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Abstract

Recent studies of the experience of the British life insurance industry indicate that a period of transition, and the development of more diversified investment strategies began in the inter war period. Australian life insurers lagged behind their British counterparts in the introduction of such strategies. This paper investigates why this was the case. It argues that in the Australian market there was both a lack of opportunity and incentive to broaden asset portfolios. However, this did not mean that asset management practices did not advance. Australian life offices became progressively more sophisticated in their approach to portfolio management during this period.
The life insurance industry has long been an important channel for savings and borrowing in Australia. However surprisingly little investigation has been undertaken into the development of portfolio management practices within this industry. Several recent overseas studies have thrown light on the development of investment practices within the British life insurance industry which have improved our understanding of the decision making process amongst these firms.¹ A common thread of these studies is that they place the evolution of life insurance investment practices within an established capital market and focus on the internal processes within firms. This type of approach concentrates on the factors which influence the demand for particular investment opportunities. An alternative method is to consider the way in which the state of the capital market influenced the development of the investment strategies of life insurers, that is, what impact the supply of investment opportunities had on the evolution of asset management strategies. A benefit of this line of inquiry is that it highlights the manner in which factors external to the firm influenced the direction of portfolio investment and the development of investment management practices within the firm.

In the mid nineteenth century the foundations of a uniquely Australian life insurance market emerged and grew rapidly. Unlike insurance providers in Britain and America, the basis of the Australian industry was formed around a group of mutual associations which
dominated the market and influenced its development. By 1900 the assets held by life insurers made it them fourth largest group of financial institutions in Australia surpassed only by banks and pastoral finance companies. However, despite having access to large amounts of capital, it is only in the post war era that life insurers adopted a broad approach to asset management. Prior to that the channels of investment were limited to a narrow range of options resulting in a concentration of funds in two basic areas. It is the aim of this paper to investigate the factors which influenced the direction of life insurance investment and to analyse the impact on investment decision making procedures within the firms. The interwar period was one of transition and development in the investment practices of overseas insurance companies. It is intended to see to what extent Australian companies followed this trend and whether or not the mutual ownership of major life insurers constrained its emergence. The paper will proceed by firstly outlining the principles which have influenced life office investment. It will consider growth of life insurance in Australia and the pattern of investment. This will then be placed within the context of the development of the capital market at this time and an evaluation made of the factors which actually determined the investment of life office assets.

II

The standard approach to the investment of life insurance funds was established by A.H.Bailey. In 1862 Bailey delivered an address to the
Institute of Actuaries in London which laid down the principles which should be applied by life insurance offices. The first principle stated that the prime consideration in any decision should be the security of the capital invested. Within this context the second consideration was to obtain the highest possible rate of interest. Whilst ensuring that a small proportion of funds were held in convertible assets the bulk of funds were to be invested in non convertible securities. The last principle reiterated that capital should be employed to aid the life insurance business. These five canons emphasised the need to protect the value of capital invested. Obtaining a suitable rate of interest was of secondary importance to ensuring the security of capital. With this in mind the most suitable form of investment was in non marketable securities such as mortgages and other types of secured loans. Initially Bailey did not favour government securities because of their 'very inconvenient fluctuations in value'. In later years this opinion was revised but he continued to oppose market based investments. This simplistic approach was to have a lasting influence on attitudes to life office investment for many years. It was not seriously called into question until the 1930s, and even in the 1990s calls were being made for its rehabilitation. During the 1920s the debate was revived somewhat at the instigation of J.M.Keynes. Keynes had an interest in management of several insurance companies during the 1920s including the National Mutual and Provincial where he acted as a consultant advising on investment strategy. Keynes accepted the basic premise of Bailey's canons; the need to ensure capital security, but he argued for a much more active approach to investment. As
part of this approach he advocated investment in equities during specific phases of the trade cycle. This was a marked departure from the prevailing orthodoxy which did not see investment in market based assets as desirable. A further case for investment in shares was put strongly in address made by H. E. Raynes in 1928 to the Institute of Actuaries. Raynes conducted a study of the movement in the share prices of a selected group of British companies over a fifteen year period. He found that a life insurance office which had restricted its investment to fixed interest bonds or debentures was worse off than one which invested in ordinary shares. He argued for investment in equities on two main grounds. Firstly because they out performed fixed interest assets over a period of time and secondly because they were a hedge against currency depreciation. Raynes, like Keynes however, was arguing within the existing investment orthodoxy. He recognised that for such a strategy to be successful life insurers would need more specialised knowledge than their investment departments currently had.

Such ideas were not knew though and the debate over share acquisition had been ongoing both in Britain and Australia for many years. In 1912 A. T. Anderson addressed the New South Wales Insurance Institute on a this theme. Anderson provided results of a similar though less comprehensive study to Raynes. In a review of the performance of Australian companies he came to the same conclusions as Raynes, although he was more particular about the types of companies he recommended. Banking and brewery companies were the two considered most appropriate
for the investment of life office funds. Anderson's comments were not well received by his audience who did not agree on the efficacy of share ownership. Not only were life offices against the concept it was also pointed out that a 'fatal' objection was the limited number of suitable Australian stock exchange securities available. It was argued, that opportunities were so limited that it would be extremely difficult to obtain even £50,000 of first class securities without seriously disturbing the market.

