IMPLICATIONS OF INCREASING COMPETITION IN THE FINANCE AND INSURANCE INDUSTRY

A NEW ZEALAND PERSPECTIVE

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1. PAPER OBJECTIVE:

The object of this paper is to examine the adequacy of the industrial classification system (NZSIC [1]) used in the presentation of statistics about the New Zealand economy, focusing on the need for separate industries for Superannuation and Life Insurance. The recommendations will also be expressed in terms of the Australia New Zealand Industrial Classsification System 1993 (ANZSIC) that will be implemented in the near future.

2. INTRODUCTION:

2.1 From July 1984 a programme of deregulation of the Finance and Insurance industry in New Zealand began. Major milestones included:

1984 -Controls on interest rates and credit growth abolished.
-All controls on both outward and inward foreign exchange transactions removed.
-Controls on overseas borrowing removed.

1985 -Compulsory ratio system requiring financial institutions to invest fixed proportions of their total funds in government and public securities abolished.
-NZ dollar floated.

1987 -Institutions, including overseas organisations, able to apply for banking licences.

1988 Introduction of full taxation on investment returns from, and withdrawal of taxation rebates on contributions to, life insurance and superannuation schemes.

1989 Superannuation Schemes Act frees up provisions relating to retirement benefits so the retirement benefit nolonger had to be taken in pension form.

[1] New Zealand Standard Industrial Classification 1987.

3. IMPACT:

3.1 The level and intensity of competition increased as the industry was exposed more and more to the influences of the market. Methods of obtaining finance changed as companies with better credit ratings than some banks started to purchase wholesale cash themselves and, in some cases, issued their own corporate bonds. These alternative methods of obtaining finance placed increasing pressure on the level of funds, in both the wholesale and retail markets, that the established participants in the Finance and Insurance industry could attract using their existing products and packages. As they strove to maintain both the market and their share of it, the traditional boundaries began to break down.

3.2 Commodities and services that were once the domain of a particular group are now being produced and provided by a much broader range of businesses. The commodities and services themselves have become more complex and all inclusive.

3.3 For example, instead of having to purchase life insurance separately from a superannuation package, a single package now exists that contains the elements of both. A single 'premium' is paid. There is no necessity for the superannuation element to incorporate an income stream for the period of retirement. There is a facility for cancellation before retirement age is reached attracting minimal/ negligible 'penalty fees'.

4. IMPLICATIONS

4.1 Questions raised by the existence of such a package are:
-Can such a product be determined as predominantly a life insurance package or predominantly a superannuation one?
-Is it actually an investor in financial assets (similar to a unit trust) that generates returns which are then used to 'purchase' life insurance and superannuation?
-Does the provision of such a package place the profider in the Life Insurance (NZSIC = 82110), Services to Insurance and Superannuation (NZSIC = 82301), or the Other Services to Finance and Investment (NZSIC = 81491) industry?
The difficulty in answering these quite clearly domonstrates the difficulties in implementing the NZSIC in its current form.

4.2 Whether we need to answer these questions or not depends on whether there is any point to the distinction between the provision of a life insurance package, a superannuation one, or a general fund with no fixed length of life. If the providers of these products do not actually operate differently, or react differently to the same economic stimuli, is there any benefit in applying a classification system that enforces a distinction?

4.3 Will it improve the understanding of what is happening in the economy or will it lead to a deterioration due to the confusion and inconsistency of classification for similar units (or, indeed, the same unit year to year)? Certainly a deterioration is exactly what has happened in other areas without adequate guidelines or practical operating rules.

4.4 I believe that the example product (outlined in 3.2 above) highlights a deficiency in the classification system that has always existed but which has been disguised by the existance of legislation. Instead of deriving a classification that distinguishes different economic activity, we devised one that delineated units by whether the commodities produced were under a particular legislative umbrella. Now that the participants have responded to the legislative changes, the adequacy of the legislative-driven classifications are called into question.

