APRA

Australian Prudential Regulation Authority

Insurance

and

Superannuation

Bulletin

December 1997

Implementation of financial system reforms

On 17 March the Treasurer released a statement announcing the implementation of the government's reforms to the regulation of the financial system.

The ISC is highly pleased with the Treasurer's announcement and regards the APRA appointees Dr Carmichael and Mr Thompson as extremely well qualified for their new roles. The ISC believes that the new arrangements will provide first rate and world class prudential supervision across the Australian financial sector, building upon the existing close and cooperative work relations that the ISC has with the RBA and AFIC. Around 90 per cent of the ISC's functions and resources are expected to transfer to APRA.

Exerpts from the Treasurer's statement are reproduced below.

Treasurer's statement

As part of its drive to make Australia a leading business centre in the Asia Pacific region the Federal Government today announced the implementation of its new system of financial regulation.

This makes Australia a world leader with best practice financial sector regulation.

The Treasurer announced the establishment of a new agency, the Australian Prudential Regulation Authority and key appointments to that Authority.

He also announced the establishment of a new market regulator and consumer protection body, the Australian Securities and Investments Commission and senior appointments to the Commission.

A new high level Financial Sector Advisory Council will report directly to the Treasurer on regulatory and other changes required to make Australia the leading financial centre of the Asia Pacific region.

The reforms are designed to increase competition and improve efficiency, while preserving the integrity, security and fairness of the financial system. Once implemented, Australia will have a stronger regulatory regime designed to better respond to developments in the industry, including globalisation and technological change, and the needs of business and consumers. The package of measures has received wide support.

Decisions concerning the new regulatory authorities and further information on the timetable is provided below.

Establishment of the Commonwealth Regulatory Framework

The Government's aim is to establish the improved regime for financial system regulation at the Commonwealth level, on 1 July 1998, or as soon as possible thereafter, subject to the passage of legislation.

Appointments to the Australian Prudential Regulation Authority (APRA)

For the new prudential regulator to be effective from day one, a number of important decisions need to be set in place regarding the operation of the APRA, including the structure of the organisation and staffing-related issues. With this in mind, the Government has decided to announce its intended nominees for appointment to senior positions in this new body.

These people will operate on an interim basis until the enabling legislation is passed by Parliament and formal appointments can be made.

The relevant appointments are:

APRA Chairman-designate -
Dr Jeffrey Carmichael. Dr Carmichael. was a member of the Financial System Inquiry and is now a financial consultant and company director. He will bring to the role considerable experience and knowledge of the financial system both as a result of his extensive academic career, where he specialised in the field of banking and finance, and, more directly, in prudentially regulating financial institutions. Dr Carmichael has previously held positions as Chairman of the Australian Financial Institutions Commission. (AFIC) and Chairman of the Queensland Office of Financial Supervision. Both institutions are involved in the supervision of building societies, credit unions and friendly societies, which are intended to be transferred to the APRA's jurisdiction if the States and Territories agree. It is envisaged that Dr. Carmichael will be engaged as a part-time consultant to the Treasury before APRA's formal creation to advise and assist with the establishment of the new prudential regulator.

APRA Chief Executive Officer-designate -
Mr Graeme Thompson. Mr Thompson is Deputy Governor of the Reserve Bank of Australia (RBA) which is responsible for financial system stability, including the prudential regulation of banks. Mr Thompson has considerable experience in prudential regulation and other key areas of the financial system. His appointment will facilitate effective consultation between the RBA and the APRA in the early years of the new arrangements. The Governor of the Reserve Bank has agreed that Mr Thompson be released now, at the Bank's expense, so he can devote most of his time to the establishment of the APRA.

Australian Securities and Investments Commission (ASIC)

Since the Government announced the establishment of the proposal for a new regulator for market integrity and consumer protection, several representations have been made about the name. The Government has decided to adopt the name 'Australian Securities and Investments Commission' (ASIC) instead of the more cumbersome Australian Corporations and Financial Services Commission (ACFSC).

Mr Alan Cameron, the current Chairman of the Australian Securities Commission will remain as the Chairman of ASIC. The Deputy Chairman, Mr Peter Day and the other Commissioner, Ms Jillian Segal, will also continue their roles as Commissioners in ASIC.

Location of the APRA and ASIC

The headquarters of the APRA will be established in Sydney to ensure that a close relationship is maintained with the RBA which has responsibility for the overall stability of the financial system. This will facilitate the close communication and consultation between the two bodies that is a crucial element of these reforms.

The ASIC will be headquartered in Melbourne, while retaining an Office of the Chairman in Sydney. The additional Commonwealth consumer protection functions to be transferred to the ASIC will be based in Melbourne.

The Government expects a presence to be retained by each of the new regulators in the major State capitals and Canberra, and that opportunities to decentralise activities would also be fully explored by the APRA and ASIC. The maintenance of local knowledge and expertise is important to the overall success of these reforms.

In line with this, the Federal Government will seek to negotiate arrangements to transfer all staff now employed by the existing State and Territory regulatory bodies to the APRA or ASIC, as appropriate, to ensure as far as possible that there be no lessening of their present terms and conditions of employment.

As the Insurance and Superannuation Commission is based in Canberra, it is expected that the APRA will retain a substantial presence there for a considerable period of time after its establishment.

Council of Financial Regulators

As announced on 2 September 1997, the Government intends to establish a Council of Financial Regulators (CFR) comprising the RBA, the APRA and the ASIC to replace the present Council of Financial Supervisors and to extend cooperation across the full range of regulatory functions. To assist in the transition to the new regulatory framework and to undertake full consideration of emerging regulatory issues, the CFR will be established immediately and will meet in an interim configuration comprising the leaders of the existing and proposed regulatory agencies.

The CFR aims to facilitate cooperation and collaboration among its members, the main regulators of the Australian financial system - the RBA, the APRA and the ASIC. Its ultimate objective is to contribute to the efficiency and effectiveness of regulation.

The CFR provides a forum for:

- sharing information and views among its members, and liaison with other regulators and agencies;
- harmonising regulatory and reporting requirements, paying close attention to the need to keep regulatory costs to a minimum;
- identifying important issues and trends in the financial system, including the impact of technological developments; and
- coordinating regulatory responses to actual or potential instances of financial instability, and helping to resolve any issues where members' responsibilities overlap.

The CFR is a non-statutory body which reports to the Treasurer and produces an Annual Report.

Like its predecessor, the CFR will complement, not substitute, the close bilateral arrangements between agencies.

Legislation

Legislation to establish the new regulatory authorities and to give effect to the main measures announced on 2 September 1997 will be introduced in the Autumn Sittings of Parliament. The new framework for Commonwealth regulation is intended to be in place from 1 July 1998 or as soon as possible thereafter, subject to the passage of legislation.

The legislation to be introduced in the present sittings covers:

- the establishment of the APRA to undertake the prudential supervision of deposit-taking institutions, life and general insurance companies and superannuation funds;

- arrangements for the establishment of the ASIC (subject to the agreement of the Ministerial Council for Corporations);
- the industry levies necessary to fund the new supervision of deposit-taking institutions, life and general insurance companies and superannuation funds;
- the establishment of a Payments System Board within the RBA with responsibility for implementing policies to improve payments system efficiency and to enhance competition in the market for payments services, and additional powers for the RBA to regulate clearing and settlement systems;
- amendments to the *Banking Act 1959* to establish a single licensing and prudential regulatory regime for deposit-taking institutions, facilitate the establishment of non-operating holding company structures and enhance the depositor protection arrangements;
- a new Financial Sector (Shareholdings) Bill to implement a standardised regime that will promote widespread ownership in deposit-taking institutions and insurance companies; and
- allocation of the existing responsibilities for insurance and superannuation, currently carried out by the ISC, between APRA and ASIC.

It is desirable to establish the ASIC simultaneously with APRA. In the first stage, steps will be taken to rename the Australian Securities Commission as the ASIC and to allow it to perform existing (or amended) consumer protection and market integrity functions in the financial sector performed by other Commonwealth agencies, such as the Insurance and Superannuation Commission.

Further legislation, covering a second stage of reforms will be introduced later this year. It will:

- subject to the agreement of the States and Territories, deal with the transfer to the Commonwealth of regulatory responsibility for credit unions, building societies and friendly societies; and
- create a consolidated law for market conduct and disclosure in the financial system to be administered by ASIC (including amendments to Corporations Law flowing from the Corporate Law Economic Reform Program).

Discussions with State and Territory Governments

The Prime Minister wrote to the Premiers and Chief Ministers on 2 September seeking 'in principle' agreement by the end of 1997, to the transfer of prudential and corporate regulatory responsibility for building societies, credit unions and friendly societies to the Commonwealth, and the establishment of the new regulator for market integrity and consumer protection. At the time of announcement of the reforms, the Government proposed that the transfer of regulatory responsibility for financial entities presently regulated by the States and Territories would, if agreed, occur by 1 July 1999.

Industry remains enthusiastic about the reforms and is keen to progress the second stage, as are most of the States.

In light of this support, and to reduce the uncertainties for the staff involved in the supervising authorities, the Federal Government would like to bring forward implementation of the second stage to maximise the benefits for credit unions, building societies and friendly societies.

To initiate the next phase of discussions, the Prime Minister has today written to the Premiers and Chief Ministers to propose that an arrangement be negotiated to achieve a transfer of prudential and corporate regulatory responsibilities for building societies, credit unions, and friendly societies as soon as possible in 1998. These discussions will cover a range of issues of interest to the States and Territories including regulatory issues regarding trustee companies and housing co-operatives. The Commonwealth Treasury will shortly be approaching the States and Territories to begin these discussions at officials' level.

