Financial intermediation beyond the banks: recent developments

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The New Zealand financial system is dominated by banks, whose assets are well over 90 per cent of those of all deposit-taking institutions. Banking groups also own fund management businesses, with more than a quarter of all funds under management. However, the activities of savings institutions, finance companies, the non-institutional market and independent fund managers are important, notwithstanding their relatively reduced role. This article discusses developments in non-bank financial institutions and markets over recent years.

1 Introduction

Following deregulation of the financial system in the mid-1980s and implementation of a framework for bank registration and supervision from 1987, banks began to grow fast relative to the rest of the financial system. A financial industry previously fragmented, and regulated by a wide variety of statutes, began rapidly to transform itself to one that by the mid-1990s was more highly concentrated, with five major banking groups accounting for over 85 per cent of the assets of all deposit-taking institutions.

By the end of 1990, little more than six years after financial sector deregulation began in earnest, registered banks already dominated the financial market. They held as much of households' financial assets on their balance sheets as were placed with all other financial institutions, including funds under management, and provided over 70 per cent of total household credit. Banks were the source of almost 80 per cent of business credit, and the consolidated assets of the banking system were over 60 per cent of total financial assets. From 1998 however, other deposit-taking institutions began gradually to grow more quickly than banks, with the pace of their advance accelerating in the last two years. Funds under management, on the other hand, peaked in late 2000, and after falling for over two years, are now little changed from four years ago. This article reviews recent developments in financial markets outside the banks, providing an overview of the regulatory framework, developing business practices and growth of 'non-banks' (including fund managers) in the last four years in particular.

2 Banks in context

A review of registered banks is covered by Andrew Rodgers' article in this Bulletin.[1] While not the focus here, their relative size compared to the total market, and recent rate of growth, is set out in table 1 to serve as a basis for comparison with other institutional groups. The table presents registered bank data on a consolidated basis, and non-institutional market assets shown exclude the $3-4 billion of securitised assets which are in the portfolios of managed funds, held by banks or by non-residents. While banks provide between $1-2 billion of funding for other deposit-taking institutions, and in their turn receive between $4-5 billion in funding from fund managers, other 'double-counting' in the table is likely to be negligible. In subsequent tables in this article, assets are allocated among banks and other institutional groups by including securitised loans with the originating institutions, in order to illustrate better the changing rates of business growth by sector. The activities and balance sheets of smaller merchant banks and financial groups specialising in corporate business are not covered. All balance sheet data are as at the end of December, in New Zealand dollars.

While between 1990 and 1995 a minor part of registered bank asset growth occurred through reclassification of assets, notably housing loans sold by the Government, from 1995 the bank data in table 1 represent 'organic' growth only. The rate of growth of bank assets from 1995 to 1998, through the peak and last phase of the rapid spurt of economic growth in the mid-1990s, was strong: other deposit-takers more or less marked time, and asset growth

1 See Rogers (2003) 'Developments in the New Zealand bankiong industry' pp. 5-17.

Table 1
Overview of financial market structure
$ billion

as at December		1990	1995	1998	2002
Liabilities					
Banks					
	Households	28	37	41	50
	Other domestic	20	26	40	54
	Non-residents	11	22	35	62
	Total	66	94	131	190
Other deposit-taking institutions					
	Households	3	4	4	6
	Other	1	1	2	4
	Total	5	6	7	13
Fund managers					
	Households	25	38	46	48
	Other	1	1	2	4
Household fixed interest		6	6	6	7
Total liabilities		103	145	192	262
Assets					
Banks					
	Households	20	41	56	76
	Farmers	4	8	11	17
	Other domestic	28	31	43	52
	General Govt	7	5	4	8
	Non-residents	2	2	5	22
	Total	66	94	131	190
Other deposit-taking institutions					
	Households	2	3	3	5
	Other	2	2	3	6
	Total assets	5	6	7	13
Fund managers					
	Domestic fixed interest		na	21	21
	Domestic equities	na	na	8	7
	Domestic other	na	na	4	5
	Overseas investments		na	15	19
	Total funds	26	39	48	52
Non-institutional assets		6	6	6	7
Total assets		103	145	192	262

Source: RBNZ

Note: Group totals shown here include components not itemised in the table.

at fund managers did not keep pace, although rising 20 per cent. The value of funds under management and net inflows continued to increase until late 2000, and values have subsequently fallen 20 per cent from their peak. Credit unions excepted, the 55 to 60 other deposit-taking institutions, finance companies especially, began to expand from 1998. They have prospered more rapidly since 2000, as a strong property market and buoyant consumer spending associated with low unemployment and rapid net migration inflows have stimulated demand for credit.

