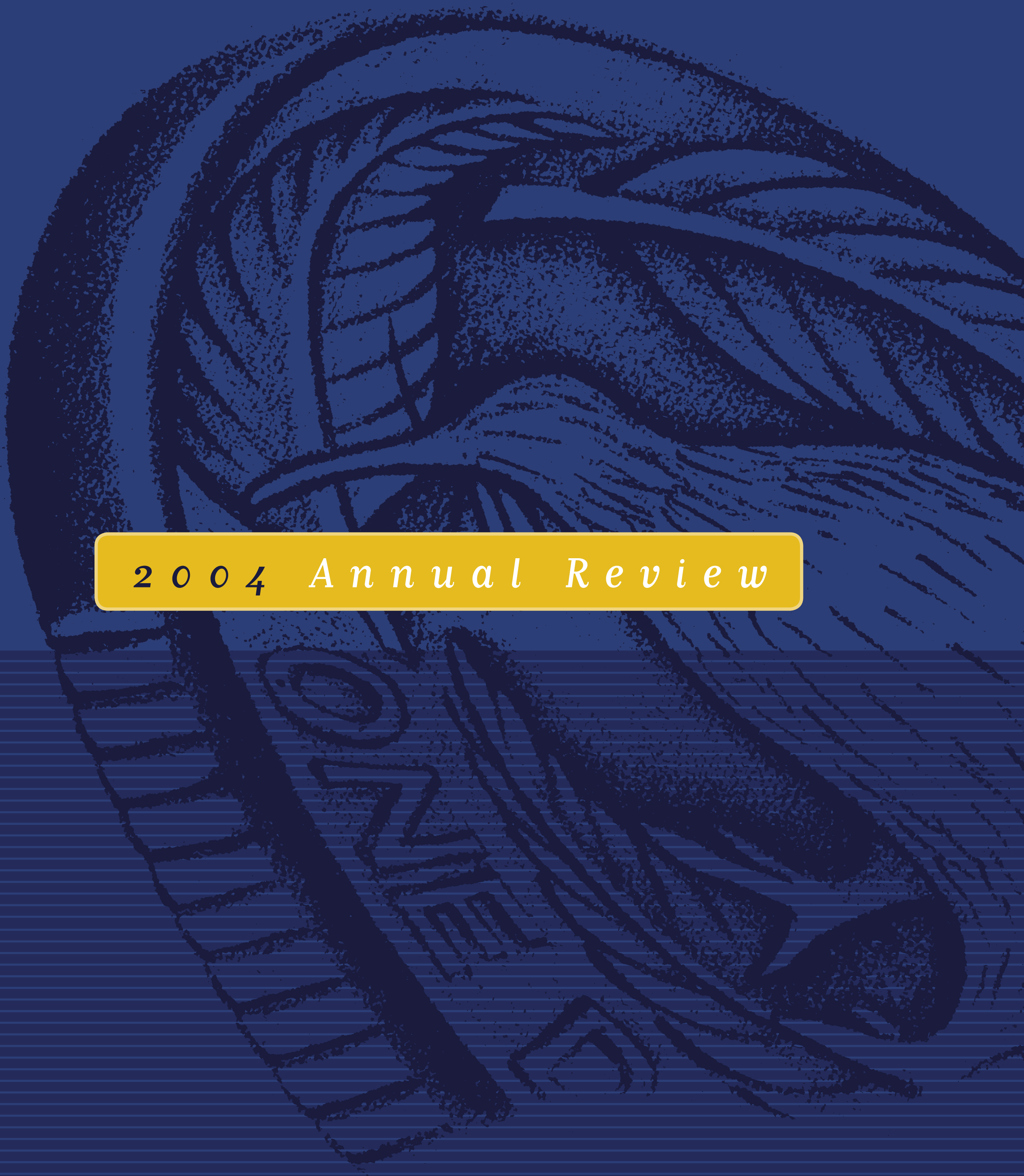
Annual Review of The Investment Savings and Insurance Association of New Zealand Inc for the Year Ended 30 June 2004