4.5 The provision of a life insurance package (that is not a pure Term Life package), a superannuation one or a general fund, are really only variations on a theme. We can view these units as providing an overall commodity of financial security. Their real, predominant economic activity is fund investment or management on a fee basis. Each of the three commodities is simply a different way of attracting funds to invest.

4.6 While they are correctly identified as spearate commodities, I cannot see that their provision involves the providing unit in different activities. Anecdotally, the delineation is like setting up separate activities between Savings and Trading Banks. This was another legislative driven classification split that ceased to have any meaning in the deregulated financial market of New Zealand. Closer to the present, it can be likened to trying to enforce a split in the banking industry based on the provision of chequing, short-term savings and long-term savings facilities. While each of these facilities involves quite clearly different cost structures, we do not try to say that they involve the providers in different activities.

4.7 A pure term life or disability package quite clearly involves the provider in a different activity from fund management, in the same way as the provision of Health and General Insurance does. In these cases the determining factor in premiums and payouts is the preceived risk of the contributor dying or being disabled. There is no long-term savings aspect to the packages. The provision of pure term life or disability packages should therefore remain separately identified in our standard industrial classification.

4.8 If it is accepted that there is no need in the industrial classification system to enforce a split between units providing non-pure life insurance, superannuation or managed fund packages, and that such providers are simply providing financial management and investment services (and in NZSIC 81491: Other Services to Finanace and Investment n.e.c.), two questions remain.

4.9 Firstly, is there any need to maintain a split in the industrial classification for firms operating separately constituted superannuation funds? (These are self-administered schemes by the employer.)

4.10 Although, like other firms providing superannuation products, these employers are providing an overall commodity of financial security, their real predominant activity is not fund investment or management on a fee basis. In these employer administered schemes, the role of the provider is to make contributions to the fund and to maintain the fund accounts. Clearly then these firms, in this role, are performing no real, economic, productive activity. The payments that they make into the fund, and the administration costs incurred, are claimable expenses (for taxation purposes) in their predominant productive role. for this reason, there is no need to maintain a split in the industrial classification for firms operating separately constituted superannuation funds.

4.11 In reality, they are simply a convenient point from which information regarding the flows associated with the fund can be collected. As such they can be noted as valid collection units, but they should not be forced to be statistical units to which an industrial classification has to be applied.

4.12 Leading on from this is the question of whether there is any need to maintain a split in the industrial classification system for Superannuation funds separately from Holder Investors? To answer this it is necessary to know if Superannuation funds react differently from Financial Asset Investors to the same economic stimuli. As the types of instruments that Superannuation and General or Managed funds invest in are generally the same, and the goals of the two are also generally the same (long-term financial security of the fund owners), it would seem extremely unlikely that they would act and react in different ways.

4.13 The argument that the statistics collated on the "Superannuation Industry" represent what people are putting away for their retirement and so should be a separately identified part of our industrial classification is not a valid one. If statistics are really required on the level of long-term saving provisions for retirement, they would need to take account of investments in housing, other real estate, and general or managed funds (that are not decreed by legislation to be "Superannuation") to name but a few. Given this, there is no reason to have these funds separated in our industrial classification.

5. RECOMMENDATION IN TERMS OF NZSIC:

We remove from our standard industrial classification system, the following delineations:

NZSIC 81330 Holder Investing n.e.c.
Investing money, on own account, mainly in financial securities including shares mortgages, patents and copyrights. Includes enterprises engaged in holding stocks and shares in their subsidiary company or companies.

NZSIC 81491 Other Services to Financial and Investment n.e.c.
The rental of safe deposits; investment research and counselling; franchise selling and leasing; dealing in oil, gas, and mineral royalties and leases; the management of finance and investment concerns on a fee or commission basis (except for separately constituted superannuation funds); the selling of financial and investment services on a commission or fee basis (except as carried out by

building society commission agents); and other services to finance and investment n.e.c.