The papers of Bailey and Raynes form the basis upon which the principles of investment policy evolved in the twentieth century. Whilst Bailey upheld the protection of asset value as paramount, Raynes demonstrated that within this context it was possible to have a varied investment portfolio which created a greater potential return without unduly increasing risk. The degree to which these principles applied has been the focus of two recent studies. Scott argues that it was during the inter war period that a transition in investment theory began, coinciding with shift in investment practices. Companies which adopted a broader approach to their investment portfolio also developed managerial expertise which gave them an advantage when investment in equities really took off in the post war period. Baker and Collins, whilst disagreeing with some of Scott's conclusions, found that there was a great deal of cross firm variety in the development of investment strategies. Both studies indicate that there was a shift in portfolio composition towards equities in at least some British life insurance firms in the inter war period. This is significant in that it indicates a growing acceptance of the development of a broadening investment
strategy and the existence of a capital market which can supply the opportunities for such investment. In this context the theory and practice of portfolio investment can evolve together allowing firms to incorporate these changes in their management practices and build the necessary expertise required within the firm. In looking at the comparative Australian experience it is evident that the opportunities to put new concepts of asset management into practice were limited and that this is turn delayed the development of more broader investment strategies. Before explaining how this came about however, it is necessary to briefly review the pattern of growth of life insurance offices which was markedly different to the British experience.

III

The development of the Australian life insurance industry is unique in that mutuals have played a significant role in its evolution. Although the first Australian mutual life office (the AMP) was formed in 1849, the establishment of an Australian life insurance industry as such, did not take place until the 1870's. During this decade ten new local life insurers entered the market. Most within a three year period from 1869 to 1872. Significantly all these new entrants were mutual offices. By 1880 mutual firms accounted for 81 per cent of new policies sold, by 1890 this had risen to 90 per cent. Only four Australian proprietary companies of any substance operated in the life insurance market after the 1870s. These were
the Australian Insurance Company, Victoria Life and General, Australian Alliance Assurance and Adelaide Life Assurance and Guarantee.\textsuperscript{xvii} In addition there were several British and American companies with agencies in the colonies. However the extent of business they conducted was variable. Between 1870 and 1879 sixteen British firms were conducting some life insurance business. By the 1899 this had fallen to three and it is unlikely that they had sold new policies in the past decade.\textsuperscript{xviii} By the 1890's the structure of the industry which was to dominate for the next seventy years was clearly visible. At this point in time the market share of the top five firms had increased to 88 per cent of new policies sold.\textsuperscript{xix} As with the British market, the Australian market emerged as a highly concentrated oligopoly, although in this case it was the mutual firms which dominated the market.

By 1890 Australian life insurers were reported as having assets in excess of £16 million compared with £8 million in 1885. In building this asset base life offices received close to £17 million in revenue from the sale and renewal of policies and £5.5 million in interest over the decade from 1880 to 1890. It was estimated at the time, that during this period life offices issued over 300,000 policies, which was, on average, one policy per ten of the population of the colonies.\textsuperscript{x} Although the onset of economic depression in the next decade slowed down the rate of expansion of this market, it is evident that the sector was becoming a significant source of funds. Table 1 presents a comparative picture which highlights the
importance of the life insurance industry within the emerging Australian finance sector.

Table 1 Assets of Australian Financial Institutions 1885-1900.

<table>
<thead>
<tr>
<th>Year</th>
<th>Trading Banks £</th>
<th>Savings Banks £</th>
<th>Building Societies £</th>
<th>Life Offices £</th>
<th>Friendly Societies £</th>
<th>Pastoral Finance Companies £</th>
</tr>
</thead>
<tbody>
<tr>
<td>1885</td>
<td>107</td>
<td>10.5</td>
<td>8</td>
<td>1</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>1890</td>
<td>151.5</td>
<td>14.5</td>
<td>22.5</td>
<td>16</td>
<td>1.5</td>
<td>26</td>
</tr>
<tr>
<td>1895</td>
<td>129.5</td>
<td>21.5</td>
<td>7</td>
<td>22</td>
<td>2.5</td>
<td>26.5</td>
</tr>
<tr>
<td>1900</td>
<td>116.5</td>
<td>30.5</td>
<td>4.5</td>
<td>31</td>
<td>3</td>
<td>224</td>
</tr>
</tbody>
</table>

Source: AIBR, 1886-1900; Pope, 'Australian Money and Banking Statistics'.

By 1900 life insurers were the third largest group of financial institutions in terms of the assets they held. Whilst the assets of building societies and pastoral companies fell after 1895 those of life insurers continued to grow. However, although life insurers were the third largest group of financial instructions in the capital market they only represented ten per cent of total assets. The money market was dominated by trading banks which held the majority of assets as is evident in Table 1. Other financial institutions were markedly smaller than these banks. This was indicative of the relatively undeveloped state, not only of the capital market, but of the Australian economy.