2004 Annual Review

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

Standing

Gail Costa *(CIGNA Life Insurance NZ Ltd)*, **Milton Jennings** *(Fidelity Life Assurance Co Ltd)*, **Paul Bevin** *(TOWER New Zealand)*, **Dennis Fox** *(Asteron Life Ltd)*, **Vaughan Underwood** *(AXA New Zealand)*, **Geoff Rogers** *(BNZ Investments and Insurance)*

Seated

Ross Kent *(AMP Financial Services)*, **Simon Swanson** *(Sovereign Ltd)*, **Vance Arkinstall** *(CEO, ISI)*

Absent

Paul Fyfe *(ING New Zealand Ltd)*, **Bernard McCrea** *(American International Assurance)*

key points

- The major advance this year has been recognition by the Government of the need for change in two key areas for this industry: savings policy and the tax treatment of collective investments. Progress was stimulated by the "Saving New Zealand" project which was a major ISI initiative at the end of the 2003 year.

- Submissions on the Officials' issues paper *Taxation of Non-Controlled Offshore Investment in Equity* in March led to the appointment of an independent person to consult with interested parties to see if a consensus could be established on the appropriate tax treatment for investment income. ISI has welcomed this initiative as a major step forward.

- In May, the Government appointed a special Savings Product Working Group to advise on the design and implementation of work-based savings products for retirement.

- ISI has joined with other industry bodies to prepare recommendations to Government on options for regulation of investment advisers in order to improve the level of confidence investors can have in the investment advice they receive.

- ISI welcomed the long overdue review of the Life Insurance Act 1908 by the Law Commission, due to report in October 2004.

- Over the year ended 30 June 2004, total retail funds under management for the industry increased 2.6% from $14.28 billion to $14.65 billion.

- In force annual premium income for life insurance business increased by 5% from $1.04 billion to $1.09 billion.

- In the year to 30 June 2004 ISI members paid policyholders $328.5 million in death benefits, $220.3 million in policy maturity payments and $114.8 million in other benefits such as income replacement.

from the Chairman

ISI has had a busy year with a number of public policy changes under discussion. We look forward with growing confidence to some improvements in the environment for collective investments in New Zealand. New Zealanders have long had a reputation as a nation of non-savers and statistics certainly indicate that we lag behind other countries in the accumulation of financial assets. ISI members believe that there need to be significant changes in several aspects of the savings environment to encourage people to change their behaviour. For the first time in many years there now seems to be a realistic prospect that the necessary changes will happen.

We are not talking about major climate change. ISI does not advocate a major redirection of Government policy away from the free market approach. We support minimal intervention in the economy and a reduction in the impact of regulation on investment decisions, together with maintenance of a safety net for the most vulnerable members of our society.

As noted under 'Our Aims' at the front of this review, one of the key objectives of the ISI is:

...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 bases its policy recommendations on the following over-arching principles:

- The country as a whole will benefit from policies focusing on stimulating economic growth;
- This will be best achieved by allowing the market to operate on a 'level playing field', with minimal Government intervention and no 'picking winners';
- Government intervention should be limited to those areas where the market is unable (for whatever reason) to provide the optimal outcome.

Applying these general principles to the tax treatment of savings, ISI has for many years been recommending comprehensive and consistent across-the-board tax on investments with flow-through of taxation to the individual at the marginal rate.

A taxation regime applied to collective investments which is neither a disincentive, nor an incentive, to choose collective investments over another investment type would require resolution of three main tax issues associated with savings:

1. Different tax treatment under current rules for different forms of saving,
2. Clarification of the capital/revenue boundary,
3. The over or under taxation of savers as a result of difference between individual and entity tax rates.

ISI supported the appointment of Craig Stobo to lead a review of the tax treatment of collective investments and we look forward to working with him.

