2006 Annual Review

I·S·I The Investment Savings and Insurance Association of New Zealand Inc

Annual Review of The Investment Savings and Insurance Association of New Zealand Inc for the Year Ended 30 June 2006












The Investment Savings and Insurance Association of New Zealand Inc

Vance Arkinstall *Chief Executive*

Deborah Keating *Executive Officer*

Street Address

Level 12, City Chambers
Cnr of Featherston and Johnston Streets
Wellington
New Zealand

Postal Address

PO Box 1514
Wellington 6015
New Zealand

Telephone 64 4 473 8730
Facsimile 64 4 471 1881
E-mail isi@isi.org.nz

Web www.isi.org.nz

Board of Directors

in order of appearance:

Greg Camm *Chairman*	AMP Financial Services
Sean Carroll *Deputy Chairman*	Asteron Life Ltd
Nicholas Scarlett	AIA New Zealand
Ralph Stewart	AXA New Zealand
Anthony Nichol	BNZ Life Insurance Ltd
Bryce Marsden	BT Funds Management Ltd
Gail Costa	CIGNA Life Insurance NZ Ltd
Milton Jennings	Fidelity Life Assurance Co Ltd
Marc Lieberman	ING New Zealand Ltd
Peter Birmingham	Medical Assurance Society
Pat Waite	Public Trust
Tony Hildyard	TOWER New Zealand

our aims

- One of the key objectives of the ISI is to work to secure the future of New Zealanders. The Association does not just represent the interests of its member companies, but works to ensure that New Zealanders are provided with the best options to secure their own future through savings, investment and the protection they receive from insurance.
- ISI's formal mission is to play a leading role in the development of the social, economic and regulatory framework in which our members operate with the objectives of:
  - promoting a legislative, regulatory and tax environment in which member companies can operate successfully;
  - promoting integrity in the industry;
  - delivering a strong cohesive industry body; and
  - enhancing the image and reputation of the industry.

key points

- ISI has welcomed the long-awaited reduction in distortions between the tax treatment of direct and indirect investments represented by the Taxation (Annual Rates, Savings Investment and Miscellaneous Provisions) Bill which contains extensive amendments to the taxation of collective investments.
- ISI welcomed the introduction of the KiwiSaver Bill following many years of work by the industry to demonstrate the need for encouragement of work-based saving for retirement.
- ISI participated in working group discussions with the Ministry of Economic Development on regulation of life insurance, superannuation and other collective investments as part of the Review of Financial Products and Providers.
- ISI also engaged in extensive consultation with the Ministry of Economic Development on their proposals for the regulation of financial intermediaries.
- Over the year ended 30 June 2006, total managed fund assets for the industry grew by 10% from $55.4 billion to $61 billion.
- In force annual premium income for life insurance business increased by 7.9% from $1.17 billion to $1.26 billion.
- In the year to 30 June 2006 ISI members paid policyholders $390.4 million in death benefits, $208.8 million in policy maturity payments and $166.7 million in other benefits such as income replacement.

ISI recommends:

Removing taxation distortions from investment decisions, and taxing investors' income at their marginal tax rates.

Encouragement to boost personal savings.

Co-regulation to increase investors' confidence in financial advice.

from the Chairman

The year to 30 June 2006 has felt like the turn onto the final straight at the end of a marathon. We have finally reached the point where we can see positive changes being made to two major issues for ISI members: retirement savings and taxation of collective investments. We have committed a great deal of time and energy over the years to consultation with officials on these issues. As well as taxation and savings, ISI has been involved from the start in consultation on the regulation of financial intermediaries and we are pleased to see that the finishing post is in sight on that issue as well.

A function of any industry organisation is to pull together members' views on issues of concern and to make sure those views are expressed in the appropriate places.

ISI has been urging successive governments for many years to amend the tax treatment of collective investments. Our submission to the Committee of Experts on Tax Compliance in 1998 identified the multiplicity of tax regimes for collective investments and the compliance issues involved in administering them. In subsequent submissions to various tax reviews since then we have pointed out the detrimental effect on personal savings of the lack of neutrality in tax treatment across savings vehicles and jurisdictions. We have continued to advocate taxation of investment income at the marginal rate of the investor and neutrality between direct and indirect investment.