While barely denting banks' dominant share of total financial assets, the change in performance of the non-bank sector has turned around a declining trend over a decade old. Other deposit-taking institutions' share of non-housing personal lending has risen since 2000, and their lending for housing has grown slightly faster than that of banks. The funds management industry has been undergoing some notable structural changes since 1998, in a period when its funds performance has attracted more attention. These changes are examined in more detail in the next sections.

3 Deposit-taking institutions

Building societies

There are currently 10 building societies operating in New Zealand. They began as mutual organisations, with core capital often comprising transferable 'term shares'. Today a few issue 'capital shares' at premium interest rates to support rapid growth, while most rely on retained earnings. Customers are shareholders by virtue of being depositors. Depositors are overwhelmingly households. The same is true of the Public Service Investment Society (PSIS), a financial institution with similar structure and functions, originally established by and for public servants. Now about half the size of the largest building society, with branches countrywide, the PSIS is incorporated under the Companies Act 1993 and Co-operative Companies Act 1996. Table 2 illustrates the basic balance sheet structure of these 11 institutions.

By the 1970s, before savings banks gained the ascendancy late in the decade, building societies were the largest private sector institutional source of residential mortgage loans. From the mid-1970s, when they gained relatively less advantage from an initial loosening of financial sector controls, the number of building societies in New Zealand – at one time over 70 - was reduced principally by way of merger as a response to greater competition. By the late 1980s, the largest building society, the product of a decade-long campaign of growth by merger and acquisition, was able to register as a bank. Societies operate today under the Building Societies Act 1989, which has been adapted to allow lending and other business practices similar to other non-bank competitors (lending for non-housing purposes was formerly tightly restricted).

One large society – the Southland Building Society - accounts for more than half the assets of all building societies, at over $1.2 billion. Only the two largest societies maintain branches well beyond their place of origin. Asset composition is now less oriented to residential mortgages than before deregulation, but housing loans continue to represent over 55 per cent of total advances. Since 1998 there has been a similar rate of growth of household compared to other loans, which comprise a mix of lending secured on farms and commercial property.

For the financial year ended 2002, these institutions' average ratio of net profit after tax to average total assets was 0.75 per cent, and net profit after tax to average shareholders' equity was 9.6 per cent, results that are significantly better

Table 2
Building societies and PSIS

$million

as at December	1998	1999	2000	2001	2002
Household deposits	1720	1880	2040	2270	2560
Other deposits	20	20	20	20	30
Total deposits	1740	1900	2060	2290	2590
Capital and reserves	150	160	190	210	230
Total funding	1960	2140	2340	2590	2930
Housing loans	1050	1200	1270	1400	1580
Other personal loans	80	70	80	90	130
Farm loans	160	200	230	280	320
All other loans	570	570	650	710	800
Total loans	1860	2040	2230	2480	2830
Total assets	1960	2140	2340	2590	2930
Capital ratio	7.8%	7.7%	8.0%	7.9%	7.8%

Source: RBNZ

than the Australian building society sector, for example. The capital ratios for the two groups are similar.[2]

Credit unions

Credit unions are 'small savings' institutions, whose objects under the Friendly Societies and Credit Unions Act 1982 are specified as the 'promotion of thrift among members' and 'use and control' of their savings for their mutual benefit. The number of credit unions has fallen from over 300 in the mid-1980s to around 60 now, while total assets have increased fourfold to about $400m. It is likely that the greater availability of personal credit after deregulation played a significant role in the fall in credit union numbers. Traditionally, these mutual societies have been formed on the basis of the existence of a 'common bond' among members. The 1982 Act requires evidence of such a bond for registration of a credit union – because of their objects, credit unions do not pay income tax.