On the savings front, ISI would like to see New Zealand Superannuation set at no more than a basic minimum income level in order not to act as a disincentive to personal saving. As an encouragement for personal savings, we endorse the recent moves by the Government into workplace savings schemes for State Sector employees and the Savings Product Working Group which looks at similar opportunities for the private sector. The removal of disincentives to save is the first priority but, in the interests of coming generations, some form of 'kick start' may be needed to re-establish the habit of saving rather than reliance on credit.

In principle, as stated above, we prefer minimal Government intervention in individual investment decisions. There is an argument for regulation however, only in cases where it will prevent harm to people who may not easily be able to protect themselves. New Zealand is also part of the global financial services industry and must take into account the pressures to conform to international standards. ISI supports recent moves by the Securities Commission to improve public comprehension of investment issues. We also support increased regulation of investment advisers to raise standards and improve consumer confidence in the industry. Higher levels of understanding on both sides will benefit everyone as more New Zealanders take responsibility for the accumulation of the financial assets necessary to ensure an active and enjoyable life after retirement.

While the role of an industry association is to represent the interests of its members, we believe this can best be done by taking a principled stand on the issues facing our industry. In the long term, decisions that will benefit the economy and the people of New Zealand will also benefit ISI members.

Simon Swanson
Chairman

the Year in Review

The Association had a successful year. The environment within which ISI members, and particularly managed funds, operate has improved markedly with significantly higher investment returns and declining outflows of funds. The activities in 2003/04 focused essentially on five issues arising from a survey of members. But as often happens in such a dynamic industry, further issues emerged as important.

1. Taxation of Collective Investments

The industry has long been disadvantaged by a system that taxes the savings and investment products of ISI members under any of five different bases.

As far back as December 1998, the Committee of Experts on Tax Compliance considered the capital revenue distinction issues raised by ISI as serious. "They cause distortions to New Zealand's savings and investment practices and should be addressed at an early date," they said in their report.

As predicted by the industry, the capital/revenue boundary distortions have grown, the over-taxation of low income savers has continued, and the advantages gained by offshore funds have finally come to attention, with the taxation status of Australian Unit Trusts (AUTs) focusing attention on the importance of these issues.

The industry welcomes the establishment by Government of a broad review with a tight reporting timeframe (October 2004) to address these outstanding matters. We are expecting industry submissions and recommendations to Government to focus on the need for comprehensive and consistent tax treatment of collective investment vehicles.

2. Regulation of Investment Advisers

It has been apparent for some time that there is growing concern within ISI, Government, the Securities Commission and sectors of the media, at the quality of advice and the inadequacy of existing adviser regulation to address these concerns.

It is interesting that, despite increasing murmuring, there has been no clear definition of the problem. Rather, there is a perception that all is not well with investment advice and it appears that some of the criticism of advice may be a result of three years of difficult investment conditions.

However, ISI accepts the need for change and has taken a leadership role among other interested groups to initiate the design of a new regulation regime to address the perceived problems. ISI recognises the need for change but would counsel strongly against adoption of the recently introduced Australian model which would put serious cost burdens on the small New Zealand market.

Later in 2004 we expect to see Government introduce legislation to implement the results of the review of the Investment Adviser (Disclosure) Act 1996. That will bring about important change, but amendments to existing legislation will not of themselves be sufficient and a new regime for investment advisers will still be necessary.

The key elements ISI has identified for consideration of a new adviser regime include:

- The change must bring about increased confidence in the advisory industry. Increasing the value or 'brand' of the investment advisor is essential.
- New Zealand is a small market and prescriptive overseas solutions would be far too expensive to implement here. (The example from Australia is that it has had a negative effect of significantly increasing the 'cost' of advice). A New Zealand solution must be cost effective in order to avoid excessive cost to our local investors.
- An approval process and a register of approved advisers would be a requirement.
- Education/competency and accreditation would be key components.
- The introduction of a transparent, independent and easily accessible disputes resolution process is essential.
- The introduction of a disciplinary process or panel which has the legislative power to 'strike off the register' those advisers who fail to measure up to the high standards expected.