The ISI view is that growth of collective investment vehicles in New Zealand has been hampered by having tax treatment dependent on:

- **Whether an investment is made directly, or indirectly through a collective investment vehicle;**
- **Whether an investment is onshore or offshore;**
- **Whether the investment is on capital or revenue account; and**
- **The nature and legal structure of the savings vehicle.**

For that reason, we welcomed the Tax Bill when it was introduced in May as a significant move towards neutrality in tax treatment of investment income. While the treatment of international investments is not ideal, the Bill represents a major improvement for people saving in collective investments. There has been a lot of dissent whipped up amongst individual direct investors in respect of the Bill's treatment of offshore investments and we agree that the proposed regime is not the optimal solution. With the objective of achieving neutrality between direct and indirect investment and domestic and offshore investment, we recommended exemption from tax on capital gains on equity investment in all except a few 'blacklist' countries. Failing that, ISI members would be prepared to accept the current proposals as long as the discount was increased from 15% to 50%.

Workplace superannuation is the other area where we have seen a major step forward, after years of apparent lack of interest by successive Governments in New Zealand's dismal personal savings rate. We welcomed the introduction of the KiwiSaver Bill as recognition that some action by the Government was needed to encourage personal savings. While ISI has a philosophical preference for minimal intervention by the state, we believe that savings products have not been competing in a neutral environment. The distortions in tax treatment referred to above have created significant disincentives to saving, fuelling an unhealthy level of non-productive investment in residential housing at the expense of more diversified financial investment. The new regime introduced by the May Tax Bill will remove the disincentive of over-taxation of investment income in superannuation schemes, enabling the KiwiSaver scheme to compete for the savings dollar on a level playing field.

Despite the removal of tax disincentives, ISI members see significant drawbacks in the technical design of the KiwiSaver scheme, which we have raised with Officials and the Select Committee. We applaud the Government's decision to take action on the savings issue, but have doubts about whether the current design will achieve the objective of increasing personal savings. For any significant improvement in savings levels in the long term, it is likely that further consideration will need to be given to some level of compulsory contribution to the scheme.

As noted above, the regulation of financial intermediaries is the other area in which there has been movement this year. In December 2005 Cabinet agreed in principle to a co-regulatory regime which would require financial intermediaries who give personal financial advice to belong to an Approved Professional Body ("APB") and have their details recorded on a public register. ISI supports the direction of policy development, as long as we don't get carried away on a wave of regulatory enthusiasm. Regulation should not be seen as the solution to every problem, or a way to micro-manage a particular industry. In the case of financial intermediaries, we believe regulatory intervention should be limited to setting up a framework, within which the APBs would set the standards for competence and business practices and intermediaries would be able to be held accountable by consumers for the quality of their advice.

We finished the year on a relatively positive note, knowing that we are not really nearing the end of a marathon but hopeful that at least we will be running on a level track.

Greg Camm
Chairman

the Year in Review

The past year has seen activity across a wide range of issues, to the extent that the landscape of the industry will be significantly changed when these activities are finally bedded down into legislation. Adapting to these changes will be a challenge for industry participants.

Overall, it has been an interesting and highly successful year in virtually all those areas where we have sought some action, with serious work undertaken in removing tax distortions, encouraging savings, increasing investor confidence, reviewing the out of date Life Insurance Act and improving the quality of personal financial advice.

Taxation

The introduction of the Taxation (Annual Rates, Savings Investment and Miscellaneous Provisions) Bill in May represented the culmination of a long period of consultation with IRD and Treasury Officials.

