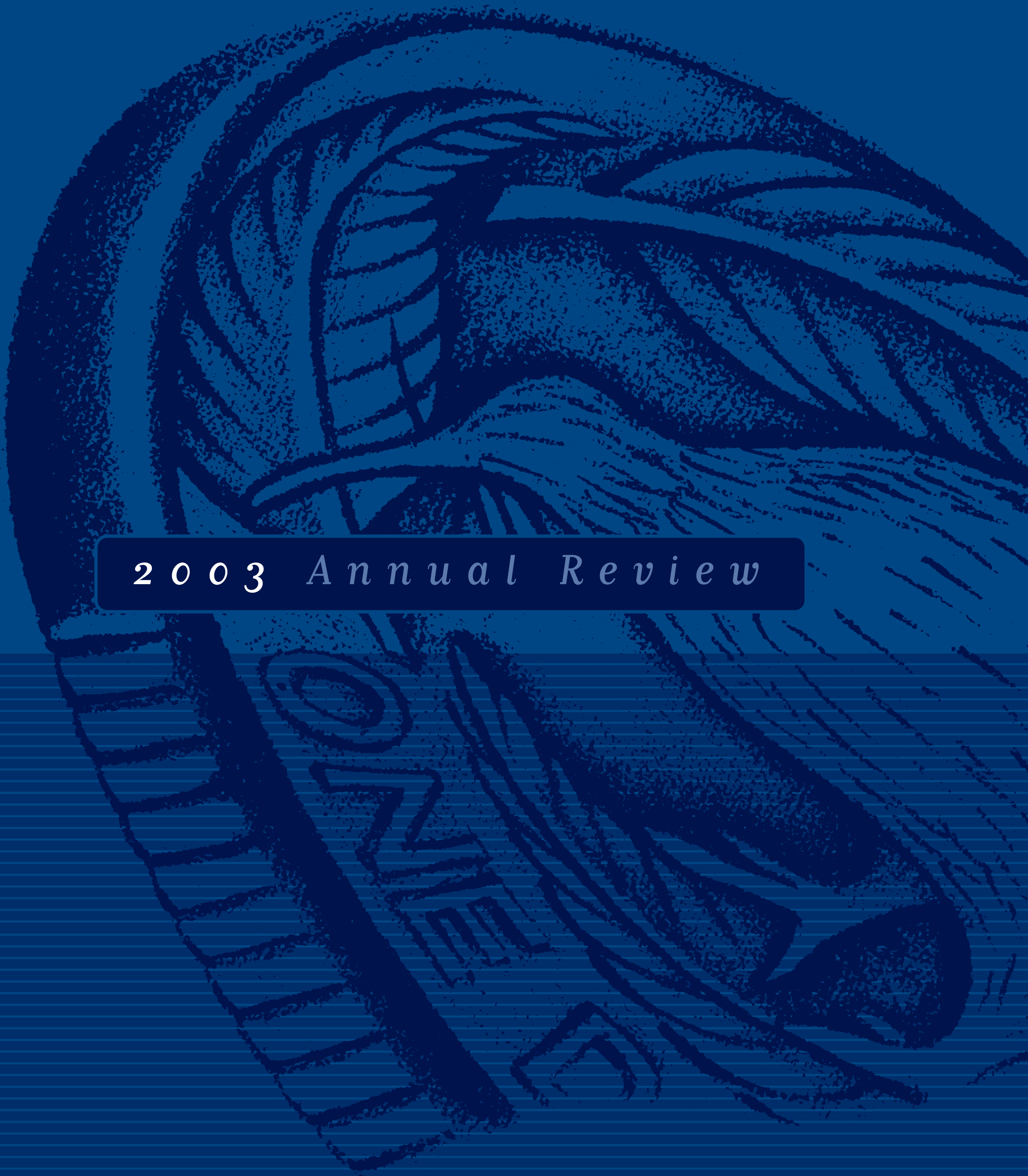
2003 Annual Review



Annual Review of The Investment Savings and Insurance Association of New Zealand Inc for the Year Ended 30 June 2003

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

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.