IV

The rapid growth of life insurance in the 1880s provided a growing pool of investment funds. However the spread of investment was rather
limited. This is evidenced in Table 2 which provides a snapshot of the
distribution of assets from the period 1880 to 1900.

Table 2 The Distribution of Life Office Investment to 1885-1900.

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Percentage of Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1885</td>
</tr>
<tr>
<td>Loans on Mortgage</td>
<td>63.7</td>
</tr>
<tr>
<td>Loans on Policies</td>
<td>13.2</td>
</tr>
<tr>
<td>Govt &amp; Municipal Securities</td>
<td>1.2</td>
</tr>
<tr>
<td>Shares &amp; etc</td>
<td>1.2</td>
</tr>
<tr>
<td>Cash &amp; Deposits</td>
<td>8.2</td>
</tr>
<tr>
<td>Property freehold &amp; leased</td>
<td>8.4</td>
</tr>
<tr>
<td>Agents Balances</td>
<td>0.4</td>
</tr>
<tr>
<td>Outstanding Premiums</td>
<td>2.1</td>
</tr>
<tr>
<td>Outstanding &amp; accrued interest</td>
<td>0.8</td>
</tr>
<tr>
<td>Sundries</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Source: AIBR 1880-1900

The majority of assets were held in loans on mortgage. Together with loans
on policies these assets accounted for in excess of 75 percent of total assets
in the 1880s. The types of investments that life offices could direct funds to
were laid out in the bye laws of the mutual society. Those of the AMP
provide an illuminating example of the options available. Far from being
tightly constrained as some have argued, life offices had a range of
investment options available to them. The bye laws for investment of funds
at the AMP, amended in 1873 state,
'The board shall lay out and invest the Society's funds in any, or all of the following modes;

1. public or government securities in Australia and New Zealand.
2. upon the security of freehold or leasehold property.
3. upon the security of city, municipal or borough rates, mortgages, bonds, debentures of railway or public companies authorised by parliament to levy rates.
4. in the purchase of, or at interest upon life interests in funds or estates and upon the security of policies of assurance.
5. on deposit or current account with ordinary bankers
6. in the purchase of premises or of land on which to build premises in the whole or part for offices for the use of the society.
7. purchase of an advance in the government securities of Great Britain or other stock finds guaranteed by the British government.'

This is in line with Bailey's canons but it is also a reflection of the state of the capital market at this time. Significantly equity investment is not specifically prohibited although there was a general assumption that it was not an appropriate form of investment for the life insurance office. In the 1880s the Australian capital market was comparatively unsophisticated largely in part because of the relatively limited demand for capital. Colonial governments were only just beginning to embark on large public works programs such as transport networks, the demand for funds by government
was limited. Capital that was required was raised on the London market rather than in the domestic market. Likewise most manufacturing businesses were small and did not require large amounts of capital. Furthermore, although Australian stock exchanges had been in existence since the 1860s they were not a vehicle for investment in industrial stocks. Up to the 1890s speculative mining shares formed the majority of business done on colonial stock exchanges.

The decade of the 1880s witnessed a boom in land and housing investment, particularly in the colony of Victoria. This boom, which became a speculative bubble in the latter part of the decade, pushed interest rates up making mortgages a very attractive form of investment. The average rate of interest earned by Australian life offices in the early 1880's was over six per cent, compared with rates in Britain of between four and five per cent. The provision of loans provided a growing source of investment income during this period. The AMP for example, generated enough income from interest alone to cover all policy claims and three quarters of management expenses.

The collapse of major financial institutions in Victoria sparked a broader downturn in that colony as the land boom of the late 1880s folded. Economic conditions in the other colonies also deteriorated leading to widespread depression in 1890. As a consequence of the financial crisis there was a shift away from investment in mortgages as is evident in Table 2. This was accompanied by an increase in holdings of government and semi government securities which had risen from 3.2 per cent in 1890 to
14.8 per cent in 1900. Whilst mortgages still represented the bulk of assets, the fall in interest rates associated with the economic downturn had made government securities relatively more attractive.

In the aftermath of the 1890s financial crisis a localised capital market began to emerge. As a result of the financial collapse the London market shunned Australian borrowers.\textsuperscript{xvii} This occurred at a time when government and semi government authorities were becoming increasingly reliant on borrowing to fund public works infrastructure and land settlement programs. These bodies turned to the domestic market to supply the necessary funds thus creating a local market in government securities. By 1910 the shift in the direction of life office investment had become more apparent. Investment in government and semi government securities had increased to 25.4 per cent of total assets, whilst loans on mortgage had declined to 45.0 per cent.\textsuperscript{xviii} These holdings of securities were very straightforward. The AMP for example, in 1910 had the majority of its holdings in NSW government securities (24.8 per cent). Aside from smaller holdings of other Australian state government securities, it held 21.2 per cent of assets in this category in New Zealand government securities and 1.7 per cent in British consuls.\textsuperscript{xxix} The interest earned from all assets of the AMP in 1910 was 4.9 per cent a significant drop from the average of 6.1 per cent earned in the 1880s.\textsuperscript{xxx} This rate of interest was much closer to that offered on government securities of around 4 per cent at the time and goes some way to explaining why this form of investment had become more attractive over time.
Taking the investment portfolio of the AMP as representative of other life insurers it is possible to draw some conclusions on the state of portfolio management in the period prior to the first world war.\textsuperscript{xxxi} Table 3 details the distribution of asset holdings in this firm in 1910.