In 2000, credit unions became subject to the general Securities Act requirement to establish a trust deed and appoint a trustee, placing them on a similar footing in that regard with other deposit-takers. The restriction limiting shares (deposits) from any one member to a maximum $40,000 was raised to a $250,000 maximum following this change. Only individuals can be members of a credit union, which in turn may lend only to members, to maximum amounts prescribed by the Act. Loans are predominantly for non-housing purposes. Following a decade of more rapid growth, credit union growth has been moderate over the past five years. Table 3 estimates data yet to be released for 2002, with the drop in assets the result of one credit union converting to building society status during the year.

Finance companies

Finance companies are the most rapidly expanding and largest group of non-bank deposit-taking institutions. Most tend to specialise in particular forms of financing, which provides a convenient taxonomy for reviewing them. The categories are based on the predominant form of lending – the property lending and business financing groups in particular often have a proportion of loans in the other sectors. The main categories of finance company are:

- residential and commercial property lenders, focused on development finance;
- vendor finance subsidiaries of multinationals, lending to facilitate product sales;
- consumer market financiers, for cars and other consumer purposes;
- business and farm financiers – plant and machinery, business equipment leasing, farm equipment and seasonal lending.

The largest finance company, UDC, which is double the size of the next biggest, is wholly-owned by a registered bank. Prior to deregulation in the 1980s, all four banks owned finance companies. UDC, and another bank-owned company, AGC, played a significant role in the finance company market throughout the 1990s. Data for UDC are

Table 3
Credit Unions
$million

Year to June	1998	1999	2000	2001	2002
Shares	350	360	350	360	350
Total funding	410	430	410	420	410
Loans to members	290	280	270	290	280
Total assets	410	430	410	420	410

Source: Registrar and RBNZ estimates

[2] 'Financial institutions performance survey 2003', KPMG; Australian Prudential Regulation Authority.

Table 4
Finance companies

$million as at December	1998	1999	2000	2001	2002
Household deposits	1540	1470	1840	2650	3340
Deposits from banks	1370	1860	2340	2700	1870
Other deposits	710	690	820	1140	2450
Total deposits	3620	4020	5000	6490	7660
Capital and reserves	590	670	700	840	1000
Total funding	4550	4970	5970	7670	9180
Consumer loans (includes off bs)	2410	2570	2850	3270	3730
Farm loans	210	220	260	310	430
Other loans	1840	2150	2640	3580	3980
Total loans	4460	4930	5750	7160	8140
Total assets (on balance sheet assets only)	4550	4970	5970	7670	9180
Capital ratio	13.0%	13.5%	11.7%	10.9%	10.8%

Source: RBNZ

consolidated with bank data throughout this article and so are not included in the following tables. AGC, sold in 2002 and now known as GE Finance and Insurance, is included in these data throughout. While coverage for finance company data is relatively comprehensive for those accepting deposits from the public, there is a modest degree of under-representation from 'vendor finance subsidiaries'. This is unlikely to exceed 5 per cent of the asset totals in table 4. Table 4 illustrates key balance sheet items for finance companies, and includes in consumer loans (but not total assets) off-balance sheet securitised hire purchase loans exceeding $500 million in 2002.

Table 4 incorporates data from 45 finance company groups – it should be noted that several of these consolidate the assets of separate trading subsidiaries. The three largest finance companies' assets represent more than a third of the total assets of the group, two-thirds are contributed by 10 companies, and 80 per cent by all companies with total assets greater than $200 million at December 2002. Over 30 of the companies are New Zealand-owned, accounting for around 60 per cent of total assets and including three of the five largest finance companies. A very few of these companies are listed or are finance subsidiaries of listed public companies – most are private companies.