Board of Directors

Simon Swanson, *Chairman*
Managing Director and CEO, Sovereign Ltd

Ross Kent, *Deputy Chairman*
Managing Director, AMP Financial Services

Paul Bevin
Chief Executive Investment Businesses, Tower New Zealand

Dennis Fox
Chief Executive, Asteron

Paul Fyfe
Managing Director, ING New Zealand Ltd

Russell Macey
Chief Executive Officer, CIGNA Life Insurance NZ Ltd

Rodger Murphy
General Manager, BNZ Investments and Insurance

Craig Stobo
Chief Executive, BT Funds Management (NZ) Ltd

Vaughan Underwood
Chief Executive, AXA New Zealand

key points

- The Saving New Zealand project was a major ISI initiative during the year. The exercise brought together a broad range of stakeholders, including employers, unions, academics, government officials, and the industry, to explore issues relating to New Zealand's savings record.

- Over the year ended 30 June 2003, total retail funds under management for the industry declined $1.1 billion (or 7.4%) to $14.2 billion. Results for final quarter began to show an improvement.

- In force annual premium income for life insurance business declined by 9% from $1.15 billion to $1.04 billion.

- ISI negotiated a successful conclusion to the Inland Revenue Department's Review of Life Office Taxation.

- ISI has set up a working group to advise on a range of options for improving the level of confidence investors can have in the investment advice they receive.

- ISI issued guidelines on recognition of tax assets in unit pricing.

- The Government appointed the ISI chief executive to chair the Periodic Reporting Group (PRG), which is convened every six years to provide advice on retirement income policy.

from the Chairman

The ISI has significantly widened the debate on retirement savings in New Zealand this year by initiating the Saving New Zealand project. The objective was to canvass the views of all stakeholders, such as employers, unions, and academics, along with those of the financial services industry, and attempt to find areas of agreement on policy.

As an industry association, ISI has a vested interest in promoting retirement savings, but that should not prevent us from making a balanced contribution to, and facilitating, a debate that is of such importance to the future well-being of all New Zealanders.

New Zealand has spent the ten years since the Task Force on Private Provision for Retirement Income debating whether we have a problem with the level of personal savings. There is still no agreement on the extent or definition of the problem, or even its existence.

Participants at the Saving New Zealand Forum in July agreed, however, that at the very least there is a significant risk that we will have a problem in 15 years time when the bulk of baby-boomers start to retire. Research last year on the living standards of older New Zealanders showed that, for the most part, even those totally reliant on NZ Superannuation considered they had an adequate standard of living. The ones who didn't were those who had suffered a 'life shock', such as redundancy or marriage breakdown, in the period leading up to retirement.

A discussion paper prepared for Saving New Zealand by economist Peter Harris noted that changing work and family patterns suggest that what were 'life shocks' for the currently retired population are likely to be common occurrences for future cohorts. Consequently, baby-boomers are unlikely to be sufficiently financially secure at retirement to be live comfortably with the State pension as their only income.

We can't be sure that this will happen – baby-boomers may start saving more – but prudent risk management suggests we should look at what policies we could put in place now to mitigate future problems. If the problems don't arise, we'll all just be that much better off.

An important first step is to acknowledge that the issue is important enough to warrant a dedicated and robust policy advice body. A major area of agreement at the Forum was that the Government needs ongoing policy advice on the adequacy of New Zealanders' provision for retirement income. Currently, the Periodic Reporting Group (PRG) is convened every six years. That is a useful exercise but the issue is too important for it to be looked at only every six years. A permanent function is needed - either by adding to the responsibilities of the Retirement Commission or by establishing an entirely new office, possibly within the Ministry of Social Development. We look forward to further discussions with the Government on these issues.

Other areas of particular interest for the ISI at present are taxation and regulation of advisers. We look forward to the imminent release of an Inland Revenue issues paper on problems with the foreign investment fund rules, which is expected to look at options around the 'risk free rate of return' method put forward by the McLeod Tax Review in 2001. The ISI has previously made the point to the Government that a more consistent, and fair, basis is needed for the taxation of collective investments. At present the industry struggles with the complexity of working within a range of different tax regimes applying to different types of investment (superannuation, unit trusts, group investment funds etc.) and with unequal treatment of direct and collective investments.