Table 3: Asset distribution in the AMP 1910.

<table>
<thead>
<tr>
<th>Asset Type (pounds)</th>
<th>Per cent of total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans on Mortgage</td>
<td>39.7</td>
</tr>
<tr>
<td>Loans on Policies and Personal Security</td>
<td>17.5</td>
</tr>
<tr>
<td>Loans on Rates</td>
<td>12.3</td>
</tr>
<tr>
<td>Reversions&amp; Life Interests</td>
<td>0.3</td>
</tr>
<tr>
<td>Govt &amp; Municipal Securities</td>
<td>22.8</td>
</tr>
<tr>
<td>Shares &amp; etc</td>
<td>0</td>
</tr>
<tr>
<td>Cash&amp; Deposits</td>
<td>2.7</td>
</tr>
<tr>
<td>Property freehold&amp;leased</td>
<td>2.7</td>
</tr>
<tr>
<td>Outstanding Premiums</td>
<td>1</td>
</tr>
<tr>
<td>Outstanding&amp;accrued interest</td>
<td>1</td>
</tr>
<tr>
<td>Sundries</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: AIBR 1911, p.538.

Ninety-two per cent of assets were held either as loans or government securities. This gives some indication of the skills necessary in the management of this type of investment portfolio. Knowledge of property values and an ability to assess risk associated with a particular mortgage was required of the investment analyst. An illustration of the skill base required of insurance clerks can be seen in the insurance institute exams. These exams were undertaken by clerks in their fourth and seventh years of
employment and were a necessary for future promotion within the firm.

Questions related to the investment of life office funds focussed on
evaluation of mortgage proposals. By the 1920s these questions required a
high degree of detailed knowledge of the mortgage market.\textsuperscript{xii}

Most investment decisions were decentralised and undertaken at the
branch office level. Branch offices were further divided into districts within
each state. The branch board responsible for approving mortgages and loans
relied on information passed on by the district manager as to property values
and business conditions in particular parts of the state. Part of the role of
branch and district managers was to investigate investment opportunities in
their local area and bring in mortgage business to the society.\textsuperscript{xxiii} By the
1920s valuers and property inspectors were also employed by branch offices
but the system still relied heavily on the local knowledge of senior
managers. These managers were also responsible for the management of the
securities portfolio in their representative states or countries.\textsuperscript{xxiv} With the
advent of the first world war the government requirement for funds
increased. Between 1915 and 1924, £274 million was raised in the domestic
capital market to fund the war effort.\textsuperscript{xxv} Although much of this capital was
subscribed by individuals, life insurance offices also increased their holding
of government securities quite dramatically. Holdings of government
securities had risen from one third of total assets in 1915 to one half in
1924.\textsuperscript{xxvi} To attract funds governments progressively raised interest rates in
the later part of the war and continued to do so in the immediate post war
period. Rates of interest offered on Commonwealth securities rose to six per
cent in the early 1920s and those offered semi government and local
government bodies to between 6.5 and seven per cent.xxxvii

The pattern of life office investment was reinforced by advent of the
war and government and semi government securities became the main
avenue of investment for the inter war period. Notwithstanding this
however, the 1920s was a period of advancement in the evolution of
investment practice. Interest rates on government securities started to fall in
the mid 1920s. Coincidentally it was at this time the Commonwealth
government established the Loans Council to co-ordinate state and federal
borrowing. Initially the agreement to co-ordinate borrowing was voluntary,
designed to bring some order back into a system which encouraged
competition between state and federal governments and contributed to
maintaining interest rates at a relatively high level.xxxviii Falling interest rates
and a loss of confidence in commonwealth government securities were the
catalyst for life offices to shift their composition of holdings of such
securities. From 1926 major life office increased their holdings of semi
government and local government securities. In 1926 the principal board of
the AMP for example, directed its manager of the Melbourne increase their
holding of Melbourne and Metropolitan Board of Works securities to
£2,167,350. This represent 6.1 per cent of their total holdings of government
securities. The board claimed there was no safer investment and the interest
yield of 5.5 per cent was higher than they could obtain on government
securities.xxxix There was also a lack of confidence in commonwealth
government securities as a form of investment in the late 1920s. When
questioned on the decline of this form of investment by the Royal Commissioners inquiring into the Monetary and Banking System, the manager of the National Mutual Life, Charles Norris, explained that his office felt there was a 'difficulty' with the commonwealth and that it was obvious that it was in trouble. As a result he had turned his attention to loans to municipalities.\footnote{\textsuperscript{xii}}