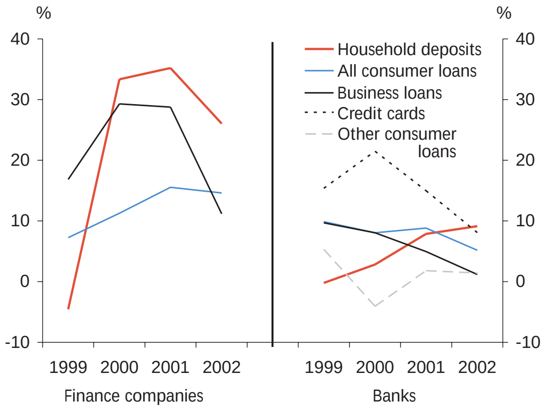
For a subset of finance companies with about 90 per cent of the assets in table 4, the percentage ratios of net profit after tax to average shareholders' funds and to average total assets were about 25 per cent and 2 per cent respectively for the financial year ended in 2002. The ratio of net profit after tax to average shareholders' funds has been very similar to that of registered banks for the past five years, averaging over 20 per cent. The provision for doubtful debts as a percentage of gross loans averaged 1.5 per cent and general provisions as a percentage of net loans were around 1 per cent.[3] Table 4, compiled from the Bank's survey of finance companies, indicates that while the non-risk-weighted capital ratio has declined over the past four years, it remains close to 11 per cent.

The most striking feature of finance company balance sheets is their rate of growth over the past four years, especially when compared to registered banks in relation to household deposits, consumer and business lending. Despite having doubled in the four years to December 2002, their total assets were not quite 5 per cent of those of registered banks (just over 3 per cent in 1998), so the overall impact of their growth on the total financial market has been limited. However, at the margin, for the balance sheet categories mentioned, their share of growth has been disproportionate, and represents a change from the previous ten year period when banks rapidly expanded at the expense of other deposit-taking

[3] 'Financial institutions performance survey 2003', KPMG.

institutions. From 1998 to 2002, finance companies increased household deposits by a fifth of the net gain made by banks, with consumer loans growing almost as much as those of banks (including credit cards) and business lending over 20 per cent of combined growth. Over 90 per cent of banks' net gain in consumer lending was through credit cards. Figure1 illustrates percentage growth rates since 1998.

Figure 1
Bank and finance company deposits and loans – annual percentage growth



The strong finance company sector growth observed over the past four or five years had three main drivers. The most important has been strong employment and earnings growth in the household sector, with its associated increase in residential building, especially apartment construction. The second factor has been a decline in the general level of retail interest rates and lately a portfolio shift from equities to fixed interest, which has ensured a ready supply of deposits for finance companies paying relatively higher interest rates. Thirdly, finance companies have combined use of ever-cheaper technology, the availability of skilled staff formerly employed by banks and the ability of smaller firms to respond flexibly to new opportunities to grow in markets where banks have not been as strongly focused.

Multi-national companies' vendor finance subsidiaries fund themselves largely by wholesale market issuance of commercial paper, which is then held in bank and managed fund portfolios. While private and commercial vehicles account for the majority of goods financed this way, they include business and farm equipment. The finance subsidiary of the multi-national borrows at an interest rate related to its parent's credit rating, and in turn assesses its credit risk through its specialised business knowledge and client relationships, providing loans to support sales of its products. About a fifth of the assets in table 4 are classed as 'multi-national' vendor finance, with virtually none of the liabilities owed to households. The few domestic vendor finance companies are classified as consumer finance companies.

The business plant and machinery (P&M) finance companies account for around a third of total finance company assets and a little more than a third of their household deposits – between 40 and 50 per cent of their total deposits are from households. Plant and equipment leasing is a major part of their business, which is spread across a wide spectrum of business classes. This is the market in which the major remaining bank-owned finance company, UDC, operates. Were it included in the 2002 figures its loans would represent around 40 per cent of the total plant and machinery group.

The most numerous group within this classification is finance companies dealing primarily with consumer finance. These companies range from those with origins in retailing groups, providing finance for the group's retail sales and for other retailers, to 'stand-alone' companies financing cars and other consumer goods directly and via retailers, to smaller finance companies lending directly to the consumer. About half of this group's $2 billion consumer loans outstanding are secured by hire purchase agreements, with about half of these being securitised. A third of deposits are from banks and over a third from households, and the total liabilities of the consumer finance group are a quarter of the total for all finance companies.