ISI is responding to signals from the Ministry of Economic Development and the Securities Commission that they are interested in beefing up the regulation of investment advisers. In comparison with some other countries New Zealand has very light-handed regulation of investment advisers and ISI has set up a working group to look at a range of options for improving the level of confidence that investors can have in the standards of investment advice in New Zealand. Our review of the regimes in place in Australia and Britain suggests that the standard of advice investors receive is not necessarily improved by a very prescriptive, process-driven regulatory regime.

The key role of the ISI is to represent the views of its members and that remains our priority. However, this year we have widened our view and engaged with employers, unions, academics, officials and others in considering questions of savings policy. It has been a challenging process and while we have agreed on only a limited number of points it represents a major step forward. This year has been one of the busiest for the ISI and there is no doubt that it is has had a very positive impact on the industry. Much of the credit for its success goes to the ISI staff, Vance Arkinstall, Deborah Keating and Marilyn Max as well as the Board Members and the various committee members who have given so much of their time and wise counsel during the year.

Simon Swanson
Chairman

the Year in Review

The industry is slowly but surely emerging from a long and difficult trading period.

Over the year ended 30 June 2003, total retail funds under management for the industry declined $1.1 billion (or 7.4%) to $14.2 billion. This followed a 6.5% decrease the previous year.

Through these testing times many members have understandably been heavily focussed on managing their existing business within the constraints that result from a reduced fee income. In response ISI has attempted, as far as possible, to restrict the call on the resources of members by taking on an increased workload and maintaining strong control over expenses. We have been successful in the achievement of both of these challenges and have maintained the 15% discount on fees introduced in 2001.

Saving New Zealand – "An idea whose time has come"

The Chairman has already commented on this major ISI initiative which has taken the first strides in building a platform with key stakeholders on the issue of savings.

This initiative has been an enormous success and has increased further the profile of ISI with Government, especially the Minister of Finance, the other political parties and officials.

For the first time in over 15 years essential stakeholder groups have entered into dialogue on the issue of New Zealanders' savings record and habits in a structured and supportive way, designed to develop solutions.

The quality of the debate and material issued was reflected in the level of engagement from stakeholders and media. A further and perhaps less obvious advantage has been the gathering of a database of employers from around the country who are interested in, and in many cases concerned at, the low savings level that exists in NZ.

Clearly, the strongest call from the Saving NZ Forum was the unanimous agreement that all existing taxation disincentives must be removed. Government and officials can no longer delay the implementation of, at the very least, a neutral taxation regime for saving.

The challenge is to maintain the momentum at a pace that retains the involvement of unions, employers, industry, officials and politicians. By organising the Saving New Zealand Forum ISI has "kick-started" the discussion and made a strong contribution to progress on savings issues.

From the wide interest and solid media commentary there is no question the need for change to increase saving in New Zealand is an idea "whose time has come."

Advice

The 2003 year saw an increase in consumer enquiries. As expected, there was a noticeable increase in the number of enquiries from investors seeking guidance on how they should react to declining managed fund values. There has also been significant growth in the number of calls relating to income-protection contracts. ISI cannot provide advice to individual consumers, but we are able to play a role in helping clients understand what was happening in the market and to assist them to adopt a process that would provide a more satisfactory solution.

The key message that has come from many consumer enquiries is a mounting concern on how to find "reliable advice." Consumers are troubled about the quality of advice that they receive. Turbulent times, particularly in investment markets, always create uncertainty and the adviser is the first to "cop the flack". Even so, it is clear that the role of the adviser will come under increasing scrutiny by consumer groups, government agencies and politicians. How the industry reacts to these challenges will be pivotal in the level of trust and confidence it is able to generate.

The Minister of Commerce, Hon Lianne Dalziel, has given the industry the opportunity to demonstrate leadership by signalling two major pieces of work:

- Review the Investment Adviser (Disclosure) Act 1996 to adopt the majority of the recommendations of the Securities Commission (ISI is supportive of these measures) and
- a review of the securities legislation (including the Unit Trust Act), which may also involve the possibility of licensing advisers (ISI is well underway in establishing its position through a working group headed by Rodger Murphy.)