Contact Officer:

Greg Smith, Financial Institutions Division, The Treasury, Tel. (02) 6263 3762

Treasury Internet Home Page:
http://www.treasury.gov.au

17 March 1998.

Australian institutional investment in Asia

The current turmoil in Asian financial markets, particularly the equity and currency markets, has the potential to significantly impact Australian savings. In this article we look at major Australian financial institutions and their exposure to Asian markets.

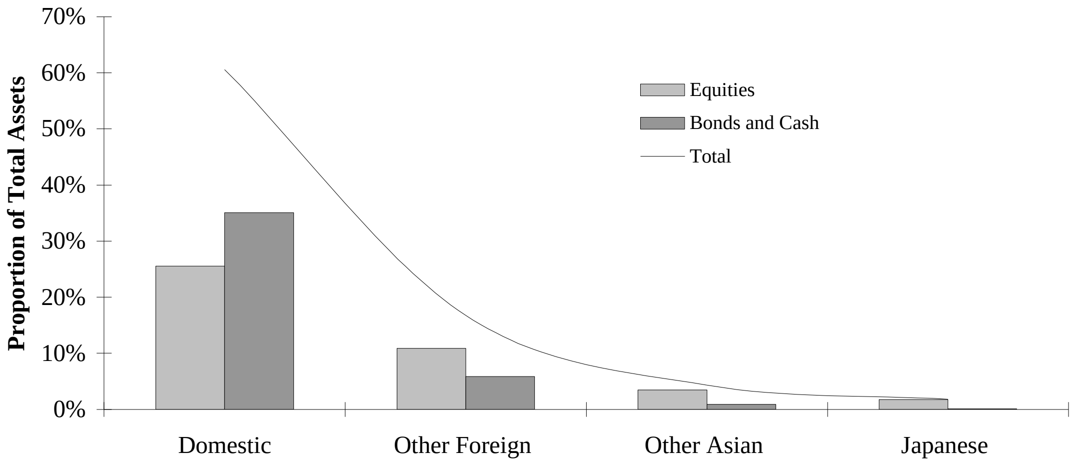
This article differs from previously published versions and now includes revisions and amendments to the original *Institutional Investor* survey data recently received by the ISC.

According to a survey recently published in *Institutional Investor* magazine, as at December 1996 the exposure to the Asian investment markets of 35 of the largest Australian and New Zealand institutional investors was around 5.7 per cent ($18.5 billion) of their total assets under management (AUM). This includes their overseas subsidiary operations, where applicable. Around 2.0 per cent ($6.4 billion) of this exposure is in investments in Japan, with the remaining 3.7 per cent invested in other Asian markets. See figure 1. The institutional investors include a range of banks, insurance companies public sector superannuation funds and independent investment managers.

Asian currency depreciation and falls in Asian equity markets since the survey have most likely seen these levels and proportions change, as both factors act to lower the AUD value of Asian investments. Nonetheless, as these movements would most likely have led to (unrealised) portfolio losses, the results of the survey are worth noting.

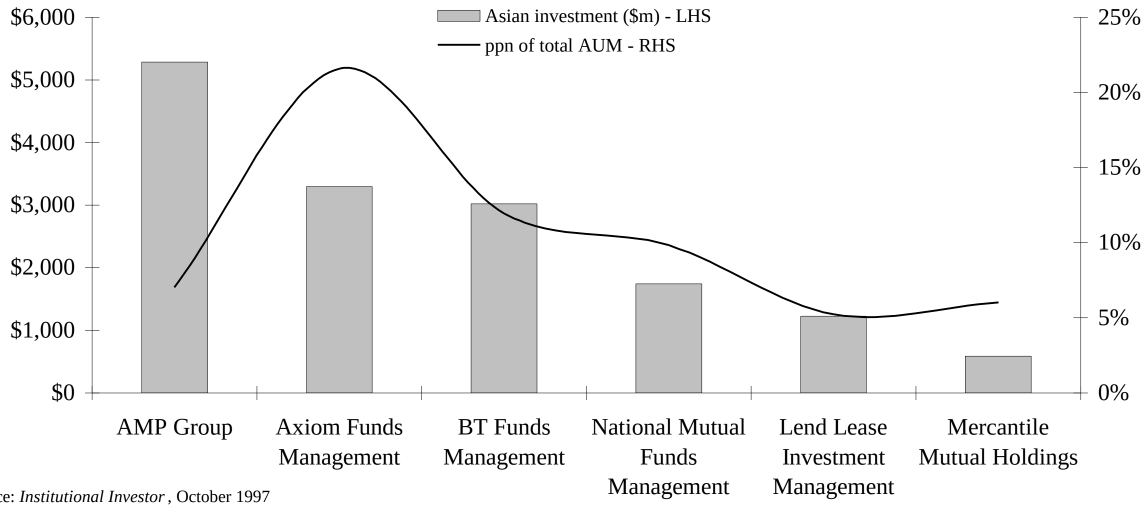
The survey results indicate that investment in offshore markets, and particularly the Asian markets, by institutions is highly weighted toward equities in preference to bonds and cash. For example, 84 per cent ($15.4billion) of the Asian investment is in equities with the remaining 16 per cent ($3.0 billion) in bonds and cash. Similarly 66 per cent ($55.9 billion) of other foreign investments is in equities. In contrast, domestic equities accounted for only 42 per cent ($198.3 billion) of the domestic

Figure 1: Australian investors global profile - December 1996



Source: *Institutional Investor* , October 1997

Figure 2: Investor Asian market exposure - December 1996



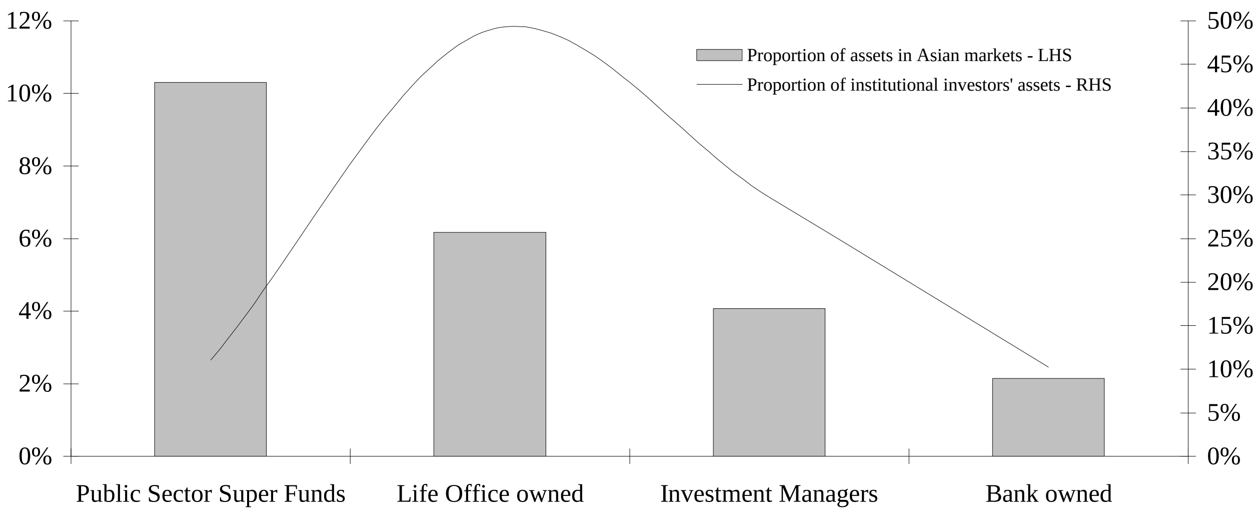
Source: *Institutional Investor* , October 1997

investment of the institutional investors surveyed. While information was contained in the survey regarding property asset holdings, disaggregation of these holdings into domestic and overseas was not available.

The six institutional investors with the greatest exposure to the Asian investment markets account for around 82 per cent of the total institutional investors' Asian exposure, with the remaining 29 institutions accounting for 18 per cent of the Asian investment market exposure. See figure 2.

The Asian investments of these six institutions represent 9.3 per cent of their AUM, indicating their levels of Asian investment are significantly above the average of the 35 institutional investors contained in the survey as a whole.

Figure 3: Institutional Asian market exposure - December 1996



Source: *Institutional Investor* , October 1997

More broadly, life office owned institutions and the independent investment managers have around the average Asian exposure at 6 per cent and 4 per cent respectively, while accounting for the major proportion of total AUM (79 per cent or $254.2 billion). Banks have the lowest exposure, at 2 per cent ($0.7 billion) AUM. Major public sector superannuation funds have the largest average Asian investment market exposure at 10 per cent ($4.1 billion) of their AUM. This high proportion of investment in the Asian markets is most likely due to the long term attractiveness and growth potential of the Asian markets at the time of the survey for superannuation funds. However, these institutions account for only 12 per cent ($39.1 billion) of the total AUM of the 35 institutional investors surveyed. See figure 3.

This analysis of the survey results suggests that for the majority of Australian institutional investors the main impact of the decline in the Asian investment markets will not be so much from their direct investments in Asia, but more from their exposure to Australian companies that have significant business interests in Asia. For example, a number of blue chip Australian stocks have all suffered recent significant drops in share price, principally due to their Asian business ventures. However, the current depressed prices of Asian stock may also provide some investment opportunities for astute buyers.

Access to health records: new ACT legislation

The Health Records (Privacy and Access) Act 1997 came into force in the ACT on 1 February 1998. The Act is the first of its kind in Australia. It protects privacy rights in relation to personal health information, wherever that information is kept; it allows access by people to health information which is kept about them; and it clarifies the limitations to such access.

Some aspects of the legislation may affect the practice of a number of other organisations which keep information relating to health, illness or disability of individuals, in particular life and general insurance companies and superannuation funds.

