Brent Sheather's

RESEARCH

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VALUE FOR MONEY AND FINANCIAL ADVICE (PART 1)

The UK equivalent of the Financial Markets Authority (FMA), the Financial Conduct Authority (FCA) has, in the last couple of years, embarked on an initiative to ensure consumers of financial services achieve good outcomes. The new regime is called "Consumer Duty" and according to the FCA "it will fundamentally improve how firms serve consumers. It will set higher and clearer standards of consumer protection across financial services and require firms to put their customers' needs first"

The FCA press release on Consumer Duty added "The Duty forms part of the FCA's transformation to becoming a more assertive and data-led regulator. With firms assessing how they're meeting their customers' needs, the FCA will be able to quickly identify practices that don't deliver the right outcomes for consumers and take action before practices become entrenched as market norms. "

Yawn. We've heard this "mission accomplished" victory speech numerous times before, from both local and overseas regulators. It is always the same confident rhetoric and bold claims. Personally I am amused by the fact that, despite all the years of intense, intrusive and expensive regulation, not to mention the in-depth analysis by the luminaries at MBIE, the cycle inevitably repeats every five years or so. If regulatory organisations were companies listed on the stock market and subject to market forces including an assessment of the extent to which they achieved their objectives they would either go bust or their management replaced.

Anyway, moving on, apparently "this time is different" and "the Duty" will finally sort things out. Requirements for firms will include:

- ending rip-off charges and fees
- making it as easy to switch or cancel products as it was to take them out in the first place
- providing helpful and accessible customer support, not making people wait so long for an answer that they give up
- providing timely and clear information that people can understand about products and services so consumers can make good financial decisions, rather than burying key information in lengthy terms and conditions that few have the time to read
- providing products and services that are right for their customers
- focusing on the real and diverse needs of their customers, including those in vulnerable circumstances, at every stage and in each interaction

That sounds a lot like a similar initiative from the FMA back in 2021 whereby the Regulator noted KiwiSaver managers' statutory obligation not to charge an unreasonable fee and required all fund managers to regularly review their fees and evaluate whether customers are receiving value for money. Maybe I have got cynical in my old age but to be quite honest I haven't seen much in the way of improvement in the environment for retail investors since 2021, except of course for the continued inexorable growth of the passive fund industry and their lower fee structures. An uncharitable comment might be to observe that the ETF sector has done more for retail investors than the combined impact of all the numerous regulatory initiatives over the last 30 years.

The FMA's 2021 "value for money" crusade only related to fund manager fees but that's just one component of the confusing suit of charges confronting someone who sits down in front of a financial advisor, private banker or stock broker.

VALUE FOR MONEY AND FINANCIAL ADVICE (PART 1)

There are actually four major components of an investment proposal:

- fund management fees
- monitoring fees payable to the advisor
- transaction costs relating to the purchase and sale of investments including brokerage, bid/offer spread and fx fees
- platform charges

By email an FMA spokesperson said that the FMA's official line on extending the "value for money" campaign to financial advisors is: "The FMA is considering work in this area." In the FAP Monitoring Insights Report the FMA said "*Over the past few years, our focus has been on the successful implementation of the new regime. This has involved supporting the sector through licensing, engaging with the market, working with industry bodies, and publishing guidance. We are now turning our attention to deepening our understanding of the diverse range of business models across the sector.*"

Reading between the lines it may well be that NZ financial advisors sooner or later will also be viewed by the regulator through the "value for money" lens. Thus the FCA's work in this area should be of interest to local advisors, their clients and maybe even the FMA. The UK legislation requires financial advisors to measure and evidence the fact that their services are providing value for money. It requires all financial advisory firms to annually assess their services to ensure they represent fair value. As would be expected there has been major pushback from advisors on this requirement, not least because there has been a lack of clear guidance from the UK regulator as regards how to measure "fair value", and what actual variables should be prioritised when defining value. That is the subject of a two part story, starting today.

In this series we will look at, and contrast, how UK consumers and advisors appraise "fair value" based on a report authored by Mike Barrett of The Lang Cat, an integrated insight, regulatory and public affairs consultancy focusing on the financial services sector and based in the UK. What I will also attempt to do is to produce some estimates of the typical charges levied by non-commission based advisors, both locally and in the UK so readers can make a better informed relative comparison of "value" for "money". From looking at various surveys of retail financial advisors and private bank charges in the UK, published in the London Financial Times, the average fee for a client with £1M under management seems to be at least 1% per annum but we need to acknowledge that a big part of UK advisors' service is tax avoidance, sorry, that should read tax advice. In contrast, in New Zealand, the tax environment for investing is relatively simple and whilst PIEs have some advantages for some asset classes, if you consider all the factors involved, including fees, the PIE structure does not have a material advantage over many overseas funds for what is typically the largest component of an investment plan, global equities. That will no doubt provoke some pushback from local fund managers for whom the PIE regime represents a major hidden subsidy to their businesses but if you consider fees and various other material factors relatively high cost active PIEs invested in global equities, even at a 39% tax rate, don't look compelling to me except for smaller clients who wish to avoid the accounting complications of the FIF regime. Furthermore, the FIF regime is apparently under review and if (when) it is abolished the relative attractions of lower cost overseas funds increases. If the FIF regime is put to sleep and at the same time Treasury can persuade the politicians that the PIE regime is being abused by the "fat cats" local investors may again have a tax regime permitting rational decisions based upon common sense and fees. Anyway I digress, in two weeks' time we will review what The Lang Cat (no relation) report argues are the important issues as regards assessing what is fair value in terms of the services from financial advisors.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.