Banks remain the largest providers of consumer (non-housing) finance, but finance companies have increased their share recently. Table 5 shows that the level of non-credit card consumer loans from banks has been virtually flat since 1998, with growth occurring in credit card borrowing. (Most credit card debt is owed to bank-owned card issuers, but there were three non-bank card issuers at December 2002.) It should be borne in mind however that it is common for 'consumer' borrowing from banks to be secured on residential property. These amounts cannot be tracked and are recorded as housing loans, thus not appearing in the table. For borrowing identified as consumer loans, the non-bank share has risen from around 40 per cent to over 43 per cent over the past four years.

Table 5
Consumer finance*

$ million as at December	1998	1999	2000	2001	2002
Finance company loans (includes major store cards)	2410	2570	2850	3270	3730
All other institutional consumer loans	320	310	310	340	380
Credit card personal loans	2020	2320	2840	3340	3680
Bank personal loans	2340	2460	2360	2400	2440
Total consumer loans	7090	7660	8360	9350	10230

Source: RBNZ

* When first published, table 5 included a 'memorandum item' row for total New Zealand HP lending, stating these figures were included in 'finance company loans' shown. These same total HP data can be found in the annual 'Household financial assets and liabilities' series (http://www.rbnz.govt.nz/statistics/monfin/index.html). A subset of the HP proportion of finance company loans in table 5 cannot be provided for confidentiality reasons. The 'memorandum row' was removed on 24 July 2003

The fastest growing of these four finance company categories, with around a fifth of total assets in table 4 by 2002, is the property development group. Growth accelerated very rapidly in 2000 and 2001 as demand rocketed for residential apartments and 'terrace housing', with total assets up over $1.5 billion in the four years to 2002, ie increasing more than sixfold in this period. Funding for this growth was supplied almost entirely by households. Figure 2 illustrates the relative growth rates of the loan portfolios of the four finance company categories from 1998 to 2002.

The larger property lenders provide 'mezzanine' (subordinated, or second mortgage) finance for residential apartment development, supplying perhaps a quarter of a project's development cost, for which banks are the primary funders. While the major part by value of their loans is in large developments, they also finance a much larger number of smaller developments where they may often be the primary or sole lender.

Figure 2
Finance company loans outstanding - annual percentage change

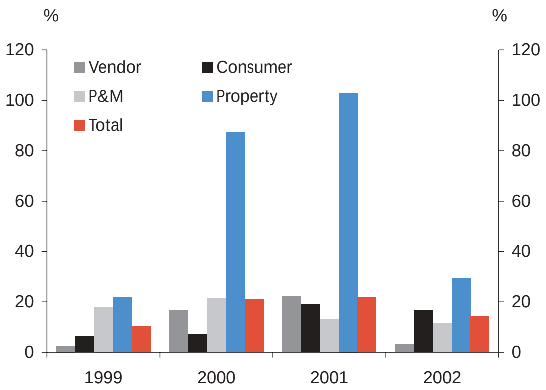
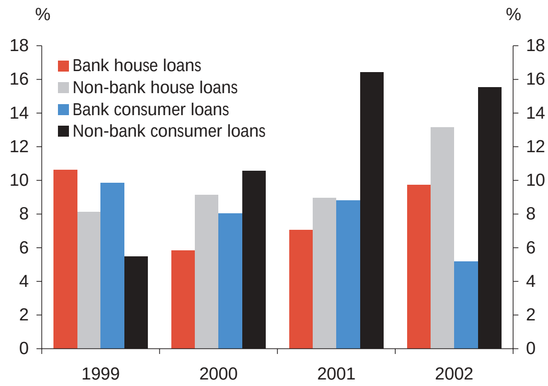


Figure 3
Bank and non-bank household lending – annual percentage growth



Finance companies' business with households is characterised by a strong reliance on them for deposits, and lending for consumer purposes. Building societies, mortgage managers, credit unions, and managed funds to a minor extent, lend to households for housing and also for consumer purposes. Figure 3 illustrates the relative rates of growth of housing and consumer credit of all non-bank sources compared to banks over the last four years. Total housing lending is over $76 billion, with non-bank sources supplying about $4 billion.