Further information about the Act can be obtained from:
The ACT Community and Health Services Complaints Commissioner:(02) 6205 2222 or
The ACT Department of Health and Community Care:(02) 6205 1340

Life insurance industry distribution channels

Over the past few years, increasing attention has been focused on the way in which life insurance companies distribute their products. In this article we review the latest findings on life insurance product distribution from the ISC Code of Practice Returns.

Changes to the way in which life insurance products are distributed have largely been brought about by commercial pressures, changing consumer requirements, and new regulatory requirements, including those contained in the Life Insurance Code of Practice (the Code). In the years ahead, developments in electronic commerce will also play a role.

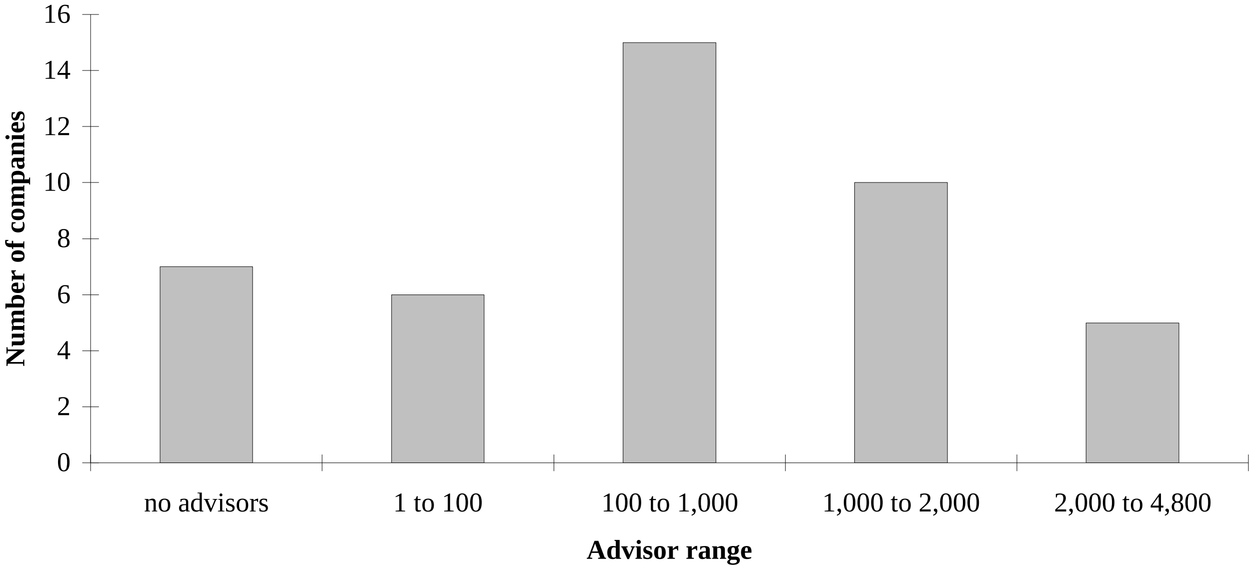
When the Code was introduced in 1995, the ISC began gathering information (through the Code of Practice Annual Returns) on changes in the use and relative importance of the various distribution channels.

In this article we analyse the number of life company advisers distributing life insurance products during the period 1996-97; the change in the number of sole agent and multi representatives during the period; the proportion of new policies distributed through the different channels; and the rates at which products sold by the different channels are discontinued by consumers.

For the purposes of this analysis, life company advisers include sole agent (including tied agents, salaried staff and first option agents) and multi-representatives. Sole and multi-agent (or agents) act on behalf of the life company or companies they represent in providing advice about life insurance products to consumers. Sole agents represent predominantly one life company, whereas multi-agents represent a number of companies, usually around four or five.

Brokers, in contrast to agents, act on behalf of (or represent) the consumer rather than the life company. Life

Figure 1: Life office use of advisors, June 1997



brokers and life broker agent are not included in this analysis of life company advisers.

Background

Determining an accurate number of advisers in the life industry is difficult because of the way in which distribution channels are structured. The majority of life insurance advisers act as multi-agents, that is they act for more than one life insurance company. Therefore, when life companies are asked to record the number of advisers they distribute through, one adviser may appear in the records of a number of life companies. In order to make allowances for this double counting, it is necessary to make an assumption for the average number of agency agreements held by multi-agents. Some industry sources estimate that, on average, multi-agents hold agency agreements with four different life companies. However, for the purposes of this analysis the ISC has taken a more conservative approach and reduced by a factor of five the raw number of multi-agents (that is, we assume there are 20 distinct agents for every 100 reported multi-agents).

Additionally, life companies may be unaware of or uninterested in which of their advisers are actually multi-agents and which act purely as sole agents for their company. This potentially results in an over-estimation of the number of sole agent in the industry.

Analysis

Number of life insurance advisers

Based upon the results of the Code of Practice survey, the ISC estimates that the number of life insurance advisers (excluding brokers and brokers' representatives) at 30 June 1997 was 13,584, an increase of nine per cent during the year.

Life company returns indicate that the number of sole agents increased by approximately 11 per cent (to 6,916) and the number of multi-agents[1] increased by 5 per cent (to 6,668). On the surface this may look as if life companies are encouraging advisors to operate under sole agency agreements rather than under multi-agency agreements. However, it is more likely that this result has been influenced by the difficulties that the industry has in explicitly identifying sole agents and therefore should be treated with caution. Notwithstanding these reservations, industry restructuring that may have contributed to this result includes changes in the status of in-house staff, variations in the number of agencies held by multi-agents and rationalisation of small multi-agencies to sole agencies.

Most companies (around 58 per cent) have agreements with between 100 and 2,000 advisers, however seven companies have no advisers (excluding any broking arrangements) while five companies use up to 4,800 advisers. See figure 1.

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1 The number of multi-agents was calculated by assuming that on average multi-agents hold five agency agreements. Based on this assumption, the total number of multi-agents recorded by the industry was divided by five to avoid over counting.

Differences between ISC figures and industry figures

Discussions with the life industry however, suggest that the number of sole/first option agents indicated by life companies on their returns may be inflated. This is because double counting often occurs when an adviser is treated inconsistently by one company as a sole agent and by another company as a multi-agent.

The variance between the industry estimates and the ISC figures (which have been supplied by the life companies themselves) indicate that the industry has significant difficulties in determining the status of the advisers with whom they have agreements. The ISC intends to seek discussions with the industry in order to resolve these apparent differences.

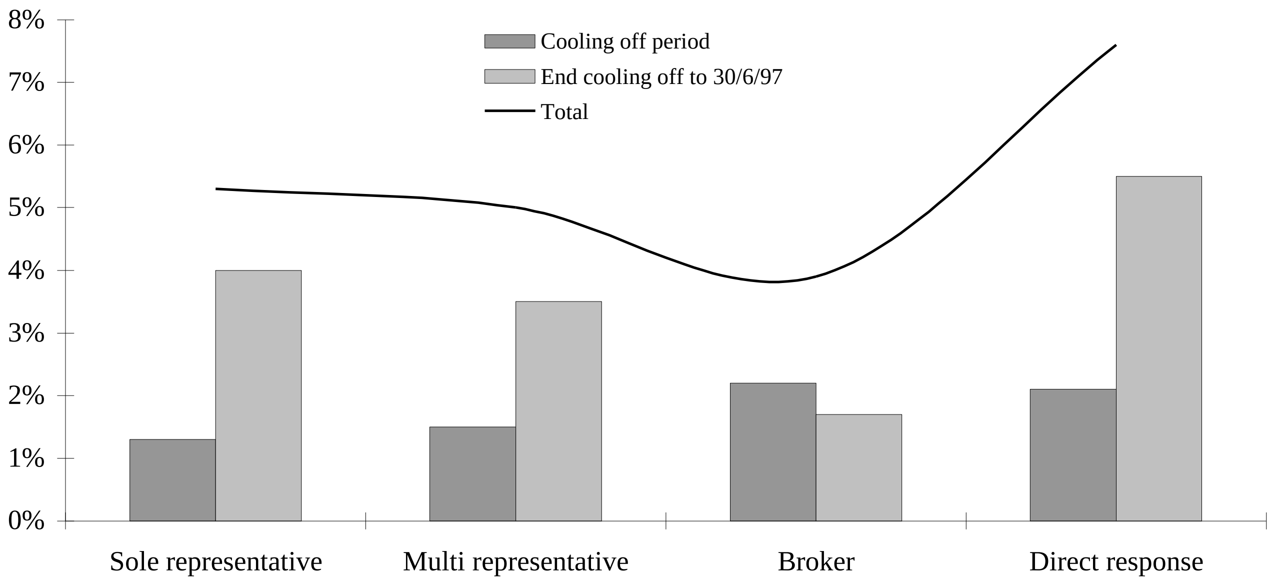
Sole agents/first option representatives

A total of 20 life companies (or 47 per cent) out of the 43 life companies selling retail business indicated that they employ sole agents to distribute their product.

Just over two-thirds (or 13) of these 20 companies also distribute their product through multi-agents. However, it appears that in these cases one form of distribution arrangement is usually preferred over the other. Reinforcing this, only one life company appears in both the top 6 sole representative principals and the top six users of multi-agents.

The top six life companies using sole agents account for around 74 per cent of the sole agents currently

Figure 2: Discontinuance rates, 1996-97



operating in the industry. These six companies accounted for 27 per cent (by number) and 42 per cent (by premium) of new policies written in 1996-97.

Multi agents

A total of 31 life companies (or 72 per cent) of the 43 life companies selling retail business indicated that they distribute their product through multi-agents. This result suggests that, particularly for smaller life companies, it is more efficient to make use of multi-agents than it is to establish a dedicated agency team.