Looking at the year ahead, ISI will have a big role to play working with groups such as FPIA, Securities Commission, Ministry of Economic Development and with the Minister in developing an "advice platform" that enhances the industry's reputation and integrity.

Tax Loss Recognition

The three year downward grind in equity values created an escalating problem with appropriate recognition of tax losses. ISI issued a guidance note in February on Tax Loss Benefit Recognition. This was a successful initiative that also found favour in Australia where their superannuation schemes suffer a similar recognition problem.

Actuarial Review of Life Office Taxation

We have previously reported to members the satisfactory outcome to the IRD's Review of Life Office Taxation.

While the result was good, the IRD's discussion paper was a matter of serious concern and caused the industry, its members and the IRD to devote significant amounts of resource to correct misunderstandings, and enable a commonsense outcome to be achieved. Taking time and known costs into account, the cost to the industry alone was an estimated $320,000. Fortunately the outcome more than justified the cost.

The industry is also on notice that a review of taxation of risk products will take place. IRD is keen for this review to take place, but has not yet committed it to the department's work programme. Indications at this stage point to a review after the new International Accounting Standards are known (introduction due 2005). Whilst we strongly support this timing, we should not be surprised if IRD moves to act sooner. Watch this space.

Life Insurance Act 1908

The decision in April 2003 to refer the Life Insurance Act 1908 to the Law Commission for review and issuing of a discussion document in October received a mixed reaction from the industry. Some consider the Law Commission's involvement as a tactic to delay the need for a Government decision and preferred the option of a review conducted by the Ministry of Economic Development. However ISI has been reassured by the quality of the person appointed to lead this Law Commission review and early meetings with the Law Commission have been encouraging.

The review will require the attention of life companies as it progresses – and ISI will require clear signals from members regarding industry preferences.

Income Protection Insurance

For some time now two issues to do with income protection insurance have been bubbling away:

- IRD concern that claimants who should be declaring their benefit as taxable may not have been doing so, and
- a growing unease that some agreed value products might be presented as indemnity value and thereby confuse the correct taxation treatment of the resulting benefit.

After at least one false start IRD has finally determined to undertake a major review which will almost certainly lead to changes to the current ruling governing tax treatment.

Once again, this is an issue that will require the close attention of income protection providers.

Survey of Members

ISI has recently issued a survey seeking comment on the services and support members require from the organisation.

A large part of our work often revolves around reacting to government statements, discussion papers and draft legislation. The secret to success and the challenge we constantly face is thinking about the future, and which of a range of options would best meet the industry's needs. Fortunately we are now more than ever prepared to meet these challenges.

We welcome advice from members on what is important in order that we not only handle the day-to-day issues well, but are on the front foot anticipating and planning for future issues.

Conclusion

I joined ISI when it was considering merging with other industry associations.

At that time I spoke bluntly about the importance of ISI having a clear picture of what it wanted to achieve and a focus on matters important to it. There was the risk that a merger to form a larger and more powerful lobby voice would also deflect attention from the big picture ISI issues, and the Board supported that view.

Through the efforts of the Board, the industry has made much progress and ISI is established as the "lead voice" for the sector. I have never doubted the importance of retaining our separate identity. We enjoy and work hard to foster excellent relationships with other industry associations. If the opportunities present then we would consider moves to share ideas, work together on projects of mutual interest and provide further economies for the benefit of members by sharing facilities and accommodation.

We look forward to another successful year as ISI members emerge from a tough trading environment.

Vance Arkinstall
Chief Executive

Industry overview

Funds Under Management

Unlisted retail investment funds under management by New Zealand fund managers as at 30 June 2003 amounted to $14.24 billion, down from $15.37 billion at 30 June 2002.

The total was made up of:

Unit trusts	$6024.1 million
Superannuation trusts	$5279.9 million
Group investment funds	$1506.3 million
Insurance bonds	$1425.3 million

While there was an overall fall of 7.3% for funds under management for the June year, the extent of the decline varied between fund types with a fall of 7.9% for unit trusts, 11.5% for superannuation trusts and 8.8% for insurance bonds. Group investment funds bucked the trend and increased by 15.9%.

