



# *capital eyes* Summer • 09

## Mystery Shoppers

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## [ Mystery Shoppers - the Consumer article on financial advisers



In early November the Consumer report on financial advisers made the headlines. It was disturbing to read how the eleven mystery shoppers fared and what the expert panel made of the advisers. There were ten investment plans from a range of firms from nation-wide chains including the banks to some stand-alone firms. In the main, the report makes for dismal reading. There is continuing criticism of the industry and another call for urgent action. There are some points where we disagree with Consumer but we do concur there is a long way to go before the industry is regarded as transparent and trust worthy.

Consumer has a long and illustrious tradition of assisting New Zealanders to make well-informed choices. Having the right information and understanding is very important so we are pleased to be able to comment on the Consumer Report here.

Continued overleaf

## Where we agree

Consumer says that much of the advice was “tied” advice. That is, the plan was a sales pitch for the products of a provider linked to the adviser. This may arise where the plan recommends investments managed by the provider or direct securities like bonds or shares where the firm is the lead broker in a new offer. More obscure, but also happening, is where an adviser has a preferred list and fund managers either pay to be on it or offer incentives for a quota of the adviser’s business. Both are clear conflicts of interest. Advice is skewed because the adviser has an opportunity for more remuneration via the brokerage, commission or incentive.

It goes on everywhere, unfortunately, and it’s often very difficult for the average person to work out if it’s happening, how it’s happening and what the potential impact might be. The ideal model is where these kinds of relationships don’t exist. What Consumer is saying, rightly so in our view, is that, if there is some way in which advice might be skewed it should be disclosed. Some clients wouldn’t mind there being a relationship. They might get great comfort from knowing that XYZ Ltd is offering the investment and has a stake in the adviser’s firm. But, whatever the arrangement, it should be disclosed.

The adviser’s Disclosure Statement is supposed to be the mechanism where relationships are fully disclosed. It’s unfortunate that many are not compliant. No-one is checking at present and it will be some time before they do. Advisers who belong to the Institute of Financial Advisers (IFA) were encouraged to have theirs checked but we don’t know how many did and many advisers are not members of any professional body. We are pleased to say that investments selected for our portfolios are selected strictly on their merit. We don’t take brokerage or commission and we have had our Disclosure Statements checked by the large national law firm nominated by the IFA who are experts in this field.

“ We no longer live in the Stone Age and, interestingly, nine of the ten planners mentioned the use of a wrap service. We think it’s obvious why they do. ”

Related to the first point about tied advice are two other practices – charging up-front fees and taking trail fees. Consumer says that, of the ten investment plans they vetted, eight involved paying up-front fees (that averaged 1.1% of the amount to be invested) and trail fees paid were also being taken. Trail fees can amount to a further 0.7% per annum. Both of these fees, in our view, are unwarranted and a further source for a potential conflict of interest. We don’t take trail or up-front fees.

On the fee/remuneration front, Consumer is calling for advisers to disclose the difference in the cost of buying and selling an investment. For example, bonds and shares are traded at bid and offer prices and the margin is how brokers and broking firms stay in business. Some advisers also take the margin as well as charging fees. Consumer says some people may not know this and they want it quantified and disclosed. We agree.

Consumer was critical of advisers using a whole heap of “expensive managed funds” to give clients access to international shares. We agree with this if the cost of the managed funds is producing a lower return than a cheaper market-linked alternative. Getting the market return is easy and inexpensive via Exchange Traded Funds or passive managed funds. That stands to reason because the costs are minimal when analysts are not being paid to research sectors and pick stocks. Investors would pay less than 0.4% per annum to access an Exchange Traded Fund or a passive managed fund and will achieve the market return. If a manager, after paying the fees, can achieve a better return, then the investor is better off. Whilst most managers don’t consistently outwit the market, there are some that do. They are worth having because the net result merits the expense. Damning all managed funds is an overly simplistic criticism but fair comment if that’s all the portfolio has. We believe there’s a place for both so long as the active managers are continuously and carefully monitored.

It was interesting to read that the survey found banks no longer provided the useful, “relatively cheap” advice they apparently had in the past. Huge investment in people and other services is required to sustain an investment advice business so, given the often high turnover of staff in some banks, it is not hard to see why they may be reluctant to give away free advice. The Consumer report noted that the average cost to have an investment plan prepared was over \$500 and ranged from \$0 to \$1,200. Not one of the firms involved went to the trouble of preparing an Investment Policy Statement (IPS). We charge \$1,500 to have an IPS and a plan prepared (if the plan is implemented) and, given the time involved, this is a loss-making activity for us. We wonder what people expect if they want professionalism.