Around 57 per cent of the multi-agents currently operating in the industry work for the top six principals of multi-agents. These companies accounted for 29 per cent (by number) and only 21 per cent (by premium) of new policies written in 1996-97, further reinforcing that it is the smaller life companies that make most use of multi-agents.

Proportion of new policies distributed through different channels

During the twelve months to 30 June 1997, around 985,000 new life insurance policies were written. This represents a decrease of approximately 10 per cent on the number of policies written during 1995-96 (at 1.1 million). Life companies distributed these new policies through the following channels:

- Sole representatives distributed 45 per cent of the new policies written during the period. This represents only a slight decrease from 1995-96 when sole agents (including tied and salaried staff) distributed 46 per cent of new policies.
- Multi-agents distributed 40 per cent of the new policies. This represents an increase of four per cent over the proportion of new policies distributed by multi-agents in the previous year.
- Direct marketing, for example direct mailing, accounted for eight per cent of the new policies. This represents a decrease of three per cent over the proportion of policies distributed by direct marketing in the previous year. This result suggests that direct distribution channels are not yet robust enough to become one of the major life insurance distribution channels.
- Brokers accounted for seven per cent. This remains unchanged from the previous period.

Discontinuance rates by distribution channels

Around five per cent of policies written in 1996-97 were discontinued prior to 30 June 1997. Discontinuances during the cooling off period accounted for nearly 30 per cent of these discontinuances.

A policy is said to be discontinued when it is surrendered or cancelled earlier than originally agreed at the outset of the policy. After the purchase of any life insurance policy, a consumer has a 'cooling off' period of at least 14 days during which time they can cancel the policy without attracting any additional penalties.

There was only minimal variation between the overall industry rate of discontinuance and the rate at which products sold by sole and multi-agents discontinued. See figure 2. In contrast, the experience of brokers and direct marketing differed significantly from the industry average.

Sales through brokers demonstrated significantly higher discontinuance rates during the cooling off period (at 2.2 per cent) than the industry average (at 1.6 per cent). However, much more favourable experience outside the cooling off period enabled brokers to experience significantly lower total discontinuance rates (at 3.9 per cent) than the industry average (at 5.5 per cent).

In contrast, discontinuance rates for policies sold through direct marketing were significantly higher than industry averages both during cooling off and from cooling off to 30 June 1997. The proportionately high level of discontinuances resulting from direct marketing sales follows the trend for discontinuances recorded in the 1995-96 Code return.

Future directions

While the exact number of life insurance advisers operating in the industry remains elusive, the data gathered from life insurance companies indicates that advisers, rather than brokers or direct marketing, continue to be the dominant distribution channel for retail products.

Over the next few years, the implementation of the Financial System Inquiry recommendation that a single licensing regime be established for all principal advisers (and through them, their authorised representatives) in the financial system is likely to have an impact on the number and classification of advisers in the life insurance industry. While it is too soon yet to predict the changes to distribution that will flow from the single licensing regime (and, of course, increasing competitive pressures) it is likely that a number of current multi-agents may well become distribution principals in their own right.

Recent trends suggest that the relative importance of non-adviser distribution channels is also likely to change over the next few years as consumers demand and technology provides greater flexibility in the way they interact with the financial system. However, it is interesting to note from this analysis that direct marketing accounting for only eight per cent of new policies written during this period. This represents a three per cent decrease from the previous period in market share secured by direct marketing. Given current industry and consumer interest in the internet and telemarketing it will be interesting to monitor this trend in the future.

Supervising Lloyd's In Australia

While the name 'Lloyd's' is relatively well known in the community very few people have more than a superficial knowledge of that organisation. In this article we attempt to unravel some of the mystery of Lloyd's and explain how the organisation is regulated in this country.

'Lloyd's' is a society or association of insurance underwriters located in London, England whose insurance business activities have created one of the world's largest insurance markets.

Operational structure of Lloyd's

Lloyd's members, whether individuals or companies, conduct their business in groups known as 'syndicates'. A member may belong to a number of syndicates. Syndicates vary in size and underwrite different types of insurance and levels of risk. Each syndicate is usually an annual venture - at the end of each year the syndicate ceases to underwrite new business. New syndicates, which may comprise the same membership, are formed for the following year. It is important to note that each syndicate member underwrites for their own account; the syndicate members are not in partnership and do not have any joint liability. In 1997 there were 164 syndicates trading.

In practice, the members themselves do not arrange their participation in syndicates - under Lloyd's rules they are not permitted to take an active role in the insurance business (beyond the liability they take on as underwriters). Instead, each member must appoint a Lloyd's registered 'members' agent' (in the case of individuals) or licensed adviser (in the case of corporates) to look after the member's Lloyd's affairs. In 1997 there were 9 959 individual members of Lloyd's, 202 corporate members, 21 members agents and 11 licensed advisers. A members' agent may look after the affairs of many members (over 1000 in some cases) and is paid a fee and commission from each.

Individual syndicates are put together and managed by a Lloyd's registered 'managing agent'. A managing agent may be responsible for a number of syndicates and may also be a members' agent (a 'combined agent'). In 1997 there were 67 managing agents and one combined agent.

A Lloyd's syndicate obtains insurance business by dealing with Lloyd's accredited brokers. To avoid any conflict of interest, a Lloyd's broker is not permitted to have any ownership in a syndicate managing agent. In 1997 there were 201 such broking firms.

Facilitating the conduct of the insurance business of Lloyd's is the Corporation of Lloyd's, a non-profit organisation which is financed by subscriptions from members and provides the building, the administrative staff, the accounting systems and other services which enable the membership to transact insurance business.

Current supervision of Lloyd's in Australia

The legislation governing general insurance underwriting in Australia is the *Insurance Act 1973*. Under this Act, any person wishing to carry on insurance business (as defined) must be authorised.

The unique operational structure of Lloyd's, as outlined above, does not lend itself to application of the general provisions of the Act (which are directed at companies). Instead, Lloyd's underwriters are made subject to special provisions set down in Part VII of, and the Schedule to, the *Insurance Act 1973.*

In brief, under those provisions Lloyd's underwriters are authorised to carry on insurance business in Australia subject to Lloyd's lodging with the Treasurer both a deposit of $500000 and a covenant given by a bank (which, in essence, is a bank guarantee). The amount of the covenant for any financial year is equivalent to the amount of premium income sourced in Australia during the calendar year one before last (in 1997/98, for example, the value of the covenant would equate to Lloyd's Australian premium income in 1995, ie $238 million). These funds arc available to be used to satisfy claims made against Lloyd's in the relevant circumstances.

In the late 1980s and early 1990s Lloyd's (and the insurance industry generally) came under great financial pressure as a result of a run of natural catastrophes hitherto unprecedented either in frequency of occurrence or magnitude of losses. At the same time, substantial claims with man-made origins, such as pollution and asbestosis, began to emerge. The effect was that from 1989 until 1992 Lloyd's incurred very large losses globally (total losses during this period were around 8 billion pounds).

To combat the situation, in the early 1990s Lloyd's embarked on a major 'renewal and reconstruction' plan to restore profitability and ensure ongoing viability. Two of the more important aspects of this plan were: first, in 1994 granting membership to corporate entities with limited liability; and second, in 1996 forming a new enterprise, known as Equitas Group, to assume all of Lloyd's 1992 and prior liabilities. These initiatives have been very successful with corporate capital now providing nearly around half of Lloyd's underwriting capacity of ten billion pounds and the organisation returning to profitability in 1993 (profit of just over one billion pounds).

Proposed new supervisory arrangements for Lloyd's

The Government is proposing to change the supervisory arrangements relating to Lloyd's. The new arrangements are intended to:

(i) better accommodate the changes to Lloyd's operations as a consequence of the implementation of its reconstruction and renewal plan;

(ii) enhance the regulatory protection for Lloyd's Australian policyholders; and

(iii) make the supervisory arrangements applying to Lloyd's more consistent with those applying to corporate insurers.

The major change will be in the way that Lloyd's Australian liabilities are financially secured.

Some major weaknesses have been identified with the current security. While the bank covenant is intended to support Lloyd's outstanding claims liabilities in Australia, its value is based on the level of premiums in Australia and therefore has no direct relationship to the value of liabilities. As there is strong potential for outstanding claims to far exceed the value of premiums written, it is likely that at any point in time the amount available under the covenant may be insufficient to fully support Lloyd's liabilities. Also, in the event Lloyd's underwriters ceased business in Australia Lloyd's would no longer receive premiums and, consequently, the value of the covenant would rapidly decline. However, Lloyd's underwriters would most likely retain substantial outstanding claims liabilities in Australia for many subsequent years. These claims would, under the existing security arrangements, be left with little or no security support.

Under the new arrangements, the present security of a bank covenant will be replaced by trust funds which will hold assets in Australia equivalent to Lloyd's net liabilities in Australia. The trust funds will be managed by a trustee approved by the Insurance and Superannuation Commissioner. Lloyd's will continue to lodge a deposit with the Treasurer but the amount will be raised to $2 million and it will be available to offset costs that may be incurred should Lloyd's cease to trade in Australia. The new arrangements will also greatly improve the Commissioner's ability to directly supervise Lloyd's activities in Australia through powers to suspend authorisation, to give directions, to carry out investigations, to revoke authorisation and to apply to the Federal Court for judicial management.

A brief history of Lloyd's

The origins of Lloyd's can be traced to a small 17th century coffee shop in London which was owned by a Mr Edward Lloyd. Mr Lloyd had no direct interest in insurance, however he promoted his coffee shop as a place where underwriters (insurers), merchants, ship owners and others could meet to arrange insurance, especially in respect of waterborne trade. Mr Lloyd tried to ensure that he had the most up to date shipping information and his coffee shop became very popular as a reliable source of marine business news. Although the Lloyd's of today has broadened its activities to encompass almost any type of insurance it remains the world's foremost marine insurance market.