There was a net outflow of funds of $659.5 million in the year to 30 June 2003, compared with the net outflow of $35.8 million in the year to 30 June 2002. The net funds outflow accounted for $441 million of the $1.1 billion fall in funds under management for the June year. The rate of decline slowed towards the end of the year, however, with outflow of $21 million in the June quarter compared with $137.5 million in the March 2003 quarter and $339.5 in the December 2002 quarter.

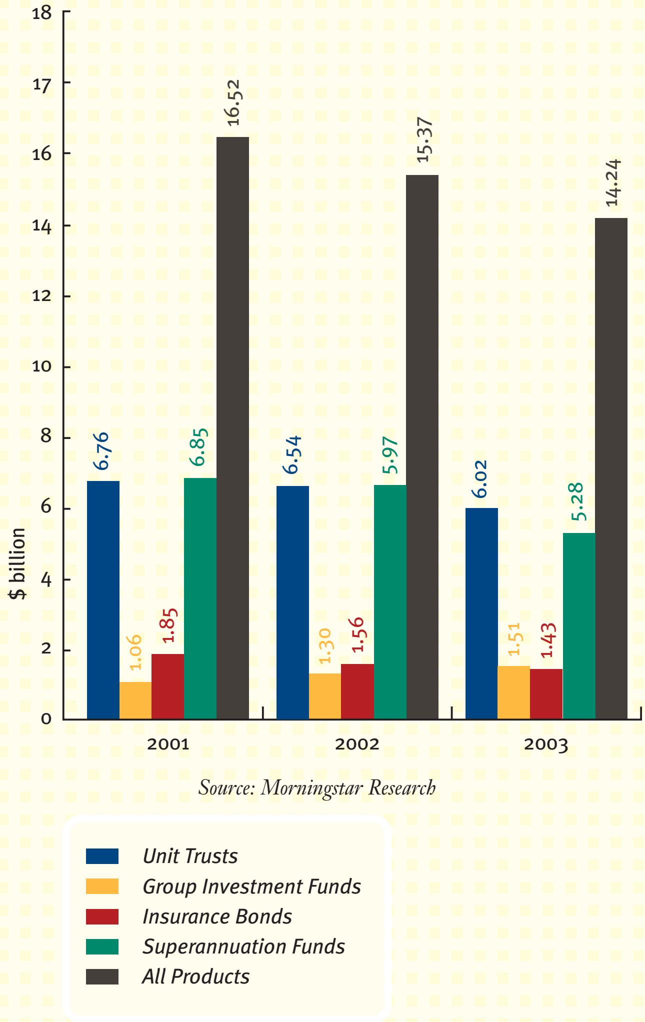
The extent of outflow for the June year varied between different fund types and was primarily from superannuation trusts, with a net outflow of $577.6 million, an increase of 68% on the outflow from that category in the previous year. There was a net outflow of $133.5 from insurance bonds whereas unit trusts and group investment funds (together) showed a net inflow of $51.5 million.

While there was a positive funds flow for unit trusts and GIFs in the June year, the rate was considerably lower than the inflow of $563.1 million in the year to June 2002.

Funds under management in insurance bonds continued their gradual decline from $1562 million at the end of June 2002 to $1425 million at 30 June 2003.

Net Retail Funds Under Management

as at 30 June 2003



Source: Morningstar Research

Industry Statistics YTD 30 June 2003

The series of ISI Quarterly Statistics has been substantially revised from September 2002 with the result that the figures reported from that point are not strictly comparable with previous years. For that reason, this Review shows figures only for the part year completed on the new basis. We regret that it was not possible to complete a full year to 30 June 2003 on the new basis.

The most obvious change in reporting is the separation of risk business from savings business. In addition, reporting is now done on the basis of products rather than movements and benefits rather than policies. Whereas previously the premium for a rider benefit was included under the main product category, now the main product and each rider will be reported as a separate benefit.

For policies that include both savings and risk benefits, wherever possible the savings and risk components will be reported separately. Initially that may not be possible in all cases, but it should enable the benefits being sold to be more easily identified as 'modular' products become more common.