During the 1920s life offices started to diversify their holdings of government securities to a far greater degree. They were not prepared to accept falling interest yields if they felt that greater returns could be made without sacrificing security. After this point investment practices enlarged. Life offices started buying Australian bonds and securities on overseas markets looking for higher yields.\footnote{\textsuperscript{xii}} This meant that investment managers now had to pay greater attention to exchange rate values and factor this in to investment decisions. In the past this issue had not been given much consideration. Funds acquired in one country were usually kept and invested in that country or if they had to be repatriated no allowance was made for exchange rate differences. As one general manager told the Royal Commission in the Monetary and Banking system, 'exchange rate variations are temporary and off setting'.\footnote{\textsuperscript{xii}} The demise of the gold standard put an end to that and by the 1930s life offices were giving serious consideration to exchange rate fluctuations.\footnote{\textsuperscript{xiii}} Changes such as these required life insurers to become more sophisticated in their approach to the investment decision making process and evolve their management processes accordingly.
Holdings of government and semi government securities also started to diversify in the 1920s and 1930s. As an illustration, the AMP, in addition to its holdings of commonwealth and state securities, were also investing in local government and statutory authorities. A snapshot of the early 1930s reveals that the life office had holdings of securities issued by the cities of Wellington, Vancouver, Sydney and Brisbane as well as issues from the Brisbane water board, Brisbane Tramway Board, Melbourne Harbour Trust, British Columbia Tramway Board and the Brisbane/Ipswich Water Board.

Throughout the 1920s and 1930s the portfolio management of life offices was becoming increasingly more complex even though there was not a great deal of diversity between the general types of assets held. The catalyst for this change was the downward trend in interest rates. From a high of six per cent interest in 1923, the rate on commonwealth and state issues fell progressively for the next eight to nine years. Life insurance offices looked for alternative ways to compensate for this fall. One method they employed was 'switching' which involved monitoring the market to take advantage of bonds which came on the market with higher yields. Such a practice was almost unheard of until the 1920s when it was increasingly used to combat falling bond yields in domestic markets. Other alternatives were to look for higher yielding securities, both in Australia and in countries where life offices had a presence. Whatever tactics adopted they involved a more informed and educated approach to the management of assets. Investment procedures in life insurance offices developed in response to this pressure.
It was in the inter war period that the investment strategies and practices of life insurance offices started to evolve beyond that of simply lending on mortgages or acquiring government securities. Whilst upholding the principles expounded by Bailey, life insurers placed increasing emphasis on attaining the highest possible rate of return within this constraint. In doing so they developed improved expertise evaluating investment decisions and monitoring the markets they traded in. However the evolution of investment practices did not necessarily occur across the whole industry in a synchronous manner. There was considerable diversity amongst firms. To understand how and why this was the case it is necessary to look briefly at how the industry evolved after world war one.

IV

In 1910 there were eleven life insurance associations operating in the Australian colonies, six of these were mutual. These mutuals accounted for 81 per cent of assets. The other five firms represented only a very limited section of the market. The industry remained small and mutual based. Between 1920 and 1925 the number of firms had risen to 35. All of these new companies were proprietary companies, and several were composite firms transacting other forms of insurance besides life. However the large mutual firms still accounted for more than 80 per cent of assets suggesting that these new companies were small with very little capital invested.
The increase in new companies came on the back of the expansion of industrial insurance. This type of policy captured a segment of the market which had not previously been tapped. Ordinary insurance grew at a much slower rate than industrial but it too experienced an increase in demand during the 1920s.

Even though they were small concerns, the influx of new companies altered the structure of the industry by highlighting the distinction between the mutual and non mutual life insurers. Analysis of asset holdings between the two groups for the inter war period reveals the disparity in portfolio management between the two groups.

Table 4 The Mean Percentage of Major Assets Held by Mutual and Non Mutual Life Offices 1920-1940.

<table>
<thead>
<tr>
<th></th>
<th>1920</th>
<th>1925</th>
<th>1930</th>
<th>1935</th>
<th>1940</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mutual</td>
<td>Non</td>
<td>Mutual</td>
<td>Non</td>
<td>Mutual</td>
</tr>
<tr>
<td>Loans on Mortgage</td>
<td>28.1</td>
<td>8.5</td>
<td>23.7</td>
<td>5.4</td>
<td>27.9</td>
</tr>
<tr>
<td>Loans on Policies and Personal Security</td>
<td>11.6</td>
<td>5.1</td>
<td>12.2</td>
<td>5.0</td>
<td>16.7</td>
</tr>
<tr>
<td>Govt &amp; Municipal Securities</td>
<td>49.6</td>
<td>76.3</td>
<td>55.7</td>
<td>74.7</td>
<td>45.7</td>
</tr>
<tr>
<td>Shares &amp;etc</td>
<td>0.0</td>
<td>1.7</td>
<td>0.3</td>
<td>2.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Property freehold&amp;leased</td>
<td>5.0</td>
<td>1.5</td>
<td>3.1</td>
<td>1.9</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Source: calculated from the AIBR 1920-1940.