The insurance activities at 'Lloyd's' continued in this rather informal way for many years (even after Mr Lloyd's death in 1713). As the market developed and expanded, however, it became clear to some of the more committed underwriters that a better organised commercial structure was necessary. In 1769 a number of them established a properly constituted society which they called the 'New Lloyd's Coffee House', moved to new premises and carried on operations in a more business-like manner.

Over the next century, the Society continued to evolve and strengthen. Membership was regulated and restricted to individuals (called 'Names') of financial means who backed the risks they underwrote with their personal wealth. In 1891 the importance and uniqueness of Lloyd's was recognised when, some 200 years after its beginnings in Mr Lloyd's coffee shop, the Society was incorporated by an Act of Parliament - the Lloyd's Act 1871. This Act gave the Society its legal foundation and formalised operating rules and principles that had up to then been voluntarily accepted by members. It should be noted that incorporation did not imply any acceptance of corporate liability by Lloyd's for the insurance business carried on by its members.

The 1871 Act, with subsequent amendments and updates, served the institution well for many years. However, as insurance markets around the world became larger and more sophisticated it became clear that the present legislation, particularly provisions relating to the constitutional basis of the Society, were no longer appropriate to address the challenges of the late 20th century. The Lloyd's Act 1982 was subsequently enacted which, among other things, removed overall responsibility and control over the affairs of the Society from the membership as a whole (which had grown to comprise around 18,000 Names) and placed it in the hands of a newly established body. the Council of Lloyd's. The Council comprises both members and non-members of Lloyd's.

Premium trends for direct insurers

Private sector direct insurers account for around 89 per cent of all private sector general insurance premium revenue. In this article we examine the structure of the direct insurance market and discuss current trends in the industry.

Introduction

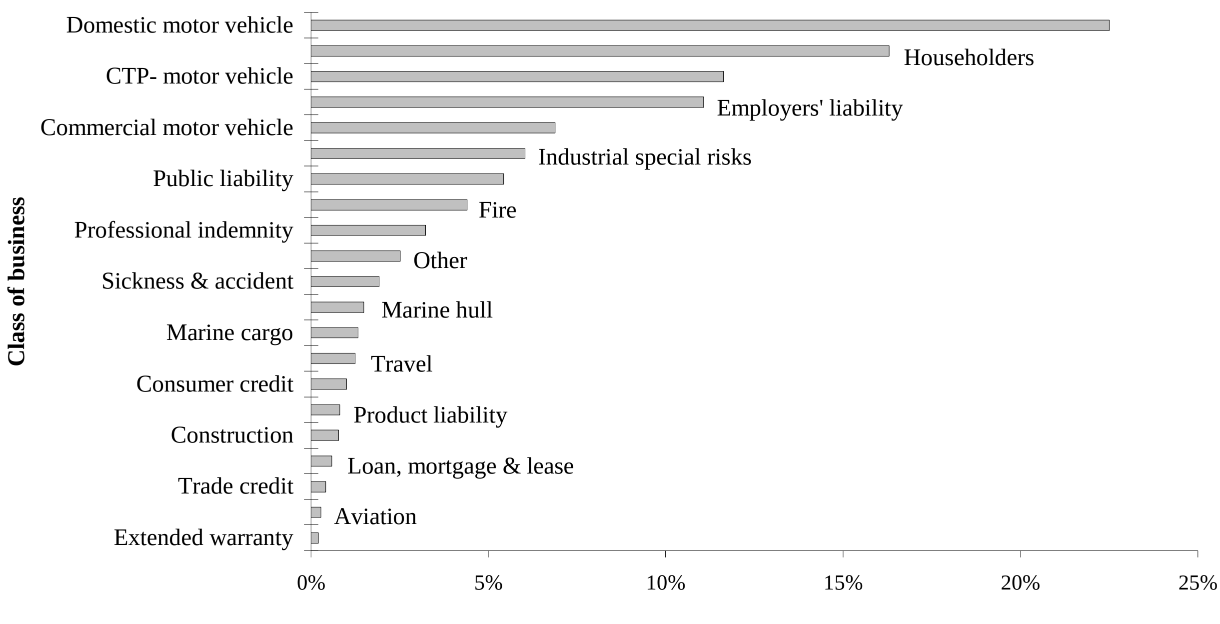
During 1996 premium revenues for the private sector direct underwriters were over $12.7 billion, with these premiums being written in 21 different classes of business. This premium revenue represents around 89 per cent of all private sector premium revenue (including reinsurers) and around 63 per cent of all general insurance premium revenue (including the public sector direct insurers).

As at 30 June 1997 there were 170 private sector insurance companies, or 22 corporate groups (accounting for 76 companies) and 94 individual companies operating in the general insurance market in Australia. Within these companies 122 are considered to be direct insurers.

Direct insurers, technically known as direct underwriters, are sellers of personal and business insurance directly to the public, as distinct from reinsurers that insure a percentage of the insurance portfolios of other insurers (as a means of spreading risk). In this article we examine the trends in the number and concentration of direct underwriters and the various classes of business in which they are engaged.

Unless otherwise specified, all premium figures quoted in this analysis are direct premiums. Direct premiums are the amounts paid by businesses and consumers for their insurance cover, and in addition to the premium set by the insurer, also includes stamp duties and other government charges.

Figure 1: Direct insurance premium proportions, 1996



Classes of Business

The classes of business in which the direct underwriters operate vary from the widely known and available, such as motor vehicle and household insurances, to more specialised classes such as trade credit and extended warranty. Reflecting this diversity in business classes, the level of direct premiums is not spread evenly across the classes of business. See Figure 1.

As can be seen from Figure 1, the largest three classes of business account for over half of all direct insurance premiums. In fact, this has been the case for the past few years (50.4% in 96, 49.6% in 94 and 52.8% in 1992). During this time domestic motor vehicle and householders insurance have remained easily the largest two classes of business, while the third largest has varied between compulsory third party (CTP) and employers' liability insurance.

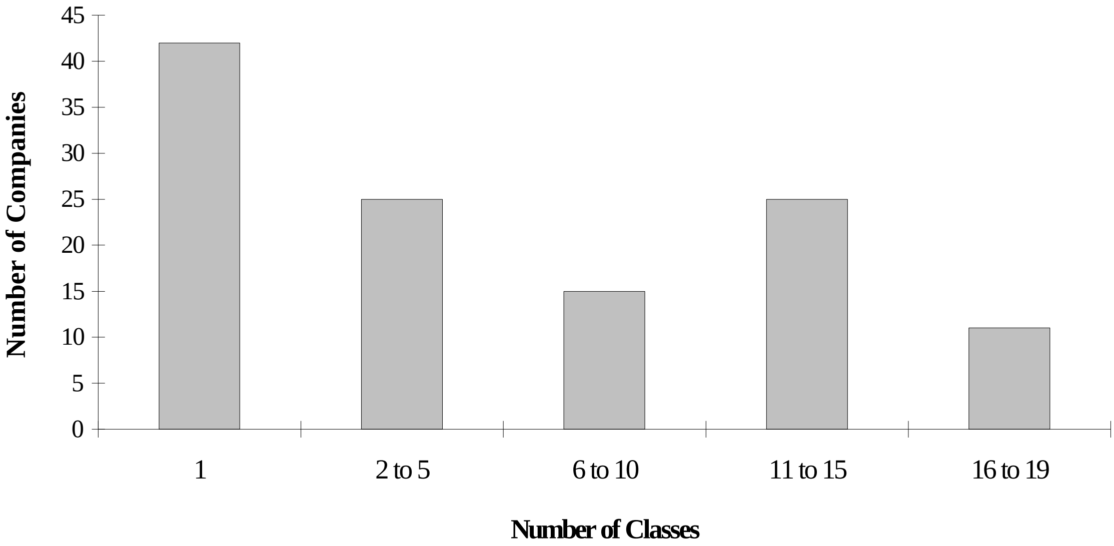
Companies

The overall number of direct underwriters has remained stable over the last few years with 121 companies operating in June 1992 compared to 122 at present. Privatisation of government insurance offices has resulted in a number of new underwriters entering the market, however this has been offset by other companies departing.

The average number of classes of business that these direct insurers each operate in is 6.5, a number that has remained relatively consistent since 1992. However, the majority of direct underwriters operate in 5 or less classes of business. See figure 2.

This result suggests that most companies do not attempt to spread their operations across a wide number of different classes, but instead focus on one or a few related business

Figure 2: Direct insurers' business classes, 1996



classes. For example, insurance groups tend to consist of a number of specialised companies that each operate in different business classes, rather than of companies that compete within a business class on a 'brand' basis. By structuring themselves in this way, the insurance group can be insulated to some extent against any unexpected losses suffered by a group company within a particular business class.

In total, 42 companies (or approximately 35% of all direct underwriters) operate in only one class of business. These companies tend to operate in the more specialised niche insurance classes, rather than in the larger classes. In comparison, two companies operate in 19 classes of business and three companies operate in 18 classes.

Premiums

Consistent with this specialisation in one or a few classes of business by companies is the fact that the concentration in premiums within individual classes of business is higher than the average concentration across the whole industry. For example the share of direct premiums written by the top 10 insurers in each class of business is greater than 60 percent, compared to only 52 percent for all classes of business. This result is especially noticeable in four of the smallest classes of general insurance business: trade credit; loan, mortgage & lease; extended warranty and consumer credit, where the ten largest insurers wrote 100 percent of the business in 1996. The larger business classes show the lowest concentration in premiums, reflecting their size and the larger number of participants within these classes.