The separate reporting of savings business was not possible for the September 2002 quarter but commenced with the quarter ending 31 December 2002. It was also substantially expanded to capture business that had not previously been reported. Savings business is now reported as either funds under management (funds for which the company receives some form of remuneration for managing the funds) or funds under administration (where the company receives some form of remuneration for administering the funds).

The following tables show the range of business information available under the new format, with an opening position as at 30 September 2002 and a closing position as at 30 June 2003. In subsequent years we will be able to show comparative figures for years to 30 June.

Traditional & Risk Business – Product Summary

3 Quarters ending 30 June 2003

Product	Annual Premiums $000							Annual Premium Contracts		Single Premium Contracts	
					Discontinuances			Benefit count		New contracts	
	Inforce at start	Contractual increases plus adjustments	New Business	Transfers	Claims & expiries	Lapses, surrenders & cancellations	Inforce at end	New	Inforce at end	Premiums $000	Benefit count
Traditional	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*	*(i)*	*(j)*	*(k)*
WholeLife & Endowment	194,907	524	3,767	72	5,934	5,954	187,382	1,924	547,360	146	0
Unbundled	153,373	-63,057	1,429	-3	4,562	7,474	79,706	1,175	91,839	14,548	410
Risk											
Term	400,287	5,572	52,526	-678	2,330	41,764	413,613	146,620	1,128,037	6,002	14,525
Guaranteed Acceptance	13,624	2,509	4,061	0	273	1,303	18,618	15,232	88,878	0	0
Trauma	52,017	7,644	12,953	43	83	7,258	65,316	38,564	213,290	0	0
Replacement Income	127,087	14,758	16,979	45	563	16,031	142,275	50,281	299,167	0	0
Lump Sum Disablement	11,669	3,448	2,511	4	17	1,739	15,876	13,941	95,549	0	0
Accidential Death	20,428	1,265	2,527	0	877	2,204	21,139	27,340	284,924	0	0
Credit Insurance	36,190	4	9,376	0	5	6,191	39,374	47,764	311,476	2,824	10,679
Group											
Death & Disablement	44,549	2,558	2,975	0	103	6,868	43,111	47	390	1	0
Replacement Income	11,114	682	1,430	0	22	1,590	11,614	17	137	0	0
Trauma	1,107	133	134	0	0	104	1,270	22	8	0	0

Savings and Investment Products – Funds Under Administration

3 Quarters Ending 30 June 2003

Product	FUA @ start	Cash Flows received in period	Withdrawals paid in period	Risk Charges in period (if any)	Adjustments*	FUA @ end
	$000	**$000**	**$000**	**$000**	**$000**	**$000**
Retail non-super	956,553	214,148	302,765	1,214	1,183,578	2,050,299
Retail super	1,564,596	226,533	234,151	250	1,041,284	2,598,011
Unit Trusts	370,686	49,066	95,658	0	323,452	647,546
Master Trusts	865,429	104,875	167,701	0	-14,421	788,183
Open Ended Investment Companies	25,115	3,904	2,143	0	-6,079	20,797
Term Deposit Bonds	0	40,924	60,869	0	101,195	81,250
Group Investment Funds	151,689	51,033	44,924	0	9,997	167,794
Australian Vehicles	13,960	5,991	1,311	0	5,106	23,746
Listed Unit Trust	605,055	0	0	0	49,473	654,528
Wrap Accounts	235,245	452,782	356,265	0	1,775,549	2,107,311

*Adjustments include Fees, Charges and Investment Returns

Benefits Paid

3 Quarters Ending 30 June 2003

	Amount paid $000		
Product:	Death	Maturity	Other Benefits
Traditional			
Whole Life & Endowment	63,725	131,050	7,292
Unbundled	8,971	21,366	6,401
Annuities	402	20,536	
Risk			
Term	118,028	222	2,863
Guaranteed Acceptance	2,386	0	0
Trauma	4,131	0	12,475
Replacement Income	6,943	0	28,260
Lump Sum Disablement	369	0	2,877
Accidental Death	1,215	7,156	391
Credit Insurance	3,072	0	2,975
Group			
Death & Disablement	25,039	0	1,572
Replacement Income	3,515	0	4,109
Trauma			813

