

2002

Annual Review



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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.

Standing (left to right) Christine Scott (Royal & SunAlliance Life and Disability (New Zealand) Ltd), Mike Newton (BT Funds Management), Rodger Murphy (BNZ Investments and Insurance), Vaughan Underwood (AXA), Simon Swanson (Sovereign), Ross Kent (AMP), Jim Minto (TOWER), David Whyte (American International).

Seated (left to right) Paul Fyfe (ING), Vance Arkinstall Chief Executive (ISI)



key points

- Agreement achieved with Inland Revenue on the appropriate application of GST to management fees of unit trusts and GIFs.
- All priority issues identified by the Taxation Committee were successfully resolved.
- Both Government and Opposition parties agreed on the value of some form of encouragement for contributions to retirement savings schemes.
- Discussions were held with the Securities Commission on improving public confidence in the financial services industry through changes such as amendment of the Securities Act and Regulations.
- An increase in premium in-flows to insurance business despite difficult investment conditions worldwide having a negative impact on retail funds under management.
 - For the year to 30 June 2002 regular annual premiums to insurance business increased by 14.25% while single premium business increased by 18.52%.
 - In force annual premium income for insurance business as at 30 June 2002 had increased by 3.81% over the previous year.
 - Retail funds under management declined in the year to 30 June 2002 from \$16.5 billion to \$15.4 billion.



from the Chairman

A quick look back to last year's Annual Review shows we were optimistic that the Government had recognised the need for encouragement to 'kick-start' long-term saving for retirement. While that optimism may have been justified at the time, there has been no movement by the Government to make it a practical reality. The facility for lower tax on savings in a 'salary sacrifice' arrangement, while welcomed, has not been extended to lower income workers and must be regarded as no more than a 'toe in the water' towards encouraging saving for retirement.

The managed funds industry still has serious issues of concern in the areas of taxation and retirement savings, and will continue to work with legislators to resolve them.

A year ago we had the prospect of a 'first-principles' review of the tax system being conducted by the Tax Review 2001 Committee, with the opportunity for public consideration before the 2002 General Election. ISI welcomed the opportunity for the fundamental issues surrounding the tax treatment of collective investments to be rationalised.

Unfortunately, discussion on tax issues arising from the Review was very muted and it would be difficult to claim that any significant progress has been achieved.

Tax treatment of long-term savings has a major influence on the future provision of retirement income and that remains one of the issues for the Government's second term. Naturally, this is a high priority for the managed funds industry but we believe it is also a growing concern for the general public, who look to the Government for some assistance and guidance.

The baby-boom generation of New Zealanders has grown up with all the benefits of the welfare state, and with the prospect of the state providing an income after retirement. This generation is now realising that anyone who wants more than a simple lifestyle in retirement will need additional savings to supplement New Zealand Superannuation. It is taking time, however, for that realisation to be converted into action and the progressive personal tax rates of the current tax system tend to work against it.

We acknowledge the economic purists' view that encouragement for certain forms of investment may not increase the sum of national savings and may divert savings away from one area into another. There is an argument, however, that encouraging some savings into a diversified range of assets that provide an income in retirement is a benefit in itself.

Whose role is it to provide that encouragement and convince people to save for their own retirement? The industry contributes a great deal to public education by such means as adviser seminars, advertising and face-to-face contact. The ISI role is to act as liaison between industry and policymakers, ensuring that the Government is aware of the impact of existing and proposed legislation. Ultimately though, only the Government can make decisions on policy changes.

It is frustrating that achieving change takes such a long time, but the industry has seen some progress this year in the resolution of a number of tax issues affecting unit trusts.

The ISI has a good relationship with the Minister of Finance, the Hon Dr Michael Cullen, and with officials of Inland Revenue, both Policy Advice Division and Corporates. This has been beneficial in enabling us to discuss issues as they arise

and (in most cases) agreeing on some form of resolution. We were particularly pleased to be able to reach an agreement with Inland Revenue on the appropriate treatment of GST on the management fees of unit trusts and Group Investment Funds. The wider topic of GST on financial services is the subject of an Inland Revenue discussion document about to be released.

Further tax issues covered in more detail in the Chief Executive's report include the risk-free rate of return method ("RFRM") and the actuarial review of life office taxation.