The objectives of the Bill align closely with the industry's long standing call for the Government to remove distortions in the tax legislation that provide advantages for direct equity investors and investment in property over collective investments. The proposals for domestic investment are welcomed, including the extension of domestic investment to include listed equities in Australia. The proposals for international equity investment are far from satisfactory, however, and some amendment of the Bill as a result of the Select Committee process is almost certain. We are hopeful that the complexity of the proposals will be reduced and that there will be an increased discount for offshore investment income subject to taxation.

ISI welcomed the deferral of implementation of the new domestic regime until 1 October 2007 and the announcement of a review of the tax treatment of life insurance that we anticipate will enable life insurance to participate in the PIE regime. These announcements demonstrated that the industry's concerns on both these points had been well received and acted upon.

Savings Policies

The introduction of the KiwiSaver Bill in February represented another significant change in the business environment for ISI members. ISI supported the objectives of the Bill but submitted to the Select Committee that a number of amendments were needed to ensure that it would succeed in changing savings behaviour and increasing the rate of personal saving. Our concern was that the scheme would not achieve its objectives because its approach is not sufficiently bold to prompt a long-term change in savings behaviour. ISI members would incur considerable costs to provide schemes and have no way of recovering those costs if there was limited uptake.

At time of writing the Select Committee has made a number of important changes to the Bill. Deferral of the implementation date for three months until 1 July 2007 will provide a relief for product providers, helping them to have new systems fully tested and operational by time the first contributions are received.

A welcome surprise came in the form of Government's announcement that Specified Superannuation Contribution Withholding Tax ("SSCWT") would not apply to employer contributions equal to the employee contributions up to a maximum of 4%. This small but important change provides encouragement to employers to support KiwiSaver and represents a major change of attitude by Government. The Minister of Finance acknowledged in a radio interview that NZ was the only developed country that does not offer either tax incentives or compulsion to generate personal savings. It is not a coincidence that NZ consistently has one of the lowest personal savings rates of OECD countries.

Regulation

The level of activity around regulation has been very high, particularly the last 6 months.

The MED discussion paper on regulation of financial intermediaries, issued in July 2006, follows the work done in 2005 by the Task Force on the regulation of financial intermediaries and discussions between MED and industry during the first half of 2006. We had hoped that the discussion document would show some development in thinking on the issues that have been comprehensively discussed since the Task Force was established in August 2004. ISI will continue to work closely with all parties, particularly the Institute of Financial Advisers, but we believe it is time for MED to place firm proposals on the table.

ISI members committed considerable time and resources to consultation with officials as part of the Review of Financial Products and Providers led by the Ministry of Economic Development. At the time of writing the release of nine discussion papers expected from this work was imminent. This Review has the potential to make major changes to the regulation of the financial services industry and it is therefore essential that we respond to the discussion documents.

Human Rights

Late in 2005 the Human Rights Commission announced their intention to review the Human Rights Insurance Guidelines and an ISI working group has been in consultation with the Commission as it drafts a discussion paper for public consultation.

The current Guidelines were released in 1996 and, based on the low level of complaints received by the Human Rights Commission, we believe the industry has done a good job of working with them. However, improvements are undoubtedly achievable and there are areas in which we would welcome greater clarity. We will participate in the consultation process in a cooperative and welcoming fashion.

Money Laundering

During the past year ISI has responded to two discussion documents from the Ministry of Justice on proposals for complying with international (Financial Action Task Force) recommendations for combating money laundering and the financing of terrorism. While we recognise that New Zealand needs to comply with international obligations, we consider that any additional regulation should be shown to be justified and cost effective.

IFRS

ISI established a working group to review the impact of the introduction of International Financial Reporting Standards ("IFRS"). The major impact identified was the 'debt/equity issue' where the application of IAS 32 will have the effect of classifying the equity of unit trusts and superannuation schemes as financial liabilities, due to their limited legal life and their ultimate obligation to transfer financial assets to unitholders/members.

The International Accounting Standards Board agreed to the release of an Exposure Draft of an amendment to IAS 32 to require classification as equity in specific circumstances. However, at time of writing further work is required as there does not appear to be any way that solution can be in place by 1 January 2007.