4 Non-institutional fixed interest markets

Overview

The Bank's long-run series of household financial assets shows that households' estimated holdings in fixed interest markets have varied from $7 billion to $9 billion over the past ten years, comprising less than 7 per cent of total household financial assets. In addition to retail bonds, solicitors' mortgage market and contributory mortgage investments, this total includes between $2 billion and $3 billion of household deposits held indirectly in solicitors' trust accounts at banks. Over this period, a strong decline in the solicitors' mortgage market and a lesser fall in government stock ownership has been more than offset from the early 1990s by a fourfold increase in retail non-financial corporate bonds. Households participate in this market almost entirely as lenders, with only a minor amount lent to them directly in the solicitors' mortgage market.

The financial institutions that hold bonds in New Zealand are principally fund managers and banks. For both government and private sector bonds, fund managers have been the largest holders. The level of banks' holdings of government securities has been more volatile than that in the portfolios of fund managers. In the past, half of the latters' government bonds have been held by the Government Superannuation Fund, but the portfolio rebalancing begun by this fund in 2002 is likely to bring the funds management industry's government bond holdings to a level closer to that of the banks. Banks and managed funds together held around $900 million of local authority bonds, and $8 billion of government bonds at December 2002.

Fund managers (life, pension, unit trust and other managed fund categories) at December 2002 held close to $3 billion in corporate bonds and commercial paper issued by the business sector. Banks tend to hold a smaller quantity of corporate bonds than fund managers, and they tend to be at shorter maturities. The corporate bond market in New Zealand has totalled around $7-8 billion over the past few years, showing little overall growth, with the share held by institutions however declining a little, to approximately half now. Short-dated commercial paper of less than a year to maturity is held by both banks and managed funds, but the former frequently manage issuance facilities and hold significant quantities of this paper in their liquidity portfolios.

Contributory mortgage brokers

It has long been the practice for brokers to market participation in loans, usually for commercial purposes, secured by contributory mortgages offering relatively high rates of interest. Significant losses were incurred by investors in contributory mortgages promoted by one or two brokers in the late 1980s. Regulations controlling the conditions under which interests in contributory mortgages may be offered to the public, and their management, were consequently introduced under the Securities Act, coming into force in 1989. Brokers, usually operating as companies, must register with the Companies Office and comply with numerous conditions of operation. Examples of these include a requirement to provide an audited annual report, to use a trust account for contributions towards mortgages and directions on the release of funds in instalments on a development mortgage.

In the second half of the 1990s there were over 20 registered mortgage brokers, and the total value of contributory mortgages exceeded $300 million by the end of the decade. Since then, however, some brokers' mortgagors defaulted, with delays in repayment and losses to investors, and several brokers were found to be operating outside the requirements of the law. Several were prosecuted, and the total of funds invested through contributory mortgage brokers has fallen quite sharply. It may be that the negative publicity associated with mortgage brokers, and closer enforcement of the regulations, will limit this form of financing in future.

Mortgage managers

Around a dozen residential mortgage originators operate as mortgage managers. Using managed wholesale funding arrangements, these firms establish a customer relationship with their borrowers, but are not the mortgagee (lender). Their mortgages are owned by a trust and are aggregated over time into parcels of mortgage-backed securities and 'securitised' – the mortgage managers do not hold them on their balance sheet. They continue to administer their loans, so that the customer relationship remains with the mortgage manager. While this form of residential mortgage lending began over five years ago, and the market is small, the value of residential mortgages outstanding from these sources is growing faster than the rest of the market.

Solicitors' mortgage market

In the late 1970s and early 1980s, over 20 per cent of residential mortgage loans outstanding were arranged through solicitors, because financial sector regulation impeded the efficient operation of the institutional mortgage market. Following deregulation, the solicitors' market rapidly declined and today fewer than 400 solicitors participate in a market of around $1 billion. Most of the mortgages financed by it are secured on commercial property, with the amount of funds advanced for farming and residential purposes estimated to be a very small proportion of the total of solicitors' mortgages. Investing and borrowing through solicitors is exempted from the Securities Act and regulations.