We welcomed Tower New Zealand into the ISI this year, enabling us to represent the views of almost all life offices and major fund managers in New Zealand. The strength of an industry association is its ability to collect and distill the views of its members and convey them to the appropriate audience. While our focus appears to have been on tax and retirement savings this year, other areas in which the ISI is active include the review of Securities Regulations and class exemptions, the review of the Life Insurance Act 1908 and the Human Rights Commission's review of its Insurance Guidelines.

I will be stepping down from the chairmanship of ISI at the Annual General Meeting, having served my allowed term, but will continue my close involvement with the Association. The ISI has performed a valuable role since its inception in 1996. I believe that it will continue to do so and that much of the credit for its success is due to the efforts of the ISI staff, Vance Arkinstall, Deborah Keating and Marilyn Max, who have made a tremendous contribution in the time I have been on the Board.

Paul Fyfe
Chairman

the Year in Review

The past year saw further excellent progress in addressing the numerous taxation anomalies that have existed for many years.

Most of these have related to back-office issues that are not in the public gaze.

Achieving resolution has removed a number of difficulties that have been frustrating for fund managers and have impacted service levels. Although a number of taxation disincentives still exist in the treatment of collective investments, it is pleasing to report that the targeted anomalies have now been totally cleared, allowing the industry to focus on looking forward towards more public and high profile matters.

Our newsletters have documented the good progress made during the year. The Taxation Committee has done an outstanding job on these matters.

This progress has not been without cost. The industry has been required to invest a considerable sum in professional support in order to fix these problems, often undertaking steps and processes to support and assist the officials. This expenditure, while affecting the bottom line this year, has produced the results sought.

The industry has continued to be consulted by officials and several political parties. The fact that the industry's views are sought in formulating policy is a reflection of the importance of the funds management and life insurance industry to the economy, and the respect that the industry has established at the highest political levels.

Superannuation

ISI has maintained regular contact with the major political parties throughout the past year. Although political consensus remains elusive, progress continues to be made. The majority of politicians now accept the industry's call for the 3 pillar model recommended by the World Bank:

- Tier 1 – publicly funded pension (NZ Superannuation)
- Tier 2 – workplace saving
- Tier 3 – additional private saving

All political parties now accept the importance of workplace saving and most claim to support the need for encouragement through the tax system to kick-start a savings ethic.

The fact that "superannuation" was not a major topic in the lead up to the election is possibly a good point, as politicians have not taken a rigid, public position. However, the indecision of politicians and the lack of constructive input from officials on creating a supportable regime that encourages savings in this country continue to be major shortcomings.

We anticipate working with the Government on two key issues:

- Extending the 6 cent tax advantage to middle and low-income members of employer sponsored schemes
- Simplifying workplace savings to make this option more attractive and easily accessible to a greater number of employees

The ISI approach will move up a notch from quietly working with politicians, largely behind the scenes. I expect that the industry will become more active in stimulating debate and commentary through the media. Our intention will be to provide balanced input, rather

than a self-interested view, in working towards a framework that is accepted and understood by the general public.

Taxation

Review of GST on Financial Services

Through the year there have been a number of meetings with officials on this important issue. We have taken the opportunity to keep the Minister aware of industry concerns at any moves that increase the cost of saving.

The industry is fundamentally opposed to the application of GST on imported services and the proposed introduction of reverse charging. However, it is almost certain that legislation will be introduced, but with the impact softened by business-to-business transactions being zero-rated.

The industry has strongly (and we believe successfully) argued that any changes require adequate lead-in time before introduction, to permit the necessary systems changes and testing to take place.

ISI continues to vigorously argue that there should be no extension of the application of GST to financial services. The wider application of GST will result in higher fees to savers and be counter-productive to the Government's efforts to improve this country's low personal savings levels.

We will continue to lobby officials regarding the strength of our views and we are prepared to reinforce these views when we respond to the discussion documents expected within the next month.

GST on Management Fees of Unit Trusts

The agreement that GST would be payable on 10% of management fees with effect from 1 January 2002 was not initially welcomed by all industry participants. However, when considered against the alternative of facing individual IRD audits and negotiation, with the commitment of significant resources and the likely retrospective application for up to four years, the benefit of this pragmatic solution quickly became apparent.

This is simply an interim arrangement until the outcome of the wider review of GST on financial services is completed.