Since the end of the year in review the

Minister of Commerce has announced the setting up of a taskforce to look into the regulation of financial intermediaries. ISI is committed to playing a major role in this process and we look forward to reporting on positive change in next year's review.

3. Review of the Life Insurance Act 1908

During the 2003/04 year we welcomed the Law Commission review of the Life Insurance Act and look forward to the report due in October 2004.

It is an embarrassment that the industry which manages life insurance assets of approximately $8 billion should be governed by such seriously out of date legislation – fortunately that is about to change.

4. Improving the Environment for Long-term Savings

The efforts of the industry on savings have been directed principally at assisting Government officials and media to understand the complexities of both the life insurance and funds management industries. This also links with education challenges. It is clear that achieving progress with a new and improved taxation regime, and a new regime for advisers, will be important steps.

The Association is generally successful in establishing an agreed position on the most important topics. However, consensus regarding steps to improve the level of personal savings has proved elusive. ISI members, consistent with the population, hold differing views. It is therefore not surprising that the industry does not have a total consensus. There is however, a significant view within the ISI membership that the original Todd Task Force may have got it right in its December 1992 report when it stated that the improved voluntary option may not be sufficient and that incentives or compulsion may eventually need to be considered. Incentives and compulsion come in many forms and we may be close to the time for serious debate.

5. Education – Public and Industry

In this area our efforts have been directed towards responding to media enquiries (TV, radio and print), preparing articles for papers and magazines and briefing officials and regulators.

Feedback indicates much of the public material has been well received. Also, it should come as no great surprise that officials find it helpful to have access to the Association to assist their understanding of complex matters.

ISI has joined our banking and general insurance colleagues in the recent formation of an industry training organisation, which will emerge through the new year.

6. Review of Practice Standards

A review of the Manual of Practice Standards is advancing well and ISI will soon be in a position to share the next revised Standards with members and the public.

7. International Accounting Standards

Representation of the industry has been through industry specialists in both the accounting profession and the Society of Actuaries. The impact will be significant in terms of disclosure and accounting treatment. ISI expects to issue guidelines to members within the very near future.

The next twelve months

The industry maintains its strong call for IRD to release its review of income protection (agreed value) policies. The ongoing delay has created an uncertainty that is not helpful to product providers, advisers and consumers.

Another major challenge over the coming months will be responding effectively to criticism (often poorly presented) regarding fees/charges, soft commissions and adequacy of disclosure.

As an industry we have made huge strides on all of these matters. This progress will continue as we operate in a global market to best serve the needs of our consumers.

Vance Arkinstall
Chief Executive

Industry overview

Funds Under Management

Unlisted retail investment funds under management by New Zealand fund managers as at 30 June 2004 amounted to $14.65 billion, up from $14.28 billion at 30 June 2003.

The total was made up of:

Unit trusts	$6218.5 million
Superannuation trusts	$5464.6 million
Group investment funds	$1587.9 million
Insurance bonds	$1384.1 million

While this represents an overall increase of 2.6% for funds under management for the June year, the increase is lowered by transfers out of some funds into funds not currently included in the Morningstar Research survey, such as mortgage income and cash income trusts.