Retail bond market

The retail bond market comprises debt securities issued mainly by non-financial corporations and held directly by retail (here construed as personal) purchasers. 'Bonds' include capital note issues, central and local government debt and corporate debt securities generally issued for terms of a year or longer. The outstanding total of this category of debt held by households is estimated to be over $5 billion dollars. While easy to define, direct market holdings by households must be calculated from a variety of sources and methods, using registers and ratings data for corporate debt totals, with all sources involving a significant degree of estimation. Households invest in bonds either at the time of issue, subscribing directly for them, or through a broker. In 2002 the retail corporate bond market grew faster than ever, with a number of new bond issues to a market seeking higher yields than those available from banks.

5 Life insurance, superannuation and managed funds

The investment of funds for life insurance, superannuation, unit trust, group investment fund (GIF) and general funds management purposes is generally described as 'funds management'. The latter group of three are called 'managed funds' here, and are dominated by unit trusts. The industry invests savings of households (non-household funds are less than 10 per cent of the total managed) channelled to it via life insurance and superannuation contributions, and from investment in unit trusts or directly under other arrangements. Investment expertise is centralised but serves various 'product' needs under a variety of forms of long-term saving.

The funds management industry in New Zealand evolved from traditional life insurance company origins, where life funds and pension investment expertise was centralised, while funds collection occurred through agent sales and company superannuation schemes. Management of unit trusts was a natural 'fit' for established companies, but at the same time offered an opportunity for new entrants to the generic business of investing pooled funds for household saving. Funds management is now a key business unit of many financial groups with both insurance and banking origins, and in the last decade there has also been growth in the number and size of fund managers unaffiliated in this way.

Distribution of 'product' (the unit trust and retail superannuation investments created by fund managers) occurs in numerous ways; through agents, branch networks, directly and from a large network of financial advisers. Fund managers seek scale to compete more effectively, and products for and links to sophisticated technological 'platforms' that allow them to meet increasing demands for 'tailored' investment solutions for savers at affordable cost.

There has been rapid industry restructuring over the past five years that has seen three of the five biggest groups with life company origins grow strongly through acquisition, with two large retail banks' funds management arms emerging among the six largest. Only one of these six is New Zealand-owned. During the same period, several smaller independent New Zealand-owned funds have grown significantly, often specialising in particular products – for example unit trusts only.

Total funds reported here are obtained from over 45 funds management groups, 10 charitable trusts and four mortgage investment trusts. Seven of the funds management groups have their origins in the life insurance industry, and more than 10 are Australian 'exempt' funds (Australian registered managed investment schemes) where the fund manager is based in Australia. The remaining group of fund managers includes the funds management arms of large retail banking groups, a couple of funds specialising in property and many independent New Zealand-owned fund managers, most relatively small but in general growing faster than the industry average.

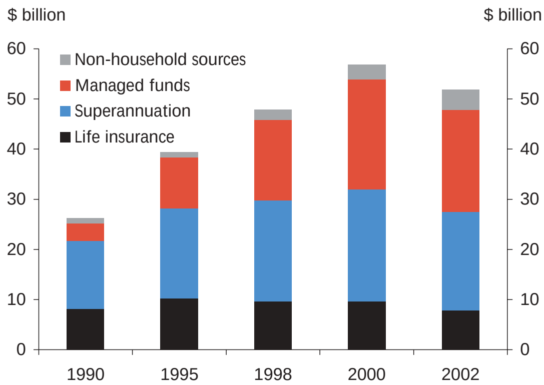
The six largest funds management groups have over 60 per cent of total industry funds of $52 billion, and five of the six largest managers have their origins in life insurance companies. However, none of these has more than a third of its funds under management on behalf of traditional life policies, and they tend to have the most diversified product mix of all fund managers. Contributions to life insurance policies, most of which had a strong investment/savings element, benefited from tax incentives until the 1980s, but since their removal, and with term life policies widely available, new business of this kind has fallen away strongly. Although ongoing contractual saving and increasing investment returns caused the value of funds managed on behalf of such policies to rise until the mid-1990s, withdrawals and maturing contract redemptions then began to exceed remaining inflows and investment growth.

