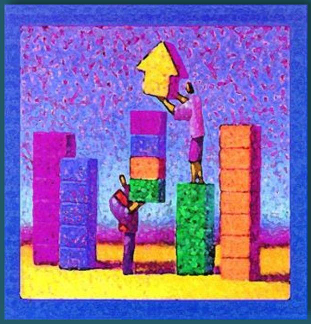

Brent Sheather's
RESEARCH

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VALUE FOR MONEY AND FINANCIAL ADVICE (PART 2)

Two weeks ago, in Part 1 of Value for Money and Financial Advice, we looked at a recent initiative (Consumer Duty) by the UK equivalent of the Financial Markets Authority, the Financial Conduct Authority, to ensure that UK consumers of financial services achieve better outcomes. As we noted in Part 1, our local regulator, the FMA, got the "value for money" religion back in 2021 but its focus thus far has concentrated only on the services and fees of fund managers. The "Consumer Duty" regime however applies to both fund managers and financial advisors and requires the latter to demonstrate and evidence the fact that their services are providing value for money. An overall perspective is critical because there is some evidence in the USA and the UK that advisors embrace low cost funds exclusively because it enables them to keep their own fees higher than they otherwise would be.

Obviously "fair value" is in the eye of the beholder and there are three major "beholders" here – regulators, consumers and advisors. The FCA has been criticised by UK financial advisors for not explicitly defining the variables which it will consider when assessing fair value so a UK regulatory consulting group, The Lang Cat (TLC), recently produced a report looking at the topic. TLC surveyed perceptions of value from retail clients and advisors and the contrast between the two views is interesting: naturally clients see performance as being particularly important whereas advisers often perceive their value proposition as involving less tangible services such as emotional and psychological support. However TLC cite hand-holding, the value of a relationship and support as being valued by consumers. One individual stated that what they valued from an advisor was "honesty, working with someone you trust, someone that listens. Education and having complex financial decisions simplified, taking the worry away". Another commented that "the thing they valued most was having a go-to person for my financial affairs".

The survey data also showed that 45% of consumers who have an adviser said investment performance was the most important factor when assessing overall value for money, but only about a quarter (24%) of advisers believed it had a big impact. TLC advise that only 35% of the firms in their survey include performance as a part of their fair value assessment. This is consistent with financial advisor chatter in NZ: keeping up with the index, let alone outperforming, is difficult given that markets are efficient and financial advisors are as fallible as any other investor, possibly more so given their conflicts of interest. So naturally they wish to play down the importance of relative performance. It's far easier to sit down with a client over a coffee and biscuits chatting about the outlook for the markets, holding their hands tightly through the bad times, reciting prayers to the ESG gods and discussing the grandchildren. Conversely, investors see performance as an easy to measure benchmark encapsulating in one number the value of a relationship with their financial advisor. That is why, as this column has argued many times previously, a key element of any financial planning service is the inclusion of a quarterly performance report which summarises short and long term returns relative to an appropriate benchmark. Trustees in particular need to keep a close eye on this aspect of quarterly reports.

Reading the numerous FCA reports defining and measuring value is especially tedious given their tendency to write extensively whilst avoiding saying anything useful in practice. Highlights include urging advisors to "take a holistic approach to assessing value" and the following paragraph - *The specific focus of the price and value outcome rules*

VALUE FOR MONEY AND FINANCIAL ADVICE (PART 2)

is to make sure the price a customer pays for a product or service is reasonable compared to the overall benefits they receive. We refer to this as fair value. We expect firms to think about price when assessing fair value, but it should not be the sole consideration. Our rules do not set prices, require prices to be low, or require firms to charge the same as competitors. We require firms to assess whether they are providing fair value and take action if they are not. We want firms to exercise judgement and find the most effective way of making sure their products and services offer fair value to retail customers. That's helpful!

One area that the FCA has clearly identified as being problematic re value for money is interest on cash balances held by a platform. Because investing is so complex, due to tax, most UK investors use a platform to invest – known as a custodial service locally. The platform typically invests the client's cash deposits with a bank but keeps some of the interest for itself. How much it keeps is the issue and the FCA wants to see the client getting more of their interest. Obviously an issue locally as well.

Summing up their report TLC made the following comments: *"The challenge of measuring the unmeasurable is highlighted when we go back to the core aim of the study, looking at what consumers actually value. The wider consumer population generally placed skills and knowledge as the top attribute they look for in an advisor, however, consumers who have experienced advice cite the emotional and psychological benefits as most important. We also know that many consumers enter an advice relationship with a specific need but end up with much wider, more holistic benefits like unexpected future planning support".*

For what it's worth my take on the " value for money " question is that it depends on the individual. Many of my clients don't have a clue about the investment markets and aren't interested either so what they are looking for is an advisor that they can trust, who is independent without conflicts and whom they can rely on to make sensible decisions for their portfolio. At the other end of the spectrum are the clients who have had a lot of experience with investing and enjoy it. They are looking for someone to pitch them opportunities whilst managing risk, report performance relative to benchmarks and to speak to them frankly when they are being silly. They are also usually men, elderly and cognisant of their mortality so see having someone they can trust as being important for when they are not around to manage their affairs.

A common sense strategy for demonstrating value is obvious, to me anyway, and that is for investment advisory firms to show that their strategies have produced, for individual clients, returns, after all fees, over the long term approximating that of the benchmark. The benchmark needs to reflect the risk profile of the client. If performance has been okay what's not to like? This measure obviously takes account of value for money because it captures both the service produced and the cost of that service.

An alternative take on what clients want which I found rather humorous appeared on a financial advisors website about 20 years ago when one advisor, who charged an exorbitant annual fee, stated that that he "added value by "speaking at clients' funerals, giving relationship tips, remembering clients' birthdays, the names of their grandchildren, etc etc." With the benefit of hindsight his 1.5% pa fee was appropriate as these high level services are the sort of thing one evidently receives in the rarified world of Private Banking today.