Other Legislative Changes

Securities Legislation Bill and Regulations

ISI submitted comments on both the Bill and a discussion document on the regulations but the Bill has not yet completed its passage through the House and no further information has been received on the regulations.

Financial Reporting Act

ISI submitted comments to MED in February 2006 on the review of the Financial Reporting Act. Amendments to the Act have appeared in the Business Law Reform Bill 2006.

Research

ISI collaborated with our Australian counterpart, IFSA, in July to commission research on the extent of under insurance (and reasons for it) in respect of income protection insurance.

Tax Treatment of Income Protection

For some years ISI has been asking Inland Revenue for clarification of the tax treatment of income protection insurance. We have made some progress on this issue this year and anticipate it being resolved as part of the review of life office taxation.

Vance Arkinstall
Chief Executive

Industry overview

Funds Under Management

Unlisted retail investment funds under management by New Zealand fund managers as at 30 June 2006 amounted to $17.83 billion, up from $17.76 billion at 30 June 2005*.

The total was made up of:

Total FUM ($ millions)

and Change from previous year

Unit trusts	7,657.2	+4.5%
Superannuation trusts	6,080.9	+6.5%
Group investment funds	2,873.8	+17.6%
Insurance bonds	1,213.7	-5.4%

Source: Morningstar Research Retail Managed Investments Market Share Report

Despite the overall increase in funds under management there was a $ 228.8 million net outflow of funds during the year to 30 June 2006. This net outflow does not necessarily indicate people deserting the funds management market, but continues a trend away from stand-alone retail schemes into master trusts and wrap accounts which are not included in the Morningstar Research Retail Managed Investments Market Share Report.

In order to provide a full picture of the movement of funds under management within the industry (both retail and wholesale) we have again included comparisons from the Reserve Bank series which includes wholesale funds and other life insurance funds. The "other funds" category includes funds managed on behalf of charities and non-profit organisations.

Managed fund assets measured by the Reserve Bank grew by 10% from $55.4 billion at 30 June 2005 to $61 billion at 30 June 2006.

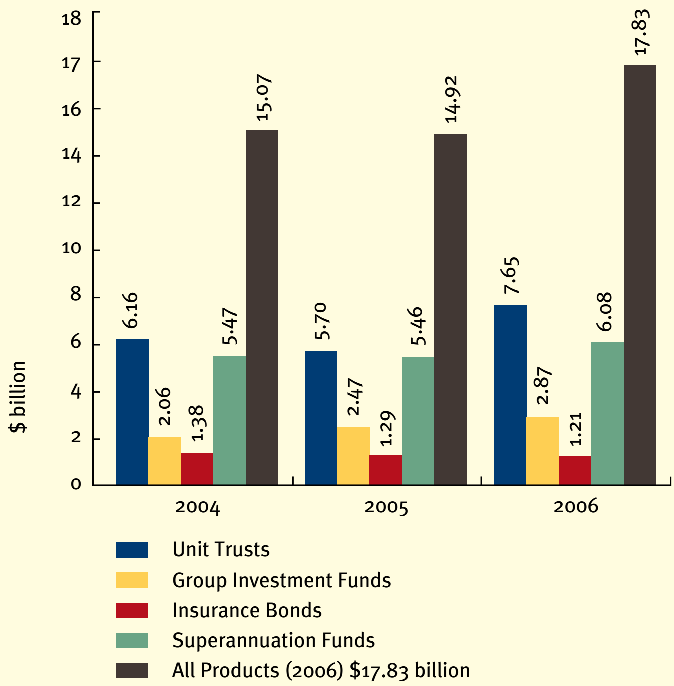
Managed Fund Assets ($ millions)

and Change from previous year

Unit trusts and GIFs	18,436	+11.3%
Life Insurance		
Unitised	1,751	-6.1%
Non-unitised	7,030	+1.5%
Superannuation		
Employee	12,716	+6.7%
Other	6,631	+9.0%
Other Funds	14,452	+20.7%