Actuarial Review of Life Office Taxation

Considerable effort has been devoted to working with IRD to assist officials to understand the complex issues surrounding taxation of a life office. The attention of the officials has been on the application of the Income Tax Act to conventional policies. The application of the Act to risk products is operating satisfactorily. However, the industry should be aware and prepare for the possibility that a review of the taxation of risk/term products will at some stage be undertaken by the Government.

Membership and Subscriptions

The 10% discount on subscriptions introduced in 2000/01 was continued in 2001/02 without compromising the level of service or participation in lobbying activities. ISI represents a low cost, effective lobbying service for members.

We welcomed new members Simpson Grierson and Tower New Zealand, bringing membership to 43 with 16 Associate members.

An area in which we have not delivered is in respect of member meetings. This has been a shortcoming that we are committed to address in the new year.

The constant rationalisation of the industry will result in further changes to ISI membership in the future, but we are currently in discussion with organisations that are considering establishing businesses in NZ and taking up ISI membership.

Securities Issues

The ISI, through the Legislation Committee, has been actively engaged in submissions to the Securities Commission on funds management practices, reviews of class exemptions, the on-going review of the Securities Regulations, and in discussions regarding the future of adviser regulation in this country. These issues have been reported to members through the newsletter.

It is clear that New Zealand is entering a new era in the regulation of securities with the Securities Commission taking a more active and higher profile. This industry enjoys a good relationship with the regulators that the Board has worked to maintain in the emerging environment.

What the Future Holds

The reputation that ISI has built with politicians and officials will provide a sound base as we look towards a number of important issues.

GST on financial services will be a key subject and one which will require close attention by members.

The Risk Free Rate of Return issue will quickly emerge in accordance with the direction in the Budget that officials

be asked to undertake a further round of consultation with the industry.

We expect the Minister of Finance to instruct officials to consult with ISI regarding increasing saving through workplace schemes and the extension of the current 6 cent specified superannuation contribution withholding tax (SSCWT) advantage to lower income earners.

We continue to be assured by the Minister and the Ministry of Economic Development that a review of the Life Insurance Act 1908 remains high on the agenda. We continue to encourage this review and hope that it does not get "bumped" off the work programme.

ISI will also continue to press for a leveling of the taxation playing field, and at the very least, the removal of the current tax barriers that act against private saving.

For life insurers the Human Rights Commission have signalled they will be engaging ISI in discussion regarding a review of the Human Rights Insurance Guidelines. The results of the Australian Law Reform Commission into genetic testing are expected in the first Quarter of 2003 and will have an impact on the New Zealand scene.

Overall, we look forward to another busy year with many important challenges.

Vance Arkinstall

Chief Executive

Industry overview

Funds Under Management

Unlisted retail investment funds under management by New Zealand fund managers as at 30 June 2002 amounted to \$15.44 billion. This was a drop of 6.5% over the year to 30 June 2002.