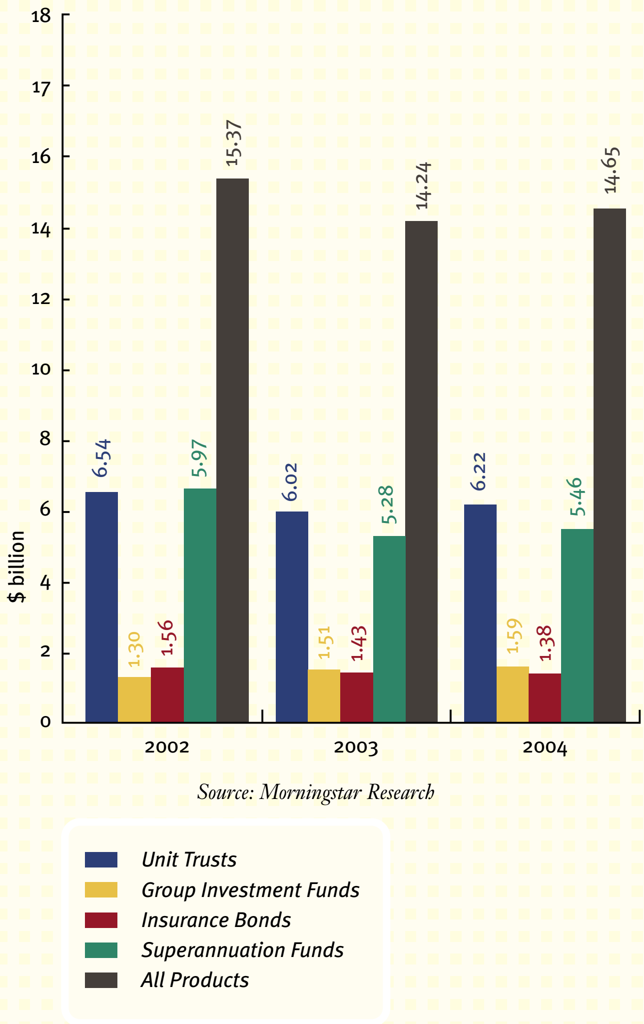
Funds under management in unit trusts increased by 3.2%, superannuation trusts increased by 3.3% and group investment funds by 4.0%. Insurance bonds continued their decline, falling by 3.6%.

There was a net outflow of funds of $209.2 million in the year to 30 June 2004, compared with the net outflow of $611.1 million in the year to 30 June 2003. Once again the outflow was primarily from superannuation trusts, with a net outflow of $195.8 million. That was 6.0% less than the outflow from that category in the previous year. There was a net outflow of $137.8 million from insurance bonds, whereas unit trusts and group investment funds showed a net inflow of $124.4 million (compared with $51.5 million in the previous year).

In the first two quarters both group investment funds and unit trusts showed positive cash flows. In the third quarter, all product groups had negative cash flows although in the final quarter, group investment funds flows became positive once again. As noted above, some of the fund flows can be accounted for by funds moving within companies to other fund types that are not picked up in these statistics.