Consumer was frustrated to find the reporting of returns on different bases. Returns were quoted before tax, after tax, before fees, after fees and so forth. We agree this makes for problems. We sometimes find it difficult to access return information on an apples-for-apples basis and would like to see the Global Investment Performance Standards (GIPS) being made compulsory here.

## Where we disagree

We disagree with the criticism that “wrap platforms” are unnecessary and expensive. We regard our wrap platform as an absolutely essential tool. It provides a platform for administration including the buying, selling and pricing of



securities. It handles most of the tax matters and allows us to produce reports for a variety of purposes. We can answer client inquiries efficiently because the wrap service puts the facts and figures literally at our finger tips.

The panel commented that they were not sure what on-going reports would result from a wrap platform but they said they “suspect the information quality is poor.” They said that people contemplating use of a wrap would need to be shown what on-going reporting quality would be like. They apparently did not consider the importance of the adviser being able to see all the holdings in a portfolio at any time. We regard this as an essential requirement of being able to manage the portfolio effectively. We found it extraordinary to see a comment that some investments need nothing other than annual tax accounting and the client could just take all the papers to their accountant at the end of the year. We no longer live in the Stone Age and, interestingly, nine of the ten planners mentioned the use of a wrap service. We think it’s obvious why they do.

The survey was critical of Investment Statements, saying they were of poor quality. These documents fall outside the domain of the investment adviser. They are provided by the issuers of the investments, not the advisers and come under the jurisdiction of the Companies Office and the Securities Commission. Consumer said that their mystery shoppers weren’t provided with Investment Statements in some instances. That’s a “no no” but, Consumer, you are barking up the wrong tree when you blame advisers for the quality of Investment Statements.

One of the most interesting questions in the survey was about whether Kiwis are being rewarded for risk. They noted that, in New Zealand, we have relatively high interest rates which provide a higher bar to jump than in other places. Investors need to be “over the bar” and achieving higher returns than

say six month deposit rates when they diversify. Consumer complained they want to see a rigorous investigation into the returns achieved by New Zealand investors in “balanced portfolios” (we assume they mean diversified portfolios) compared to “risk free” assets. Well, Consumer, this has been done and the information is readily available, if you know where to look. The data goes back over 30 years and addresses returns for various kinds of portfolios relative to “the bank”.

Has progress been made? You can’t put things right if you don’t know where they’re wrong. The Consumer article is useful in this regard. We were glad to read they felt all the processes followed were appropriate, that the planners got the mix between growth and income assets generally right and that every shopper learnt something.

In 2010, new regulations will require everyone working in the financial services industry to either be an Authorised Financial Adviser (AFA) or work under a Qualifying Financial Entity (QFE). Every Adviser and QFE will need to be registered. QFEs will be required to show their employees are only working in areas where they have competence and AFAs will need to demonstrate their individual competence. Everyone will have to abide by a Code of Conduct (being written now by the Code Committee) and also provide access to an approved dispute service. Adviser activity will be audited by the Securities Commission which may, at random, check all the processes and procedures an adviser uses to arrive at the advice they provide. Those processes and procedures must be written up in an Adviser Business Statement. Advisers and QFEs may be struck off the register for a breach.

These measures are designed to protect investors and, together with market regulations, it is hoped that confidence in the industry will gradually return.



## Client survey results

Over the last few months we have been surveying clients to find out how they think we are doing. We are really grateful for the feedback. Thanks very much to all the people who took the time and trouble to score us on the various questions and also provide comments. We have it all on board.

We asked you to score us on communication, accessibility, relationship management, professionalism and investments. We also asked you to tell us what things you liked and disliked the most. Here are the results.

Scored items	Score
Communication – face to face and written	86%
Accessibility – to adviser, staff and by phone	91%
Relationship Management – being understood, dealing with problems etc.	90%
Professionalism – being reliable, thorough, accurate	89%
Investments – performance relative to expectations	84%

### Here are some of your comments – both positive and negative

- Professional, supportive, open and honest.
- I am confident CIP have my best interests at heart.
- I value the personal understanding you provide.
- You have kept to a high standard.
- The bank does not stay in touch with me. My funds will come to CIP.
- Generally satisfied. You are trustworthy, helpful and friendly.
- Happy overall but disappointed in markets. Excellent service from Planner.
- Would like more contact with the Planners.
- Poor reporting.
- Appreciate willingness to acknowledge when investments have not gone well.

Thanks once again. Whether they are brick bats or bouquets, we need to know.

## Christmas closing and opening times

Our offices will be closing on Dec 23rd at midday and opening on Jan 11th, 2010.

**We wish all our readers a very happy and relaxing Christmas.**



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For truly impartial advice about your investment needs, contact us to arrange a no-obligation consultation free of charge. One of our highly experienced and qualified investment advisers can help sort through the myriad of choices out there, so that you achieve your goals.



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