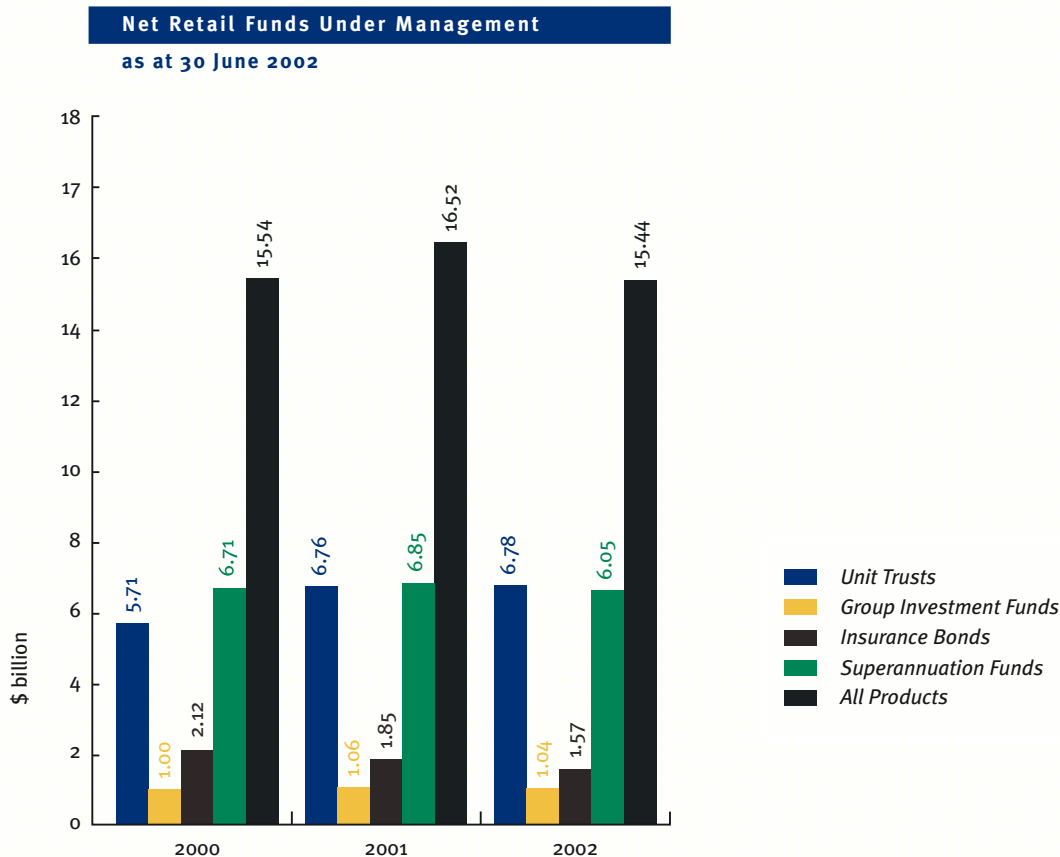
The industry also saw a net outflow of funds amounting to \$35.8 million in the year to 30 June 2002, compared with a net inflow of \$1,138 million in the previous June year.

The outflow, while disappointing, can be seen as an expected reaction to the major decline in value of overseas shares, and the extreme volatility of investment markets. In spite of the turmoil and uncertainty that prevailed over the period, the increased maturity of New Zealand investors and efforts to educate the public about the potential volatility of certain investments have combined to prevent a more serious funds outflow.

The only category to experience a positive funds flow for the June year was unit trusts, with an inflow of \$563.1 million achieved in difficult circumstances. As expected, investors sought the protection of 'safe havens', with mortgage trusts recording the greatest net funds inflow of any product type.

Superannuation trusts and Group Investment Funds saw net outflows of \$121.9 million and \$22.4 million respectively.

Funds under management in insurance bonds continued their gradual decline from \$1,854 million at the end of June 2001 to \$1,573 million at 30 June 2002.