Net Retail Funds Under Management

as at 30 June 2004



Source: Morningstar Research

Traditional & Risk Business – Product Summary

Year ending 30 June 2004

Product	Annual Premiums $000							Annual Premium Contracts		Single Premium Contracts	
					Discontinuances			Benefit count		New contracts	
	Inforce @ start	Contractual increases plus adjustments	New Business	Transfers	Claims & expiries	Lapses, surrenders & cancellations	Inforce @ end	New	Inforce @ end	Premiums $000	Benefit count
Traditional	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*	*(i)*	*(j)*	*(k)*
Whole Life & Endowment	187,383	997	3,961	27	7,928	7,245	177,185	2,645	512,609	293	0
*2003**	*194,907*	*524*	*3,767*	*72*	*5,934*	*5,954*	*187,382*	*1,924*	*547,360*	*146*	*0*
Unbundled	79,707	874	309	8,263	4,217	5,128	79,808	464	101,011	4,809	56
*2003**	*153,373*	*-63,057*	*1,429*	*-3*	*4,562*	*7,474*	*79,706*	*1,175*	*91,839*	*14,548*	*410*
Risk											
Term	413,607	27,599	71,152	-10,096	1,730	51,540	448,992	180,243	1,144,056	13,357	21,396
*2003**	*400,287*	*5,572*	*52,526*	*-678*	*2,330*	*41,764*	*413,613*	*146,620*	*1,128,037*	*6,002*	*14,525*
Guaranteed Acceptance	18,616	-65	5,162	8	484	1,974	21,261	18,950	97,213	0	0
*2003**	*13,624*	*2,509*	*4,061*	*0*	*273*	*1,303*	*18,618*	*15,232*	*88,878*	*0*	*0*
Trauma	65,321	5,906	16,849	-552	182	10,648	76,704	53,583	250,766	0	0
*2003**	*52,017*	*7,644*	*12,953*	*43*	*83*	*7,258*	*65,316*	*38,564*	*213,290*	*0*	*0*
Replacement Income	142,275	9,315	22,847	-8,724	394	21,862	143,454	54,687	303,397	0	0
*2003**	*127,087*	*14,758*	*16,979*	*45*	*563*	*16,031*	*142,275*	*50,281*	*299,167*	*0*	*0*
Lump Sum Disablement	15,876	1,568	3,395	-256	48	2,829	17,702	17,735	96,754	0	0
*2003**	*11,669*	*3,448*	*2,511*	*4*	*17*	*1,739*	*15,876*	*13,941*	*95,549*	*0*	*0*
Accidental Death	21,138	-21	2,120	-5	566	2,787	19,872	23,564	260,304	0	0
*2003**	*20,428*	*1,265*	*2,527*	*0*	*877*	*2,204*	*21,139*	*27,340*	*284,924*	*0*	*0*
Credit Insurance	39,375	2,705	10,028	0	9	8,713	43,387	54,784	306,538	4,136	11,873
*2003**	*36,190*	*4*	*9,376*	*0*	*5*	*6,191*	*39,374*	*47,764*	*311,476*	*2,824*	*10,679*
Group											
Death & Disablement	43,113	2,778	5,546	0	140	4,557	46,742	74	279	0	0
*2003**	*44,549*	*2,558*	*2,975*	*0*	*103*	*6,868*	*43,111*	*47*	*390*	*1*	*0*
Replacement Income	11,613	780	2,917	0	42	2,256	13,013	20	17	0	0
*2003**	*11,114*	*682*	*1,430*	*0*	*22*	*1,590*	*11,614*	*17*	*137*	*0*	*0*
Trauma	1,272	50	122	0	0	41	1,403	4	10	0	0
*2003**	*1,107*	*133*	*134*	*0*	*0*	*104*	*1,270*	*22*	*8*	*0*	*0*

* Comparison with 2003 Annual Review. The ISI statistics series was revised with effect from the quarter ending 31 December 2003. Accordingly, only three quarters of the year to 30 June 2003 are included in these tables.

Savings and Investment Products – Funds Under Administration

Year ending 30 June 2004

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	2,050,299	267,614	398,858	1,337	94,652	2,012,368
*2003**	*956,553*	*214,148*	*302,765*	*1,214*	*1,183,578*	*2,050,299*
Retail Super	2,559,298	429,010	417,525	364	559,872	3,130,291
*2003**	*1,564,596*	*226,533*	*234,151*	*250*	*1,041,284*	*2,598,011*
Unit Trusts	647,546	587,869	570,203	0	1,066,713	1,731,925
*2003**	*370,686*	*49,066*	*95,658*	*0*	*323,452*	*647,546*
Master Trusts	624,494	155,726	203,714	0	398,955	975,462
*2003**	*865,429*	*104,875*	*167,701*	*0*	*-14,421*	*788,183*
Open-Ended Investment Companies	20,797	9,833	6,180	0	-3,672	20,778
*2003**	*25,115*	*3,904*	*2,143*	*0*	*-6,079*	*20,797*
Term Deposit Bonds	81,250	49,282	83,437	0	2,490	49,585
*2003**	*0*	*40,924*	*60,869*	*0*	*101,195*	*81,250*
Group Investment Funds	167,794	77,820	84,627	0	-4,094	156,892
*2003**	*151,689*	*51,033*	*44,924*	*0*	*9,997*	*167,794*
Australian Vehicles	23,746	13,355	12,213	0	-455	24,431
*2003**	*13,960*	*5,991*	*1,311*	*0*	*5,106*	*23,746*
Listed Unit Trust	654,528	0	0	0	-4,076	650,452
*2003**	*605,055*	*0*	*0*	*0*	*49,473*	*654,528*
Wrap Accounts	2,107,311	710,470	511,541	0	169,885	2,476,125
*2003**	*235,245*	*452,782*	*356,265*	*0*	*1,775,549*	*2,107,311*

* Comparison with 2003 Annual Review. The ISI statistics series was revised with effect from the quarter ending 31 December 2003. Accordingly, only three quarters of the year to 30 June 2003 are included in these tables.