Source: Reserve Bank Table C15 Managed Fund Assets, by Product Category

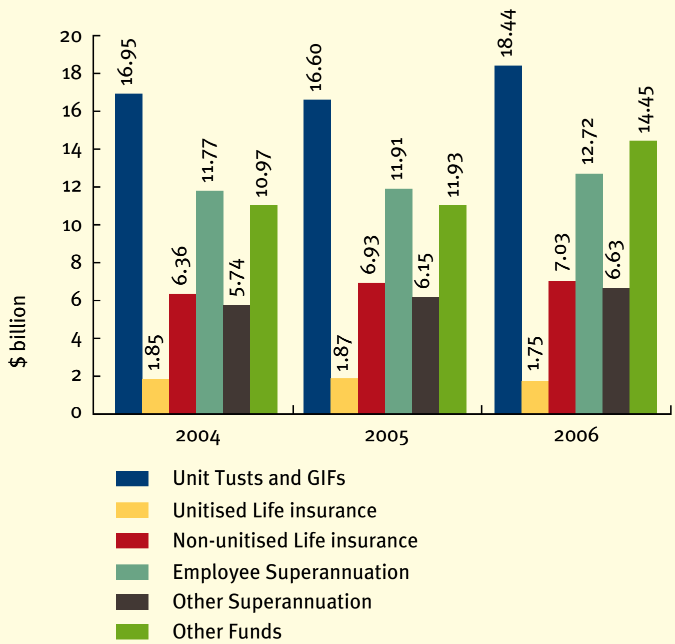
Net Retail Funds Under Management



Source: Morningstar Research Retail Managed Investments Market Share Report

Managed Fund Assets by Product Category

as at 30 June 2006



Source: Reserve Bank Table C15 Managed Fund Assets, by Product Category

Traditional & Risk Business – Product Summary

Year ending 30 June 2006

Product	Annual Premiums $000							Annual Premium Contracts		Single Premium Contracts	
					Discontinuances			Benefit count		New contracts	
	Inforce @ start	Contractual increases plus ad-justments	New Business	Transfers	Claims & expiries	Lapses, surrenders & cancel-ations	Inforce @ end	New	Inforce @ end	Premiums $000	Benefit count
Traditional	**(a)**	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**	**(g)**	**(h)**	**(i)**	**(j)**	**(k)**
Whole Life & Endowment	167,025	1,180	2,399	1,110	7,982	5,825	157,900	1,209	448,883	162	0
2005	*177,185*	*1,043*	*2,936*	*48*	*7,241*	*6,941*	*167,030*	*1,814*	*479,707*	*336*	*0*
Unbundled	73,294	3,804	345	0	2,635	2,546	72,261	388	57,364	0	0
2005	*79,808*	*-979*	*303*	*0*	*2,953*	*2,885*	*73,294*	*621*	*61,597*	*607*	*11*
Risk											
Term	501,350	36,560	73,034	-957	1,718	55,502	552,776	167,007	1,200,942	14,100	24,459
2005	*448,992*	*23,084*	*70,995*	*448*	*1,911*	*49,261*	*501,347*	*179,432*	*1,178,215*	*10,417*	*22,136*
Guaranteed Acceptance	23,526	539	3,016	1,621	456	2,251	25,993	11,170	108,423	0	0
2005	*21,261*	*373*	*4,605*	*324*	*489*	*2,551*	*23,523*	*17,922*	*104,878*	*0*	*0*
Trauma	92,520	7,930	23,349	-49	256	13,087	110,408	64,924	311,720	0	0
2005	*67,704*	*7,808*	*19,167*	*243*	*266*	*11,148*	*92,508*	*58,291*	*281,483*	*0*	*0*
Replacement Income	158,450	13,619	24,637	-926	194	23,741	171,854	55,640	310,054	0	0
2005	*143,454*	*14,466*	*22,652*	*-497*	*598*	*21,027*	*158,450*	*54,456*	*302,338*	*0*	*0*
Lump Sum Disablement	20,063	2,353	4,422	520	73	3,635	23,639	21,969	114,767	0	0
2005	*17,702*	*2,078*	*3,295*	*86*	*101*	*2,996*	*20,064*	*16,953*	*99,406*	*0*	*0*
Accidental Death	20,183	-1,013	2,708	-527	609	2,349	18,395	18,775	225,821	0	
2005	*19,872*	*-52*	*3,231*	*0*	*191*	*2,676*	*20,184*	*30,445*	*249,815*	*0*	*0*
Credit Insurance	46,175	315	17,669	0	50	13,575	50,536	91,290	324,041	11,101	19,594
2005	*43,387*	*30*	*10,876*	*0*	*15*	*8,101*	*46,177*	*58,363*	*338,932*	*5,291*	*13,433*
Group											
Death & Disablement	51,463	3,933	8,204	1,384	5	5,874	59,109	18	161	0	0
2005	*46,742*	*3,466*	*6,319*	*0*	*9*	*5,052*	*51,466*	*21*	*235*	*0*	*0*
Replacement Income	15,662	2,081	1,238	0	0	95	18,885	0	2	0	0
2005	*13,013*	*2,077*	*2,379*	*0*	*0*	*1,806*	*15,663*	*1*	*3*	*0*	*0*
Trauma	1,510	68	12	0	0	-146	1,738	0	16	0	0
2005	*1,403*	*79*	*30*	*0*	*0*	*2*	*1,510*	*1*	*9*	*0*	*0*