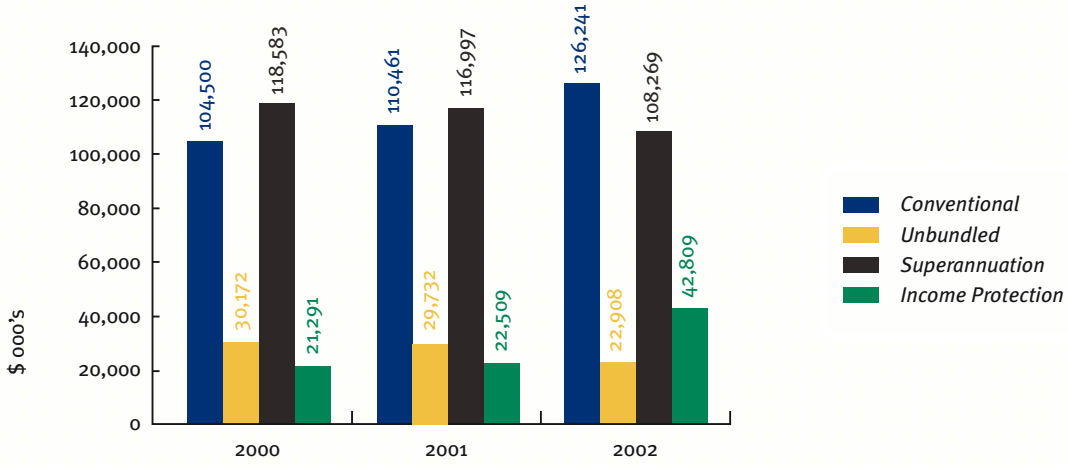


Source: Morningstar Research

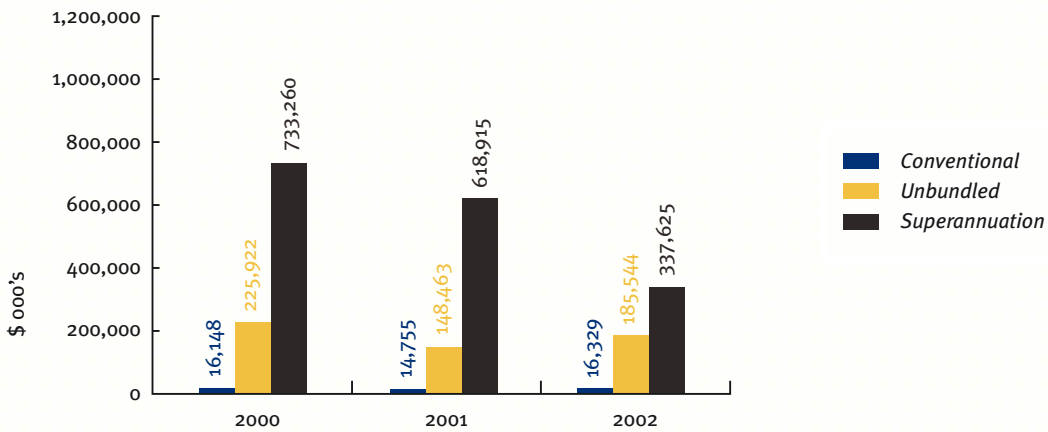
Insurance Business				
Years ending 30 June	2000 (\$000's)	2001 (\$000's)	2002 (\$000's)	% Change This Year
<i>New Business</i>				
Annual Premium Income	169,572	174,987	199,926	14.25
Single Premiums	245,454	174,995	207,403	18.52
<i>Discontinuances of Annual Premium Income</i>				
Lapses	5,498	6,976	6,917	-0.85
Surrenders	138,155	145,863	139,487	-4.37
All Other Discontinuances	15,029	9,546	18,861	97.58
<i>Annual Premium Income In-Force</i>	1,092,824	1,105,010	1,147,084	3.81
Superannuation Business				
Years ending 30 June	2000 (\$000's)	2001 (\$000's)	2002 (\$000's)	% Change This Year
<i>New Business</i>				
Annual Regular Contributions	118,583	116,997	108,269	-7.46
Single Premiums	733,260	618,915	337,625	-45.45
<i>Discontinuances of Annual Regular Contributions</i>				
Lapses	3,889	4,579	4,407	-3.76
Surrenders	42,556	46,368	39,243	-15.37
Other Discontinuances	10,806	10,649	11,037	3.64
Superannuation Scheme Cancellations	39,902	9,296	24,339	161.82
<i>Annual Regular Contributions In-Force</i>	673,826	690,986	705,625	2.12
Cash Flow for Insurance and Superannuation Business				
Years ending 30 June	2000 (\$000's)	2001 (\$000's)	2002 (\$000's)	% Change This Year
Premium Income	2,533,097	2,598,603	2,466,717	-5.08
Investment Income	1,484,795	212,279	-468,813	-320.85
<i>Sub Total</i>	4,017,892	2,810,882	1,997,904	-28.92
Taxes	136,522	44,771	-62,199	-238.93
Commissions	231,154	258,519	291,645	12.81
All Other Management Expenses	400,218	368,840	438,259	18.82
Payments to Policy Holders	2,621,988	2,356,668	2,308,014	-2.06
<i>Sub Total</i>	3,389,882	3,028,798	2,975,719	-1.75
<i>Incomings Less Outgoings</i>	628,010	-217,916	-977,815	