NZSIC 82110 Life Insurance.
The provision of life insurance, life re-insurance and other life insurance including mortgage repayment insurance. Includes superannuation and mutual fund operation not separately administered.

NZSIC 82200 Superannuation and Mutual Fund Operation.
Operation of separately administered superannuation and pension funds. Exclude the management of such funds on a fee or contract basis.

NZSIC 82301 Services to Insurance and Superannuation
Include insurance broking and agency services; adjustment, assessing and consulting services; the management of pension and superannuation funds on a commission or fee basis.

and replace with:

*** Holder Investing n.e.c.**
Investing money, on own account *(includes enterprises representing superannuation and pension funds and unit trusts),* mainly in financial securities including shares mortgages, patents and copyrights. Includes enterprises engaged in holding stocks and shares in their subsidiary company or companies.

*** Management and Sales Services to Finance and Investment.**
The management of finance and investment concerns *(includes the management of superannuation and pension funds)* on a fee or commission basis; the selling of financial and investment services on a commission or fee basis; and investment research and counselling.

*** Other Services to Finance and Investment n.e.c.**
The rental of safe deposits; franchise selling and leasing; dealing in oil, gas, and mineral royalties and leases; and other services to finance and investment n.e.c.

*** Life Insurance**
The provision of term life and disability insurance carrying no investment component where payouts only occur on the death of the contributor and the premium is only linked to the risk.

*** Services to Insurance**
Include insurance broking and agency services; adjustment, assessing and consulting services.

NOTE:
The purpose of splitting the 'Other Services to Finance and Investment n.e.c.' in two is so that we keep as small as possible those classifications that are inclusive of the not-elsewhere-classified activities.

6. RECOMMENDATION IN TERMS OF ANZSIC

We remove from ANZSIC, the following delineations:

ANZSIC 7340 Financial Asset Investors.
This class consists of units (except units of separately constituted superannuation funds) mainly engaged in investing money on their own account in predominantly financial assets (including mortgages). Also included are unit trusts mainly engaged in holding financial assets.

ANZSIC 7411 Life Insurance.
This class consists of units mainly engaged inproviding life cover.

ANZSIC 7412 Superannuation Funds.
This class consists of units of separately constituted funds mainly engaged in providing retirement benefits.

ANZSIC 7519 Services to Finance and Investment n.e.c.
This class consists of units mainly engaged in providing nominee, trustee, investment management or advisory services (except insurance or superannuation). Also included in this class are units of incorporated stock exchanges.

ANZSIC 7520 Services to Insurance.
This class consists of units mainly engaged in profiding insurance broking or agency services, or other services to insurance such as consultant, claim assessment or adjustment services. This class also includes foreign based insurance underwriters mainly engaged in insurance broking (not carrying) domestically, as well as units mainly engaged in managing or in carrying out the operations of separately constituted superannuation funds on a commission or fee basis.

and replace with:

*** Financial Asset Investors.**
This class consists of units *(including units of separately constituted superannuation funds)* mainly engaged in investing money on their own account in predominantly financial assets (including mortgages). also included are unit trusts mainly engaged in holding financial assets.

*** Life Insurance.**
The provision of term life and idsability insurance carrying no investment component where payouts only occur on the death of the contributor and the premium is only linked to the risk.

*** Finance and Investment Management or Advisory Services**
This class consists of units mainlyengaged in providing finance and investment management and advisory services *(includes the management of superannuation and pension funds)* on a fee or commission basis.

*** Services to Finance and Investment n.e.c.**
This class consists of units mainly engaged in providing nominee or trustee services. Also included in this class are units of incorporated stock exchanges.

*** Services to Insurance.**
This class consists of units mainly engaged in providing insurance broking or agency services, or other services to insurance such as consultant, claim assessment or adjustment services. This class also includes foreign based insurance underwriters mainly engaged in insurance broking (not carrying) domestically.