Reflecting the relative structural stability of the general insurance market, this characteristic has been shown consistently over the past few years. In each year since 1993 even the business class with the least concentration has still exhibited greater concentrated than the industry is as a whole. See Table 1.

Commercial forces may also have contributed significantly to this specialisation in niche products that is apparent for direct insurers. As general insurance covers such a diverse range of insurance markets, it is unlikely that any one company would have the business familiarity needed to accurately price the underwriting risk across all of these markets. Therefore, direct insurers tend to specialise in insurance markets where they are most familiar with the business processes.

Table 1: Direct underwriter premium concentration 1993 to 1996

Top 10 Companies	**1993**	**1994**	**1995**	**1996**
All business classes	56%	52%	54%	52%
Least concentrated business class	64%	66%	66%	62%

Focus on defined benefits funds

While still forming a very significant part of the superannuation industry, defined benefit funds' share of the market continues to decline. In this article we examine recent growth trends in defined benefit funds, explain some of the unique features and discuss the different regulatory approaches that have been taken in recognition of these features.

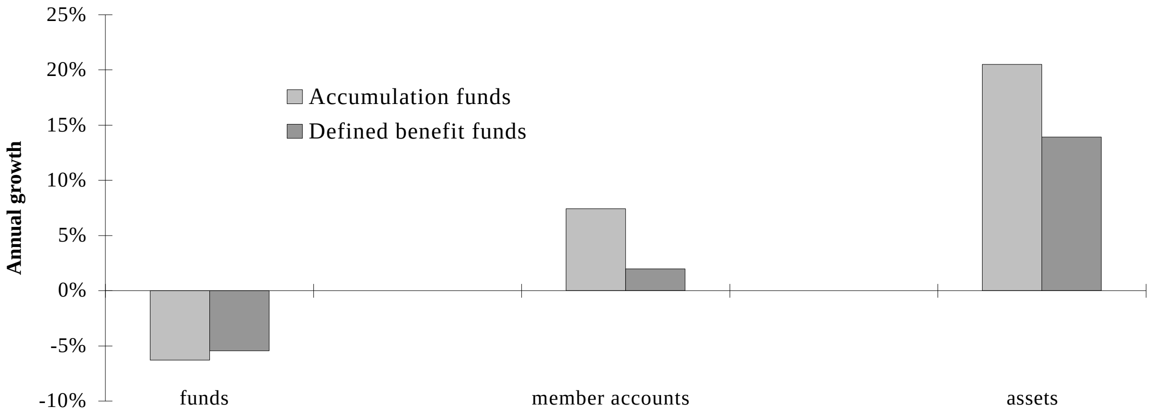
A defined benefit superannuation fund is one where at least part of the value of a member's retirement benefit is some specified amount, calculated according to a predetermined formula and often related to length of service and salary at or near retirement. Employer contributions to defined benefit funds are used to finance the fund's benefits in aggregate, and are not allocated directly to a member's account. In this way the investment risk is borne by the fund employer sponsor.

These funds are therefore markedly different to the now much more common accumulation funds where the value of each member's final benefit is determined solely by the accumulated value of contributions made on their behalf and interest on their account balance, with employer (and where relevant employee) contributions credited directly into a member's account. Defined benefit funds have traditionally been most popular in the public sector, and in long standing private sector corporations with high numbers of white collar staff.

While still forming a very significant part of the superannuation industry, defined benefit funds' share of the market continues to decline. For example, in the two years to June 1997 the proportion of superannuation fund assets managed by defined benefit funds fell from over 50 per cent to around 45 per cent. In terms of fund numbers and member accounts, defined benefit funds continue to be smaller than their accumulation fund counterparts, at June 1997 representing around 30 per cent of all larger (non-excluded) superannuation funds and around 16 per cent of larger fund member accounts.

The reduction in defined benefit funds' relative share of superannuation assets and member accounts has been due to the slower growth rates experienced by defined benefit funds compared to the

Figure 1: Growth rates for large superannuation funds June 1995 - 97



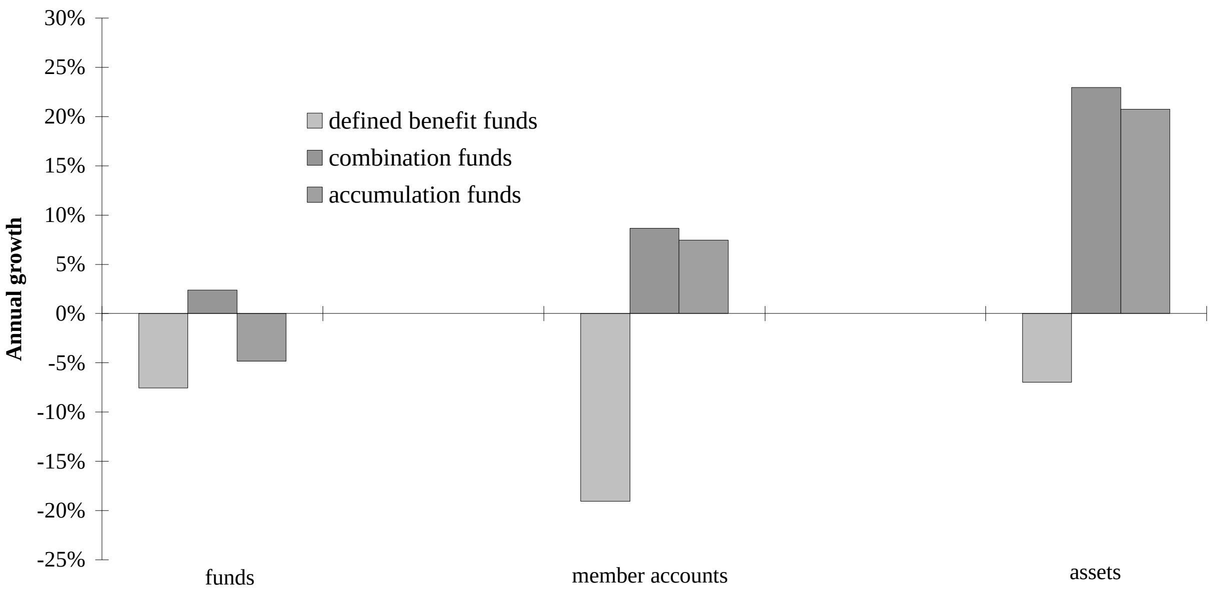
larger accumulation funds. This has been more a reflection of the popularity of accumulation funds and changes in the structure and operation of defined benefit funds rather than any marked difference in investment earnings. See figure 1. The difference in asset growth, in particular, is even more pronounced if small self-managed (excluded) funds, which are considered to be accumulation funds are included in the analysis.

This latest result is a continuation of the trend away from defined benefit funds that commenced with the introduction of award and SG superannuation. Factors influencing this trend have most likely included:

- the fact that the new award and SG superannuation arrangements were specified in terms of contribution levels rather than benefit levels;
- the consequent desire by employers to manage these new employee superannuation entitlements as simply as possible;
- concern by employers to minimise exposure to industrial and regulatory (or compliance related) risk; and
- a desire by employers to avoid the investment risk inherent in defined benefit plans.

Defined benefit funds are unallocated in nature, meaning that they do not have a separate account for each member. Due to this complexity, winding up a defined benefit fund may not be a straight-forward and efficient option for an employer-sponsor who has decided that it is not 'in principle' desirable to continue the operation of a defined benefit fund for their staff into the future.

Figure 2: Growth rates for ISC Survey funds June 1995 - 97



1. In addition to funds that contain both defined benefit and accumulation members, combination funds also include those funds where the retirement benefit is a combination of accumulation and defined benefit components. For example, where the members' contributions accumulate with interest and the employer benefit component is based upon length of service and salary. These funds are also referred to as hybrid funds.

Often in these cases, the defined benefit fund is merely closed to new entrants and the employer establishes a new accumulation based fund for new employees. This most likely explains the smaller decrease in the number of defined benefit funds compared to accumulation funds shown in figure 1. The defined benefit fund would then continue to operate until all existing members had left the fund.

However, in some cases where this type of restructuring takes place a new fund is not established for the accumulation members, but an extra sub-fund within the existing defined benefit fund is formed. This practice has been relatively common among public sector funds. In this case the restructured fund is considered to be functionally a combination or hybrid fund (that is, a fund having both defined benefit and accumulation elements). Under the legislation a fund with any defined benefit element is regarded as a defined benefit fund, so that the defined benefit fund results in figure 1 include these combination funds as well as funds that are exclusively defined benefit. [1]

If the defined benefit funds are viewed in terms of these more functional categories, it can be seen that funds that are exclusively defined benefit in nature have actually been decreasing in terms of funds, member accounts and assets over the two years to June 1997. Figure 2 shows the comparative growth of exclusively defined benefit funds and combination funds based upon results obtained from the ISC quarterly survey of superannuation (which includes funds with assets greater than $10 million).

From June 1995 to June 1997 combination funds increased their share of all defined benefit fund assets from 66 per cent to 78 per cent and their proportion of all defined benefit fund member accounts from 73 per cent to 83 per cent, largely due to restructuring into combination funds by previously exclusively defined benefit funds. At June 1997 exclusively defined benefit funds managed around $26.5 billion in assets and had fewer than 500 000 member accounts.

Defined benefit funds and the SG

The minimum level of superannuation that an employer must provide for each of their employees is defined under the Superannuation Guarantee (SG) legislation as a proportion of each employee's salary. Where an employer meets their SG obligations using a defined benefit fund, the employer is required to obtain a benefit certificate from an actuary. This certificate will state the notional employer contribution rate for each class of employees in the fund.