Benefits Paid

Year ending 30 June 2006

Product		Amount paid $000 Death	Maturity	Other Benefits
Traditional				
Whole Life & Endowment		77,008	196,858	12,948
	2005	*79,834*	*182,709*	*17,285*
Unbundled		7,113	12,028	6,507
	2005	*7,213*	*11,778*	*8,577*
Annuities		0	28	25,600
	2005	*0*	*0*	*26,580*
Risk				
Term Deposit Bonds		220,469	-468	657
	2005	*190,356*	*75*	*1,383*
Guaranteed Acceptance		3,886	0	0
	2005	*3,124*	*0*	*2,000*
Trauma		13,865	0	34,207
	2005	*7,137*	*0*	*26,158*
Replacement Income		14,867	0	44,391
	2005	*13,723*	*15*	*43,235*
Lump Sum Disablement		6,100	0	5,239
	2005	*490*	*0*	*4,351*
Accidental Death		3,100	365	206
	2005	*3,499*	*19*	*186*
Medical		5,456	0	28,892
	2005	*-*	*-*	*-*
Credit Insurance		2,889	0	3,950
	2005	*4,071*	*223*	*4,530*
Group				
Death & Disablement		30,368	0	755
	2005	*34,166*	*0*	*-776*
Replacement Income		3,790	0	2,773
	2005	*5,117*	*0*	*2,949*
Trauma		174	0	560
	2005	*549*	*-*	*288*

Note: 'Maturity' includes return of premiums on cash back policies. 'Other Benefits' includes benefits being paid periodically but excludes surrenders.

Acknowledgements

The ISI would like to acknowledge the contribution the following people have made to the industry in the past year by their participation in committees and working groups:

Taxation

Adele Smith	*ANZ/National Bank*
Alex Lau	*ASB Bank*
Simon Pennington	*AMP Financial Services*
Greg Grant	*AMP Capital*
Drew Herriott	*AXA New Zealand*
Tim Steel	*Bank of New Zealand*
Donald Wong	*Deloitte Touche Tohmatsu*
Irene Singh	*ING New Zealand*
Tony Lines	*Kensington Swan*
Paul Dunne	*KPMG*
Paul Mersi	*PricewaterhouseCoopers*
Michael Heffernan	*Promina*
Damien Smith	*Public Trust*
Robyn Mills	*Sovereign Ltd*
Brett Paitry	*Tower New Zealand*
David Clement	*Westpac*
Matthew Hanley	*Ernst & Young*