Life insurance companies are regulated under the Life Insurance Act 1908, but are also in general required to comply with the provisions of the Securities Act, such as the requirements for a trust deed and trustee to be appointed and for product disclosure. The 1908 Act requires audited annual financial statements to be provided to the government, and for actuarial reports to be forwarded to the Government Actuary. In addition to these statutory requirements, many insurance and managed fund companies pay voluntary levies to fund an independent Insurance and Savings Ombudsman to act as a disputes resolution service.

As figure 4 illustrates, since 1990, managed funds have shown the strongest growth in funds under management. Over 70 per cent of the $20 billion in this category is invested by households in GIFs and unit trusts, which have shown the fastest growth. GIFs are legal vehicles enabling the joint management of pooled funds by or under the supervision of a statutory trustee company, and in addition to the general provisions of the Securities Act, are principally governed by the Trustee Companies Act 1967. Funds invested directly in GIFs are nonetheless a small proportion of total managed funds.

Unit trusts in New Zealand are for the most part 'open-ended investment trusts', which enable investors to purchase 'units' that participate in the capital and income returns from specified assets owned by a trust. In addition to the Securities Act, unit trusts are principally regulated by the Unit Trusts Act 1960. Important provisions of this Act are that a unit trust must have a company as manager, a trust deed governing the functions of the trust owning the assets in which investors have 'an interest' (usually 'units'), an independent trustee, and that units must be transferable.

Figure 4
Funds under management by product type, $ billion



Superannuation schemes are defined in the Superannuation Schemes Act 1989 as any trust established principally to provide retirement benefits. Schemes registered by their trustees under the Act provide members and prospective members with disclosure protections that go beyond those required of unit trusts, and give certain regulatory powers to the Government Actuary in relation to protection of members' interests. There are no general taxation benefits conferred on investment returns in superannuation schemes.

However, when the top rate of personal income tax increased to 39 per cent in 2000, the tax at source for employer contributions to superannuation schemes was retained at 33 per cent, providing an inducement for higher earners to channel more of their earnings through their employer to superannuation saving. Fund managers invest by far the largest proportion of total superannuation funds but the aggregate data reported here is derived from the annual report of the Government Actuary, to ensure full coverage.

The number of members in employer occupational schemes has been declining as a ratio of the workforce since the end of the 1980s, following major changes to the superannuation regime. The number of smaller employers offering schemes has fallen greatly. Fund managers have responded in part by offering retail superannuation products. The total value of retail funds now exceeds 35 per cent of all superannuation funds under management. It is likely too, that for many households, 'saving for retirement' is done by investing in unit trust products. Unlike unit trusts however, registration distinguishes retail superannuation products by compulsory fee disclosure and additional supervision provisions, as well as measures limiting early withdrawal. The products themselves, in terms of investment mandates and performance characteristics, are in general similar.

6 Conclusion

Non-bank deposit-taking institutions remain small in relation to banks, but have grown significantly faster than banks over the past three years. Total growth in the savings institution sector has kept pace with that of banks over the period, and its household lending, for both groups dominated by residential mortgages, has grown faster. Finance company household lending growth, by contrast, is focused on consumer lending, and has outstripped that of banks over the past three years. Business lending by finance companies has also been more rapid than that of banks, and their household funding has also grown more rapidly. It appears as though a minor 'rebalancing' of the distribution of finance from deposit-taking institutions away from banks may have been underway since 1998.

The life, superannuation and managed funds industry experienced strong growth in household sector funds inflows and the value of funds under management over the decade to 2000. From then, funds under management have fallen, as equity market values have sharply reversed much of the gains of the late 1990s. In 1998, households' funds in this sector equalled their total deposits, but at the end of 2002 were about 85 per cent of total deposits. Over the same period the funds management industry has become more concentrated, mainly as a result of merger and acquisition activity initiated offshore. At the same time, however, a number of locally-owned smaller fund managers have grown significantly faster than the industry average.

Banking groups' financial market influence extends beyond their banking subsidiaries. Over a quarter of the value of funds under management in New Zealand is now controlled by major banking groups, which have pursued a strategy of diversification with respect to the financial asset business of households. Measured in this way, financial assets managed by banking groups are in excess of three quarters of totals reviewed in this article, and this proportion has increased steadily since 1990.