251A and 251B	5.69
Item 37	7.42

Schedule 5:

Bill reference	***Paragraph number***
Items 1 to 6 and 8 to 11	8.16
Item 7, Subsection 25(1)	8.9
Item 7, Subsection 25(1A)	8.12
Item 7, Subsection 25(1B)	8.14
Item 7, subsection 25(1C)	8.8
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