Three quarters of the assets of non mutual life insurers were held in government securities until the late 1930s. Mortgages and loans made by
these companies comprised less than 15 per cent of their assets whilst for mutual life offices it represented between 30 and 40 per cent. Equity investment represented a higher rate in non mutuals and in fact only two of the five mutuals owned any shares. Notwithstanding this, investment in shares represented a relatively small proportion of total assets held by either group. Table 4 indicates that investment practices in non mutuals were not as diverse as the mutuals. There is evidence to suggest however that they were prepared to take a broader approach than appears from just considering aggregate figures. A case in point is the Australian Provincial Assurance Association (APA). In 1929 it reported that it had recently invested in Australian and New Zealand banks as well as certain gilt edged industrial shares. The board of this firm cited the work of J.M.Keynes as instrumental in leading them down this path.¹ Mutual firms were much more reluctant to invest in the equity market. Of the five mutuals, only two, the City Mutual and the National Mutual invested in equities at this time and this was a relatively minor part of their portfolio. In 1929 shares and debentures represented 1.4 per cent of City Mutual's assets, 1.1 per cent of National Mutuals assets. At this time the non mutual APA held 8.1 per cent of assets in shares and debentures. This had increased from 4.8 per cent in the previous year whilst the ratio of the two mutuals had remained constant. The range of holdings further highlights the distinction in asset management between the two different types of life insurance offices. Table 5 shows the range of assets held in each category.
Table 5 Minimum and Maximum Ratio (%) of Specific Assets to Total Assets held by Life Offices 1920-1940.

<table>
<thead>
<tr>
<th></th>
<th>1920</th>
<th>1925</th>
<th>1930</th>
<th>1935</th>
<th>1940</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgages</td>
<td>11-51</td>
<td>0-59</td>
<td>5-58</td>
<td>0-93</td>
<td>0-42</td>
</tr>
<tr>
<td>Loans on personal security</td>
<td>3-13</td>
<td>0-5</td>
<td>5-14</td>
<td>0-7</td>
<td>0-17</td>
</tr>
<tr>
<td>Govt. Securities</td>
<td>24-72</td>
<td>0-86</td>
<td>20-79</td>
<td>0-89</td>
<td>13-88</td>
</tr>
<tr>
<td>Shares</td>
<td>0-1</td>
<td>0-22</td>
<td>0-1</td>
<td>0-26</td>
<td>0-13</td>
</tr>
<tr>
<td>Property</td>
<td>2-12</td>
<td>0-23</td>
<td>2-11</td>
<td>0-30</td>
<td>1-21</td>
</tr>
</tbody>
</table>

Source AIBR 1921-1941

Table 5 indicates that mutual firms have a much more consistent approach to investment and asset management than the non mutuals during the inter war period. Holdings of major assets retained a relatively stable pattern until the late 1930s when there is a shift in emphasis away from mortgages and government securities. There was much greater variation amongst non mutual firms in the major asset categories. Very few of these firms had well balanced portfolios. Assets tended to be held in one form often to the exclusion of others. This was particularly so of new firms which entered the market in the 1920s, these firms often had large establishment accounts which amounted to a significant proportion of total assets. The remaining funds were then placed in one particular type of investment. For example the Equitable of Australia which commenced operations in 1922 held 43 per cent of its assets in its establishment account and the majority of other assets in government securities. Seventeen of the 26 non mutual life insurers had substantial establishment accounts which comprised a large proportion of their total assets in 1925. This imbalance in portfolio composition was a
symptom of the immaturity of the emerging non mutual life insurance market. During the decade of the 1930s the disparity reduced gradually and more non mutual firms began to spread their investments over broader categories of assets however this was also accompanied by a rationalisation of the industry with a number of the newer and smaller firms progressively going into liquidation or merging with others. From its peak of 31 in 1925 the number of life insurers fell to 21 in 1930 and 18 in 1940.

The pattern of asset holdings indicates a degree of divergence in the investment strategies of life offices during the inter war years. The newer and smaller non mutuals had a relatively simplistic approach to investment constrained by the size of the organization and the limited capital available. The mutuals and long established proprietary firms, on the other hand, showed signs of developing a clearly defined approach to portfolio management. This approach, whilst it could be termed conservative, was actually becoming increasingly sophisticated within the confines of the opportunities available. A perennial problem faced by the larger life insurers was where to invest funds. The fact that investment opportunities for Australian life offices were limited was pointed put on a number of occasions in the Australasian Insurance and Banking Record and other forms.\textsuperscript{10} The immaturity of the equities market in Australia at this time did not provide the investment opportunities these firms looked for. However this did not mean that life offices were averse to private sector investment. Loans on mortgage provided a vehicle for this form of involvement. Whilst there was a clear preference for loans to broad acre farming sector, during
the 1920s there was also a shift towards business lending. For example, in 1921 the Victorian branch of the AMP lent in excess of £220,000 to local businesses. This represented 29 per cent of all new loans on mortgage granted by the society in that year. Mortgages to businesses fell later in the decade as the economy deteriorated but increased again in the mid 1930s. A benefit of this type of lending was that gave life offices an insight into the management and finances of many local firms. This put them in a better position to evaluate the viability of shares issues once the equity market began to develop more fully in the late 1930s. One of the driving concerns in making investment decisions was the rate of interest prevailing. The large established life insurers actively pursued investments which provided a higher rate of return and in doing so developed the expertise within their organizations to evaluate investment proposals. The nature of Australian capital markets during the inter war period meant that the highest rate of return was often attained by investing in government and semi government securities. During this period this form of investment remained the main focus of asset management.