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

Acknowledgement

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

Greg Kerr	AMP Financial Services
Drew Herriott	AXA New Zealand
Spyros Papageorgiou	Bank of New Zealand
Greg Haddon	Deloitte Touche Tohmatsu
Paul Butler	ING New Zealand Ltd
Tony Lines	Kensington Swan
Paul Dunne	KPMG
Paul Mersi	PricewaterhouseCoopers
Robyn Mills	Sovereign Ltd
Anthony Merritt	Tower New Zealand
David Clement	Westpac
Patrick McCalman	Westpac

Superannuation

Jonathan Falloon	AMP Financial Services
Liz Rowe	AMP Financial Services
George Harvey	AXA New Zealand
Helen Moody	Jacques Martin NZ Ltd
Craig Furness	Sovereign Ltd
Vena Crawley	Sovereign Ltd

Legislation

Clif Corbett	AMP Financial Services
Therese Singleton	AMP Financial Services
Elizabeth Rinckes	AXA New Zealand
Graeme Edwards	Simpson Grierson
Mark Todd	Bell Gully Buddle Weir
Sarah Johnstone	BT Funds Management (NZ) Ltd
Tim Williams	Chapman Tripp Sheffield Young
Simon McArley	Kensington Swan
Don Mather	Public Trust
Martin Hunter	Sovereign Ltd

Standards Review

Anne Lord	AMP Financial Services
Wayne Burns	BT Funds Management (NZ) Ltd
Rachel Taylor	Phillips Fox
Gaylene Turbott	Public Trust
Graeme Edwards	Simpson Grierson

Advisor Regulation

Jonathan Falloon	AMP Financial Services
Brian Lenehan	Asteron
Rodger Murphy	BNZ Investments and Insurance
Matthew Mimms	BT Funds Management (NZ) Ltd
Tom Lyall	Sovereign Ltd
Ian New	Westpac

Actuarial

Maarten Romijn	AMP Financial Services
Jonathan Moss	AMP Financial Services
Quentin Wilson	AMP Financial Services
Richie Rama	AXA New Zealand
Ivan Hoshek	Asteron
Ian Perera	Sovereign Ltd
Daryl Hayes	Tower New Zealand

Statistics

Catherine Manning	AMP Financial Services
Jason Elsworth	AMP Financial Services
John Bateson	AMP Financial Services
John Feyter	Asteron
Richie Rama	AXA New Zealand
Charmaine Green	Sovereign Ltd

Directory

Member Offices as at 30 June 2003

American International Assurance
AMP Financial Services
Asteron (previously Royal SunAlliance Life & Disability Ltd)
AXA New Zealand
BNZ Investments and Insurance
BT Funds Management (NZ) Ltd
CIGNA Life Insurance NZ Ltd
Club Life Ltd
Equitable Life Insurance Co Ltd
Fidelity Life Assurance Co Ltd
General & Cologne Life Reinsurance Australasia Ltd
Gerling Global Reinsurance
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Jacques Martin New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
National Bank of New Zealand Ltd
Public Trust
RGA Reinsurance Co. of Australia Ltd
Save and Invest Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand
Westpac Financial Services

Associate Members

Bell Gully Buddle Weir
Buddle Findlay
Burrowes & Co
Chapman Tripp Sheffield Young
Davies Financial & Actuarial Ltd
Deloitte Touche Tohmatsu
Ernst & Young
Frank Russell Company (NZ) Ltd
InvestmentLink (New Zealand) Ltd
KPMG
Kensington Swan
Melville Jessup Weaver
Morningstar Research Ltd
NMG Financial Services Consulting (Pty) Ltd
Phillips Fox
PricewaterhouseCoopers
Russell McVeagh
Simpson Grierson
Tacit Group Ltd

Vance Arkinstall
Chief Executive, Investment Savings and Insurance Association of NZ. Previously Managing Director, Norwich Union Life Insurance NZ Ltd and General Manager Westpac Financial Services.

Deborah Keating
Executive Officer, Investment Savings and Insurance Association of NZ

The Investment Savings and Insurance Association of New Zealand Inc

Chief Executive
Vance Arkinstall

Executive Officer
Deborah Keating

Street Address
Investment Savings and Insurance Association of New Zealand Inc
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

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 2003