Disability Income Working Group

Nicholas Scarlett	*AIA*
Brent Wright	*AIA*
Michael Hewes	*AIA*
Jonathan Lee	*AMP Financial Services*
Matthew Hanley	*Ernst & Young*
Milton Jennings	*Fidelity Life*
Naomi Ballantyne	*ING Life*
Peter Birmingham	*Medical Assurance*
Robyn Mills	*Sovereign Ltd*

Human Rights Working Group

Anne Lord	*AMP Financial Services*
Sean Carroll	*Asteron*
David Wright	*Asteron*
Dorothy Fenner	*AXA New Zealand*
Wendy Katene	*Medical Assurance*
Viv Mutimer	*Medical Assurance*
Stephen Potter	*Sovereign Ltd*
Grant Hill	*Tower New Zealand*

IFRS Working Group

Dean Norton	*AMP Financial Services*
Scott Hamilton	*ASB Group*
Sarah Johnstone	*BT Financial Group*
Tim Williams	*Chapman Tripp Sheffield Young*
Mark Ngan Kee	*CIGNA*
Jeremy Nicoll	*ING NZ*
Bill Wilkinson	*KPMG*
Lisa Crooke	*PricewaterhouseCoopers*

Superannuation/KiwiSaver

Greg Camm	*AMP Financial Services*
Roger Perry	*AMP Financial Services*
Jonathan Falloon	*AMP Financial Services*
Ian Miller	*AMP Financial Services*
Ralph Stewart	*AXA New Zealand*
Gordon Noble-Campbell	*AXA New Zealand*
David Franks	*AXA New Zealand*
Allan Hogg	*AXA New Zealand*
Shannon Marra	*BNZ*
Mark Todd	*Bell Gully Buddle Weir*
Peter Lee	*Fidelity Life*
Marc Lieberman	*ING NZ*
David Boyle	*ING NZ*
Nigel Jackson	*ING NZ*
John Melville	*Melville Jessup Weaver*
Greg Austin	*Mercers*
David Drillien	*Sovereign*
Tony Hildyard	*Tower New Zealand*
Robert Gatward	*Tower New Zealand*

Legislation

Therese Singleton	*AMP Financial Services*
Elizabeth Rinckes	*AXA New Zealand*
Mark Todd	*Bell Gully Buddle Weir*
Sarah Johnstone	*BT Funds Management (NZ) Ltd*
Tim Williams	*Chapman Tripp Sheffield Young*
Gregg Dell	*ING NZ*
Graeme Edwards	*Public Trust*
Martin Hunter	*Sovereign Ltd*

Advisor Regulation

Jonathan Falloon	*AMP Financial Services*
Richard Latta	*Asteron*
Gordon Noble-Campbell	*AXA New Zealand*
Shannon Marra	*BNZ*
David Drillien	*Sovereign Ltd*
Patrick Middleton	*Spicers*
Peter Conroy	*Tower New Zealand*

Actuarial

Maarten Romijn	*AMP Financial Services*
Richie Rama	*AXA New Zealand*
Ian Perera	*Sovereign Ltd*
Daryl Hayes	*Tower New Zealand*
Herwig Raubal	*Tower New Zealand*

Under Insurance Working Group

Sean Carroll	*Asteron*
Nicholas Scarlett	*AIA*
Michael Hewes	*AIA*
Peter Lee	*Fidelity Life*
David Drillien	*Sovereign Ltd*

Directory

ISI Members as at 30 June 2006

American International Assurance
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Life Insurance Ltd
BT Funds Management Ltd
CIGNA Life Insurance NZ Ltd
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
Public Trust
RGA Reinsurance Co of Australia Ltd
Save and Invest Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand

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Bravura Solutions
Buddle Findlay
Burrowes & Co
Chapman Tripp Sheffield Young
Davies Financial & Actuarial Ltd
Deloitte Touche Tohmatsu
Ernst & Young
InvestmentLink (New Zealand) Ltd
Kensington Swan
KPMG
Melville Jessup Weaver
Mercer Human Resource Consulting Ltd
Morningstar Research Ltd
Phillips Fox
PricewaterhouseCoopers
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Russell McVeagh
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