VI

Unlike the experience of British insurance offices, Australian life insurers did not have access to the same range of investment opportunities in the inter war period. The two mutuals which held equities had very limited share portfolios. The bulk of the National Mutuals holdings were
shares in the Fourth Victoria Building Society. The smaller City Mutual which took a more adventurous approach had acquired shares in the Bank of New South Wales, the Colonial Sugar Refining Co and the Daily Telegraph. Less than half the non-mutuals owned any shares at all during the 1920s and 1930s. This position changed very rapidly in the aftermath of world war two. The AMP, who had acquired some company debentures in 1939 (0.8 per cent of assets), acquired ordinary shares in 1947. The Colonial Mutual did the same and the Australasian Temperance and General followed in 1949. By 1950 all mutual firms had added ordinary shares to their asset portfolios, the City Mutual had increased its holdings of shares to 20 per cent of total assets compared with three per cent in the late 1930s. The three other main mutuals held between five to seven per cent of assets in shares whilst the Australasian Temperance and General lagged behind with less than one per cent of assets in equities. Non-mutuals followed a similar pattern. By 1950 half the firms had acquired shares which represented less than ten per cent of total assets Three out of the 12 firms had holdings of 20 per cent or more, the highest being 36 per cent, whilst two firms held no shares.

Once they entered the share market life offices embraced it and invested in a diverse variety of stocks. An indication of the range can be seen in a brief survey undertaken by Grant of the major life insurers holdings of ordinary shares in South Australia. The major life offices were found to have holdings in transport companies, mining, banks, pastoral agents, retailers and manufacturing companies. Investment in equities
expanded so rapidly that life offices were forced to devote more resources to this activity. In 1949 for example, the AMP reorganised its Securities Departments which had formerly overseen investments. Two departments were created; the property investment department and the general investment department. The function of the latter was to specifically focus on stock exchange securities including shares and government securities, and to further develop analytical expertise in the finance industry.\textsuperscript{101}

The extent of change in the asset portfolios of life insurers after world war two is evident in Table 6

Table 6: Mean Life Office Holdings of Specific Assets as a Percentage of Total Assets.

<table>
<thead>
<tr>
<th>Year</th>
<th>Mortgages</th>
<th>Loans on personal security</th>
<th>Govt Securities</th>
<th>Shares</th>
<th>Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>1935</td>
<td>20</td>
<td>13</td>
<td>57</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>1940</td>
<td>24</td>
<td>10</td>
<td>49</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>1945</td>
<td>14</td>
<td>4</td>
<td>71</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>1950</td>
<td>9</td>
<td>4</td>
<td>63</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>1955</td>
<td>32</td>
<td>4</td>
<td>48</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>1960</td>
<td>36</td>
<td>5</td>
<td>36</td>
<td>16</td>
<td>6</td>
</tr>
</tbody>
</table>


The fall in holdings of government securities which was temporarily reversed during the war, recommenced after 1945. The Australian government's commitment to a low interest rate regime was the major
catalyst for this shift. Life offices faced two problems which made the acquisition of government securities unattractive. In the post war period there was a large increase in new business and associated with this an increase in establishment costs. With the low return on government securities the gap between the rate of interest earned and that used for valuation purposes narrowed. Secondly, the rise in general prices during the 1950s also reduced the attractiveness of fixed interest earning assets. Investment was diverted to loans and share acquisitions.

By 1960 the continuing fall in holdings of government securities was becoming a matter of serious concern for the Australian government who had come to rely on life office funds as a means of financing capital works programs. In that year the Commonwealth Treasury negotiated with the Life Offices Association in an attempt to achieve a voluntary undertaking that they would increase their holdings of government securities. They were almost successful when at the last moment three of the major life offices rejected the proposal on the grounds that it was an unnecessary intervention into their affairs. Federal Cabinet whilst being reluctant to consider any measure which introduced an element of compulsion, finally introduced measures which were to influence the direction of life office investment for the following twenty years. The 30/20 rule was introduced in May 1961. It required life insurers to hold 30 per cent of assets in government securities, and 20 per cent of this specifically in Commonwealth government securities. There were taxation penalties for firms that did not comply with this ruling. The extent of this rule did not dramatically alter the proportion
of assets life offices held in government securities. However, it did place a constraint on the investment policies of firms and in so doing altered the process of development evident in portfolio management which this paper has chronicled.