Source: ISI Quarterly Statistics

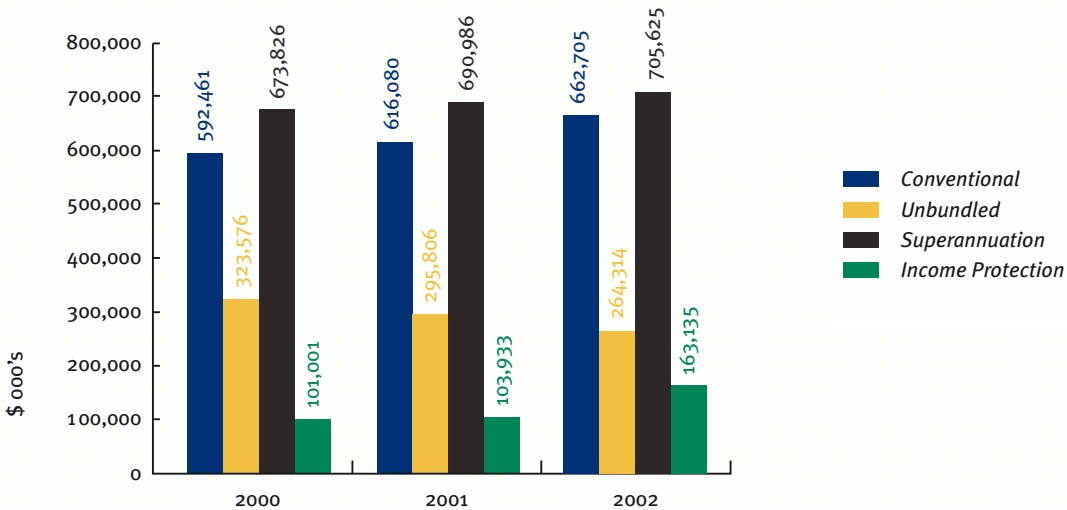
Regular Annual Premium, New Business by Policy Type
for year ending 30 June 2002



Single Premium, New Business by Policy Type
for year ending 30 June 2002



In Force, Business by Policy Type
as at 30 June 2002



Source: ISI Quarterly Statistics



Paul Fyfe, *Chairman*
Managing Director,
ING (New Zealand) Ltd.
Past Member of Superannuation
2000 Taskforce.



Ross Kent
Managing Director, AMP
Financial Services since
November 2001. Director of AMP
(Services) NZ Ltd., AMP
Superannuation (NZ) Ltd.,
Financial Services Distribution
Ltd. and eloannz.co.nz Ltd.



Jim Minto
Chief Executive Officer, TOWER
New Zealand since January 2002.
Responsible for TOWER Managed
Funds, TOWER Health & Life,
TOWER Insurance and TOWER
Group Network.



Rodger Murphy
General Manager, BNZ
Investments and Insurance.



Mike Newton
Chief Operating Officer and
Director of BT Funds
Management (NZ) Ltd. Industry
representative on Insurance &
Savings Ombudsman Board.



Christine Scott
Managing Director, Royal &
SunAlliance Life and Disability
(New Zealand) Ltd.



Simon Swanson
Managing Director, Sovereign
since 2001. Previously
Managing Director of the
Commonwealth Banking
Group's business in Fiji.



Vaughan Underwood
Chief Executive,
AXA New Zealand since March
2002. Previously Chief
Executive of Sterling Grace
Group.



David Whyte
Vice President & General
Manager, American
International Assurance
New Zealand. Industry
representative on Insurance &
Savings Ombudsman Board.

Directory

Member Offices as at 30 June 2002

American International Assurance
AMP Financial Services
ANZ Funds Management
AXA New Zealand
BNZ Investments and Insurance
BT Funds Management Ltd
Challenger International (NZ) Ltd
CIGNA Life Insurance NZ Ltd
Club Life Ltd
Equitable Life Insurance Co Ltd
Farmers' Mutual Group
Fidelity Life Assurance Co Ltd
General & Cologne Life Reinsurance Australasia Ltd
Gerling Global Reinsurance
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
National Bank of New Zealand Ltd
Pacific Life Ltd
Public Trust
RGA Reinsurance Co of Australia Ltd
Royal & SunAlliance Life & Disability (New Zealand) Ltd
Save and Invest Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand
WestpacTrust Financial Services Ltd

Associate Members

Bell Gully Buddle Weir
Buddle Findlay
Burrowes & Co
Chapman Tripp Sheffield Young
Davies Financial & Actuarial Ltd
Deloitte Touche Tohmatsu
Ernst & Young
KPMG
KPMG Legal
Melville Jessup Weaver
Morningstar Research Ltd
Phillips Fox
PricewaterhouseCoopers
Russell McVeagh
Simpson Grierson
Tacit Group Ltd



Vance Arkininstall

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 Arkininstall

Executive Officer

Deborah Keating

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