Supervising defined benefit funds

In recognition of the differences between defined benefit funds and accumulation funds, special provisions have been made in the Superannuation Industry (Supervision) Act (SIS) and Regulations that deal specifically with defined benefit funds. These provisions deal with the solvency, funding position and triennial reviews of defined benefit funds.

Every defined benefit fund is required to have an actuary sign a funding and solvency certificate for the fund, indicating that the fund is solvent and likely to remain so for a period not exceeding five years. Solvency means that the fund has sufficient assets to meet its minimum benefit obligations (often related to where the defined benefit fund is being used to meet the employer sponsor's SG obligations). Where this is not the case the fund is technically insolvent.

The minimum benefit obligations however do not include the total accrued benefits of fund members. To ensure that the fund remains capable of meeting its full benefit obligations every defined benefit fund must undergo an actuarial investigation every three years, commonly known as a triennial review. The investigation determines whether the fund has sufficient assets to meet its liabilities to members and recommends a level of employer contributions for the next three year cycle.

Where the value of assets is inadequate to meet the accrued benefits of the fund's members the fund is said to be in an unsatisfactory financial position. Actuaries are required under the Act to notify the trustees of funds they consider to be either insolvent or in an unsatisfactory financial position and in some cases the Insurance and Superannuation Commissioner.

Defined benefit funds and fund choice

Traditionally, retirement benefits paid by defined benefit funds have often been considered to be more generous than would be the case solely under the superannuation guarantee (SG). Additionally, knowledge of the actual benefit to be received (irrespective of investment risk) is of great assistance to defined benefit members when determining their financial strategy in retirement. For these reasons, there is no obvious reason to conclude that member choice of fund will accelerate the reduction of defined benefit funds' market share in terms of member accounts.

This was not the experience in the UK however, where many members of generous defined benefit schemes were enticed to leave those schemes and transfer to inferior products. In order to minimise the risk of a similar experience in Australia, the government has included in the choice of fund legislation a provision that where the existing in-house fund is a defined benefit fund, employers are responsible for advising their employees of the implications of leaving that fund to join another.

Table 1: Corporate defined benefit funds on a contribution holiday 1995-96

	Ratio of assets to liabilities		
	1 to 1.5	Above 1.5	*Total*
Less than $10million	31	48	*79*
$10million to $50m	14	22	*36*
More than $50million	7	6	*13*
Total	*52*	*76*	*128*

However, while the final *retirement* benefit in defined benefit funds is often more generous than would be the case solely with SG contributions, this is not necessarily the case for *resignation* benefits from defined benefit funds. This is due in part to the vesting provisions that can be attached to a defined benefit fund.

The vesting scale for a fund in this context describes the elapsed period over which a member's resignation benefit gradually comes to be calculated on the same basis as the retirement benefit. During any vesting period, the resignation benefit will be less than the retirement benefit calculated for the same period of fund membership. This has the effect of encouraging staff to stay longer with the company, sometimes referred to as 'golden handcuffs'. Note that any defined benefit fund benefit is subject to a minimum value, being that calculated by an actuary to be the equivalent to SG contributions. When a member has reached full vesting they are entitled to have their resignation benefit calculated on the same basis as for a retirement benefit. The *TOPICS 1995 Australian Superannuation Survey* conducted by Towers Perrin found that around 35 per cent of funds (including some accumulation as well as defined benefit funds) do not commence vesting above the (minimum) SG level until a person has at least five years of fund membership. Additionally, around 18 per cent of funds require fund membership of at least 15 years in order to reach full vesting.

In determining the appropriate level of funding to be made by the employer-sponsor into a defined benefit fund, actuaries need to make a number of assumptions about the likely future experience of the fund. This means that when a fund has a better experience than that previously assumed by the actuary, for example when investment earnings have been higher than expected, a fund can end up in surplus (that is, the fund assets are greater than the fund liabilities). When a fund's surplus is sufficiently large, the employer-sponsor may be entitled to take a 'contribution holiday'. That is, the investment earnings of the fund are large enough to negate the need for the employer sponsor to make contributions for a period of time. Where the fund is very large and the surplus has accrued over a number of years, the contribution holiday may in turn last for many years.

Conversely, where a defined benefit fund has worse than expected experience, the fund's employer-sponsor may have to make very high levels of contributions in order to keep the fund solvent and capable of meeting its future liabilities for member benefits.

An analysis of the 1995-96 Annual Returns suggests that around nine per cent (128) of corporate defined benefit funds were having a contribution holiday. The majority of these funds (62 per cent) had assets of less than $10 million, most likely reflecting the executive schemes of the larger corporates. See table 1.

Defined benefit funds and the superannuation surcharge

Defined benefit funds, like accumulation funds, are subject to the superannuation surcharge. However, while assessing the surcharge liability (if any) for members of accumulation funds is relatively straight-forward, a different approach is required for defined benefit funds. This is because contributions to defined benefit funds, unlike contributions to accumulation funds, are not specifically allocated to an individual member. Rather, contributions and investment earnings are pooled, and benefits are paid as they arise. Therefore, before a surcharge liability can be assessed, a mechanism is needed to attribute (or allocate) contributions to individual fund members.

In recognition of this, the Government, in implementing the surcharge arrangements, approached the Institute of Actuaries of Australia and formed an actuarial advisory committee to recommend a way of applying the surcharge to defined benefit funds. That committee recommended that each defined benefit fund be required to have an actuary estimate the value of benefits which accrue to each member over a year, which the scheme would then report as the member's surchargeable contributions.

To do this, an actuary calculates the *Notional Surchargeable Contributions Factor* (NSCF) for each member , or class of member, of the defined benefit fund, having regard to age, length of membership and so on. The NSCF is then multiplied by the member's superannuation salary to arrive at the member's surchargeable contributions.

Defined benefit funds and divorce

The Prime Minister in his statement of 8 March, 1998 announced reforms to the treatment of superannuation following marriage dissolution. These reforms will include the development of clear rules for valuing superannuation so that it can be included in the division of marital property in cases where division is in dispute. In recognition of the differences between defined benefit funds and accumulation funds, the statement indicates that the reforms will be consistent with the type of superannuation fund. Like other areas in superannuation referred to above, this means that different valuation methods will be developed for defined benefit funds than for accumulation funds.

Joint Forum on Financial Conglomerates

The forces of competition, globalisation and technological change have contributed to the emergence and growing influence of large, multinational financial conglomerates. In this article we discuss the ways in which the World's regulators are responding to these new global entities.

The phenomenon of groups of companies operating under common ownership and whose activities straddle the boundaries of banking, insurance and securities has posed some unique challenges for financial supervisors. In particular, it has heightened the need at both the domestic and international levels for greater co-operation and co-ordination between supervisors and a refinement of supervisory methods and techniques.

The most prominent example of regulatory co-operation at the international level has been the work of the Joint Forum on Financial Conglomerates (the Joint Forum). The Joint Forum is made up of nine member countries from each of the Basle Committee on Banking Supervision (Basle Committee), the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). Broadly speaking, the Joint Forum's mandate, conferred by the three parent bodies in 1996, is to examine regulatory issues associated with financial conglomerates and to develop principles for more effective supervision of those entities.

Australia is well represented on the Joint Forum: the group is chaired by Mr Alan Cameron AM, Chairman of the Australian Securities Commission (ASC) and an officer from each of the ASC and ISC participates under the auspices of IOSCO and IAIS respectively.

The Joint Forum has undertaken substantial work on developing supervisory principles for financial conglomerates. These address issues of 'fit and proper' tests for managers, directors and shareholders; capital adequacy; intra-group exposures; and regulatory coordination and information sharing arrangements in both emergency and non-emergency situations. The Joint Forum has consistently emphasised that its work is intended to provide a supplementary range of tools to assist existing regulatory frameworks, rather than an additional mandatory layer of supervision or a substitute for existing regimes.

On 19 February 1998 the Basle Committee, IOSCO and IAIS released a package of papers prepared by the Joint Forum for consultation with industry and regulators. The papers deal with:

- measurement techniques and principles for assessing the capital adequacy of financial conglomerates on a group-wide basis (in particular, to identify instances of double or multiple gearing);

- 'fit and proper' tests for managers, directors and major shareholders;

- information-sharing among financial regulators; and

- co-ordination arrangements between financial regulators.

The consultation process will assist in refining the supervisory principles set out in the papers and in the implementation of supervisory guidelines. While the focus of the papers is financial firms with complex structures whose large-scale activities cross national borders and sectoral boundaries, the Joint Forum considers that similar considerations could also apply to smaller conglomerates or conglomerates that operate domestically.

The views of industry and regulators around the world are being sought by 31 July 1998. The papers are available on the ISC's web-site (http://www.isc.gov.au). Comments on the papers obtained through the ISC can either be addressed to the IAIS Executive Director or the Assistant Commissioner (Policy), at the ISC.

Improvements in average life expectancy

Retirement savings may have to last for a longer period of time than most people think. This article explains way.

Some people choose to live "each day as it comes" or to treat each day "as if it were the last". Planning for retirement, especially for those who are considering investing a lump sum to generate an income stream (that is a pension or an annuity), over their remaining years can call for a longer term view. Using published life expectancies may not, however, give an adequate picture of how long the income stream needs to last.

Background

The mortality of the Australian population is analysed by the Australian Government Actuary. A series, published by the Actuary, has been prepared regularly since the first table was produced covering the experience of the Australian population of the ten years from 1881 to 1890. This series, known as the "Australian Life Tables" or ALT provides a record of changing mortality rates and highlights the dramatic improvements in mortality and consequent increases in life expectancies for Australians over the last century.

The most recent table in this series covers mortality experience in 1990-92 (the three years around the 1991 census). The next table will analyse the experience for the three years centred on the 1996 census and will be released early in 1999. The *Income Tax Assessment Act* makes reference to the life expectancies reported in these tables in determining the taxable components of annuities and pensions purchased by retirees.