VII

The life insurance industry has historically been one of the largest institutional sources of investment funds in the Australian economy. Recent studies of the experience of British life insurers indicate that a period of transition and the development of more diversified investment strategies began in the inter war period. Although there is some disagreement on the extent of this shift it is clear that the basis of post war portfolio management principles had their genesis in the investment practices of British life insurers in the 1920s and 1930s.

Australian life insurers lagged behind their British counterparts in the development of such strategies. A principle reason for this was the lack of investment opportunities available to these offices. The Australian domestic capital market was relatively underdeveloped during this period. This was a reflection not only on an historical reliance on overseas capital market but also on the structure of the Australian economy. The dominance of the primary sector and the relative immaturity of the manufacturing sector resulted in a limited demand for corporate finance. This was reflected in the focus of the various stock exchanges at this time. The trade on the
Melbourne stock exchange for example was primarily in fixed interest securities of which government and semi government securities dominated.

In addition to the lack of investment opportunities there was a reluctance on the part of life offices to move away from the two major categories of investment namely mortgages and government securities. Part of this can be attributed to the relative immaturity of the industry during the inter war period. During this 1920s there was an influx of small business which lacked both the expertise and funds to diversify. More significantly, high interest rates on government and semi government securities meant that these forms of investment were very competitive and there was little incentive for the larger more established firms to move away from them. Whilst it has been argued that mutuals were constrained by their bye laws in investing in equities this was not necessarily a firm impediment. Most bye laws of mutual institutions did not specifically prohibit equity investment. Furthermore these laws were frequently altered as the circumstances in which life offices operated changed. The real impediments to this type of investment was lack of opportunity and incentive. The immaturity of the equities market and the high yields obtainable from other forms of investment did not make this option viable.

However, despite the concentration on certain forms of assets there is evidence to suggest that life insurers were evolving more sophisticated investment strategies. Firms were not content to accept the going rate on Commonwealth securities. They were increasingly shopping around for higher yields in domestic and overseas markets. As they did so they
developed greater financial expertise and investment departments within firms evolved accordingly. Likewise the provision of debt financing to private sector firms provided a further avenue in which life offices could extend financial management skills. The developments of the inter war period provided the grounding for post war expansion in equity markets and further growth in asset management practices.
Footnotes


\(\ ^{a}\) D. Pope, 'Australian Money and Banking Statistics', *ANU Working Papers in Economic History*, 11 (1986 ); thereafter Pope, 'Australian Money and Banking Statistics'.

\(^{iii}\) A.H.Bailey, 'On the principles on which the finds of life assurance societies should be invested' *The Assurance Magazine and Journal of the Institute of Actuaries*, 10 (1862) pp.142-47; thereafter: Bailey, 'Principles of life assurance investment',

\(^{iv}\) Bailey, 'Principles of life assurance investment', p.144.

\(^{v}\) Bailey, 'Principles of life assurance investment', p.144.

vii F.B.Swift Discussion on W.Penman, 'Review of Investment Principles and Practice', *Journal of the Institute of Actuaries*, LXIV, (1933); Dodds, 'A suggestion for the rehabilitation of A.H.Bailey's canons'.

viii Westall, *The Provincial Insurance Company*, Ch.15.


xii Anderson, 'Investments of Life Offices in Australasia', p.27.

xiii Scott, 'Towards the 'cult of equity'??; Baker and Collins, 'The asset portfolio composition of British Life Insurance Firms.

xiv Scott, 'Towards the 'cult of equity'??', p.103.


xvi *Australasian Insurance and Banking Record*; thereafter: *AIBR*, 1882, 1891.


xix *AIBR* 17 January 1891, p.52.
The assumption is based on the fact that the AMP was the largest Australian life insurer and a perusal of the statistics relating to the assets of life insurance office reveals that other firms followed a very similar pattern in regard to the distribution of the holdings of assets. These statistics are available annually in the AIBR.

AMP Branch Circulars: Staff Control Section 5, Responsibilities of District Managers c.1920s.

AMP Business Papers and Principal Office Minutes 1910-1920
AMP Archives, Sydney.


AIBR, 1916, 1925.

AIBR, 1925, p.681.


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Royal Commission into the Monetary and Banking System, Minutes of Evidence, p. 778. Australian Archives Series A571 1935/1470; thereafter Royal Commission into Money and Banking, Minutes.


Royal Commission into Money and Banking, Minutes, p. 778


xvii calculated from the AIBR, 1910, p.538.

xviii AIBR, 1925.

xix The figures were calculated by from the total assets held by mutuals and non mutuals.

1 AIBR, 1929, p.167.

2 AIBR 1926, p. 807

iii See for example, AIBR 1933, p.340.

iii AMP Victorian Branch Minute Book 1921

AMP Archives

liv Assets of Australian Life Offices, AIBR, 1920,1921.


lix Assets of Australasian Life Assurance Offices, AIBR 1951.


lxii AMP Head Office/Staff Administration 5 April 1949. University of Melbourne Archives, U36/4.


lxiv Scott, 'Towards the 'cult of equity'?', Baker and Collins, 'The asset portfolio composition of British Life Insurance Firms.'