** Adjustments include Fees, Charges and Investment Returns.

Benefits Paid

Year ending 30 June 2004

Product	Amount paid $000 Death	Maturity	Other Benefits
Traditional			
Whole Life & Endowment	78,301	187,207	13,769
*2003**	*63,725*	*131,050*	*7,292*
Unbundled	10,097	29,304	6,808
*2003**	*8,971*	*21,366*	*6,401*
Annuities	1,699	29	25,425
*2003**	*402*	*20,536*	*-*
Risk			
Term Deposit Bonds	174,524	83	1,445
*2003**	*118,028*	*222*	*2,863*
Guaranteed Acceptance	3,133	0	0
*2003**	*2,386*	*0*	*0*
Trauma	6,068	0	18,584
*2003**	*4,131*	*0*	*12,475*
Replacement Income	12,766	0	37,026
*2003**	*6,943*	*0*	*28,260*
Lump Sum Disablement	1,315	0	4,294
*2003**	*369*	*0*	*2,877*
Accidental Death	2,121	3,710	260
*2003**	*1,215*	*7,156*	*391*
Credit Insurance	5,500	0	3,989
*2003**	*3,072*	*0*	*2,975*
Group			
Death & Disablement	30,282	0	-951
*2003**	*25,039*	*0*	*1,572*
Replacement Income	2,250	0	2,985
*2003**	*3,515*	*0*	*4,109*
Trauma	543	-	1,235
*2003**	*-*	*-*	*813*

* Comparison with 2003 Annual Review. The ISI statistics series was revised with effect from the quarter ending 31 December 2003. Accordingly, only three quarters of the year to 30 June 2003 are included in these tables.

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

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:

Acknowledgements

Taxation

Rebecca Singh	AMP Financial Services
Drew Herriott	AXA New Zealand
Tim Steel	Bank of New Zealand
Donald Wong	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
Matthew Hanley	Ernst & Young

Superannuation

Jonathan Falloon	AMP Financial Services
George Harvey	AXA New Zealand
Helen Moody	Jacques Martin NZ Ltd
Val Murray	Jacques Martin NZ Ltd
Vena Crawley	Sovereign Ltd

Legislation

Therese Singleton	AMP Financial Services
Elizabeth Rinckes	AXA New Zealand
Mark Todd	Bell Gully Buddle Weir
Sarah Johnstone	BT Funds Management (NZ) Ltd
Fiona Oliver	BT Funds Management (NZ) Ltd
Tim Williams	Chapman Tripp Sheffield Young
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

Advisor Regulation

Jonathan Falloon	AMP Financial Services
Brian Lenehan	Asteron
Matthew Mimms	BT Funds Management (NZ) Ltd
Tom Lyall	Sovereign Ltd
Ian New	Westpac
Peter Conroy	TOWER New Zealand

Actuarial

Richie Rama	AXA New Zealand
Ian Perera	Sovereign Ltd
Daryl Hayes	TOWER New Zealand

Life Insurance Act Review Group

Milton Jennings	Fidelity Life
Bernard McCrea	American International Assurance
Jonathan Falloon	AMP Financial Services
Daryl Hayes	TOWER New Zealand
Ian New	Westpac
Stephen Ladanyi	Asteron
Hugh Smith	Bank of New Zealand
Michael Burrowes	Burrowes & Co.
Ian Perera	Sovereign Ltd
Martin Hunter	Sovereign Ltd

Directory

ISI Members as at 30 June 2004

American International Assurance
AMP Financial Services
ANZ National Bank Ltd
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
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
Westpac Financial Services

Associate Members as at 30 June 2004

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

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