Since 1996, the Australian Government Actuary has also supported a table published annually by the Australian Bureau of Statistics (ABS). This series uses estimates of the population between each census to derive mortality rates and provides an up to date estimate of mortality for those wishing to make use of the latest available data. These tables have no status for taxation purposes. The most recent table in this new series covers the three years 1994-96.

So what do life expectancies mean

Published life expectancies represent the <u>average</u> number of years that would be lived by people of a given age <u>provided</u> mortality rates continued at their current levels. It is important to understand how these limitations affect the relevance of life expectancies to an individual planning for retirement.

As an average, reported life expectancies cover a range of outcomes. The lifespan of an individual will be affected by a variety of factors, including their genetic inheritance, their lifestyle choices and environmental hazards to which they may be exposed. Reported life expectancies average out these differences to arrive at a single figure which masks the variation.

For example, ALT 1990-92 reported that the life expectancy of a male infant at birth was 74.3 years. However, almost 60% of infants subject to these mortality rates throughout their lives could be expected to reach or exceed this age, 25% would not live beyond

68 years and 25% would live to at least 85.

The second qualification which must be borne in mind is that most reported life expectancies do not allow for future improvements in mortality experience. However, an examination of the ALT series shows a long history of improving mortality rates at almost all ages. At older ages, improvements can arise from on-going advances in medical care, greater awareness of health issues and general lifestyle changes in the community, and, every now and again, a dramatic discovery which treats or cures some otherwise fatal condition. As an example, many Australians would be able to recall a time when heart disease was considered a serious and untreatable condition. Modern treatment techniques mean that many of those suffering from heart disease have a significantly improved prognosis, and even those who have had a heart attack can, in many cases, return to a fairly normal life within a relatively short period.

For these reasons, a person who is considering retirement and plans to spread available funds over the reported life expectancy is considerably more likely, all other things being equal, to exhaust their funds than to have funds remaining on death.

To demonstrate the impact of mortality improvement on life expectancy, values for life expectancy have been calculated that allow for future improvement in mortality rates for ages

Table 1: Effect of improved mortality on life expectancy

Age	ALT 1990-92 no allowance for improvement	ABS 1994-96 no allowance for improvement	ABS 1994-96 with allowance for improvement[2]	%increase in life expectancy over ALT 1990-92
Male				
60	19.09	19.62	22.22	16%
65	15.41	15.82	17.68	15%
70	12.14	12.45	13.72	13%
75	9.31	9.51	10.33	11%
80	7.00	7.04	7.54	8%
Female				
60	23.42	23.83	26.70	14%
65	19.26	19.61	21.77	13%
70	15.37	15.67	17.21	12%
75	11.87	12.07	13.11	10%
80	8.85	8.92	9.58	8%

1.These values were calculated using improvement factors derived by the Australian Government Actuary, not the improvement factors provided in Appendix E of ALT 1990-92, which were reproduced from an earlier ABS publication.

2.These numbers have been calculated to illustrate the effect of mortality improvement on life expectancy and should not be used for taxation purposes. It is also important to note that the anticipated improvements incorporated into these calculations are based on historical trends which may or may not persist in the future.

60 and above in line with the fairly consistent rates of improvement experienced in Australia over the last 25 years [1]. See table 1

These values are of course still averages, and around half of the people at any given age could expect to live longer than these expectancies. However, they suggest that on the basis of mortality improvement alone, Australians currently aged 65 can expect to live some two years longer than reliance on the tabulated figures would suggest.

For retirement planning, it is important to consider the consequences of longevity, including the likely effects of future improvements in mortality rather than assuming that the published life expectancies represent the most likely duration of retirement.

For further information please contact Tim Higgins at the office of the Australian Government Actuary on 02 6213 5358.

Superannuation survey highlights - December 1997

Main features

- Total superannuation assets had reached $325.7 billion by end December 1997, representing growth of 1.2% during the quarter, or 17% during the year ended December 1997.
  - *note that this result is in spite of the effects of the October slump in the capital markets.*
- Weak capital market performance during the December quarter caused net earnings to be only a minor component of growth, accounting for just 6% of net growth. Net deposits accounted for 94% of the growth during the quarter.
- Contributions during 1997 were up 12.8% compared to the previous 12 months, increasing from $28.1 billion to $31.7 billion.
- Discounting the rapidly growing excluded fund sector, contribution growth for large funds is still 12.6% per annum.
- The strongest growth continues to come from member contributions, increasing by 27% over the previous year to $11.5 billion. Employer contributions increased by 6% to $20.2 billion.
  - *average weekly earnings (AWE) increased by 4% during the year.*

Industry structure

The assets managed by small self-managed funds (ie, excluded funds with less than 5 members) grew fastest during 1997, increasing by 30% ($8.8 billion). This was closely followed by industry funds which grew by 26.5% ($4.5 billion) during the last year.

Corporate fund assets grew by only 11%, or $6.3 billion during the year. Public sector assets grew by 18% ($11.4 billion) and retail assets grew by 22% ($14.3 billion).

Retail funds currently hold around 24% ($79.9 billion) of total superannuation assets, public sector funds hold 23% ($74.6 billion), corporate funds 20% ($64.7 billion), excluded funds 12% ($38.4 billion), and industry funds 7% ($21.6 billion).

The excluded fund, industry fund and retail market segments all increased their market shares slightly during 1997, while the public sector remained the same and the corporate fund sector reduced their share slightly. The largest movement in market share was in the segment which represents annuity products, fund reserves and unallocated profits of life office statutory funds. The proportion of the superannuation industry represented by these ‘balance of statutory fund’ assets has reduced to 14% (from 16%) during 1997.

Contributions and benefits

During the December quarter, employers contributed slightly over $4.9 billion into superannuation, up 4.9% on the 1996 December quarter. In contrast, the $3.1 billion employees contributed into superannuation during the same period was up 41.5%.

The contributions into small self-managed funds were 14.4% higher during 1997 than 1996. Growth in net inflows to these funds was 17.4% higher than in the previous 12 months, being largely fuelled by the growth in the number of excluded funds, eg. the number of excluded funds increased to 168 161 by December, up 3% during the quarter.

Reflecting a decrease in the strong consolidation in corporate and retail fund numbers characteristic of recent quarters, inward transfers accounted for 41% of all money deposited into superannuation during the December quarter, more in line with the normal average of around 36%.

Lump sums, excluding outward transfers, accounted for 83% ($4.9 billion) of the benefits paid during the September quarter. The remaining 17% ($1.0 billion) of benefits were paid as pensions. Similarly to inward transfers, outward transfers accounted for 41% of all fund withdrawals during the December quarter.

Benefit payments, excluding transfers, during 1997 were up by 21.5% compared to the previous 12 months (on the back of a 24% increase in the level of lump sum benefit payments). The higher growth rate of benefit payments as compared to contributions has led to net contributions (ie., contributions less benefits) being down marginally (0.4%) for 1997 compared to 1996. Nonetheless, during 1997 $11.1 billion in net contributions flowed into superannuation (compared to $11.2 billion in 1996).

Manner of investment

Assets placed with an investment manager showed the strongest growth during the quarter, increasing by 1.9%. Assets invested through the statutory funds of life offices grew by 0.9%, while assets directly invested by trustees grew by 0.6% during the quarter.

Investment managers had 39.8% ($129.5 billion) of total superannuation assets at the end of December 1997, unchanged from December 1996. The share of directly invested superannuation assets increased marginally to 24.5% ($79.8 billion) , with the statutory funds of life offices falling below 36% for the first time to 35.8% ($116.5 billion).

Asset allocation

The share of superannuation assets invested overseas rose slightly to 17.8% ($51.6 billion) at the end of December 1997, despite a 0.7% appreciation of the AUD against the TWI during the quarter (acting to automatically decrease the AUD value of overseas investments). This suggests that trustees invested around an additional net $4 billion overseas during the quarter, perhaps seeking to take advantage of the stronger buying power of the AUD and in light of decreases in the Australian markets.

Superannuation investment held in equities decreased by 1.5% ($1.2 billion) during the December quarter. Since the ASX accumulation index decreased by 5% in the December quarter, it follows that there was still a net inflow of around $2.9 billion into the equities markets by superannuation funds. Superannuation equity holdings overall decreased marginally to 28.0% of total superannuation assets.

Unit trust holdings increased by 0.3% ($98 million) in the December quarter. They are now represent 11.1% of the total value of superannuation assets.

Reflecting the decline in long term bond yields during the December quarter, holdings of long term debt securities increased by 1.3% ($0.6 billion). The proportion of superannuation assets held as long term debt securities rose marginally to 17.0%.

In contrast to long term bond yields, short term debt security yields rose during the December quarter. Despite this however, holdings in short term debt securities rose by 5.8% ($1.5 billion) during the December quarter. The proportion of superannuation assets held as short term debt securities rose slightly to 9.1%.

Holdings of cash, deposits and placements fell the most of all asset classes, decreasing by 4.1% ($1.1 billion) in the December 1997 quarter. Cash rates actually rose slightly (from 4.45% to 4.5%) during the quarter.

These movements would appear to indicate that during the December quarter superannuation funds were net buyers of overseas assets and short term debt securities, and to a lesser extent Australian equities.

This result suggests that superannuation funds, while still supporting the Australian equity market, moved during the quarter to increase their flexibility to meet market opportunities by increasing their short term debt security holdings and took advantage of the increased buying power of the AUD to increase the level of overseas investments in the face of declining Australian equity markets.

The value of assets held in direct property continued to fall in the December quarter, representing 4.6% of total superannuation assets at the end of the quarter, down from 5.9% in December 1996. Other investments account for around 4% of total superannuation savings.