

**SUBMISSION TO THE PRODUCTIVITY COMMISSION:  
BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR  
STIMULATING SERVICES COMPETITION**

Submitter:

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**Introduction**

1. This submission addresses the Commission's concern with service sector competition, with specific reference to competition within the investment advice industry.
2. It suggests that there is a gap in information available to consumer investors. Specifically, there is a lack of comparative information available about the performance of investment advisers. It also suggests that this gap represents a market failure which has a significant impact on competition and consumer choice within the industry, and therefore has an adverse effect on investors and the wider economy.

**About the submitter**

3. Miles Hayward-Ryan has experience as an in-house corporate lawyer in three public listed companies, leading to the Company Secretary / Legal Counsel role. He has also worked in the superannuation industry, and spent 20 years as an investment adviser while also being a start-up venture capital adviser, consultant, director, and business executive.
4. This combination of experience, coupled with a strong motivation about consumer protection, gives him a unique insight into the lack of information about investment adviser comparative performance and led him to found IAPM, a consumer service aimed at providing consumer investors with better information about investment adviser performance.

## **Availability of investment market information**

### *The investment adviser market*

5. The investment adviser market includes investment advisers in brokerages, boutiques and banks. Investment advisers provide a service to consumer investors (and wholesale investors) which includes financial planning and investment portfolio design and implementation.
6. Every investment client is provided with ongoing quarterly (typically) investment reports which include a summary report specifying opening balance, and a closing balance, and if applicable deposits or withdrawals, and performance for the quarter. This information is usually on an after-tax and after-fees basis which is especially available since tax paid PIEs became available.
7. However, this information is not publicly disclosed. As a result there is no opportunity for independent analysis of investment adviser performance. Nor is there any opportunity for investors or others to compare that performance.

### *The wider market*

8. Investment advisers operate in the wider investment market. That market includes the diversified portfolio investment market of government and private superannuation schemes, Kiwisaver, managed funds of shares, property funds, fixed interest markets, and cash.
9. These diversified portfolio markets operate exactly like all government and other superannuation funds. However the public perceive the operations of investment advisers as somehow different. There is a perception issue which may to a significant extent be overcome with increased performance disclosure.
10. The participants in the diversified portfolio market include the Stock Exchange, and managed fund performance ranking information suppliers (FundSource, Morningstar, and others) which provide comparative performance information. That information is essential for these markets to operate.
11. Performance at the Stock Exchange level is analysed and published. Performance at fund manager level is also analysed and published. It is in the interests of market participants to ensure that information is available.

## **Consequences of lack of information about investment adviser performance**

12. For a market to operate efficiently, consumers require meaningful information about price and quality. In respect of investment advice, quality essentially means performance derived from competence.
13. The lack of comparative information about investment adviser performance means that effective competition is hampered and the market for investment services cannot operate efficiently. This appears to be having adverse impacts on the development of the industry, on investment decisions, and on the wider economy.
14. Because of this lack of information, consumer investors cannot make informed decisions about whether to use the services of an investment adviser or to invest elsewhere, such as in real estate, or in a bank deposit. Among those who do choose to use an investment adviser, consumer investors cannot make an informed decision about which adviser to use. After choosing an investment adviser, consumer investors cannot make an informed decision as to whether or not to switch.
15. The Reserve Bank has reported [based on independent professional consumer research] that, of people who could use investment adviser services, only about 20% do so. It is reasonable to assume that one of the reasons for this is that investors do not have access to information about investment adviser performance, and therefore are choosing investment options which are essentially default options. Anecdotal evidence supports this assumption based on informal interviews.
16. Over the last three years, bank deposits have paid a return of about 4% before tax. Many investment advisers have produced higher returns – believed to be about 8-12% after tax and fees (although exact figures cannot be known due to the lack of comparative information). The lack of information about investment adviser performance may be denying bank deposit investors opportunities for significantly higher rates of return. This is also anecdotally evident among younger investors who choose to avoid the property market so defaulting to bank deposits.
17. As well as influencing the performance of the investment advice industry and potentially adverse impacts on investor returns, the lack of performance information about investment advisers may also be adversely affecting the wider economy by skewing investment away

from lower risk fully diversified investment towards low rate bank deposits or undiversified residential real estate.

### **Consumer demand for better information**

18. Existing investment adviser clients wish to know how well their investment adviser is performing compared with other advisers. In June 2013, IAPM conducted independent market research among users of [www.grownups.co.nz](http://www.grownups.co.nz) website. Sufficient qualifying responses were received to qualify for standard 95% accuracy. The survey of investors who use the services of investment advisers found:
- 78% would like to be able to compare the performance of their own investment adviser against other investment advisers.
  - 65% wanted more information about the performance of their own investment adviser.
  - 100% wanted to know if their investment adviser was performing poorly when compared with other investment advisers.
  - 96% wanted to know if their investment adviser was performing well when compared with other investment advisers.
  - 74.5% would have more certainty and peace of mind about their investments if they had access to an independent and impartial report ranking their investment adviser against others.
  - 52.9% were willing to provide data on the performance of the investments of their investment adviser in order to obtain a report ranking their investment adviser against others in their area.

### **The investment adviser response**

19. Investment advisers assess the risk profile of clients and mainly use model portfolios to apply to those clients. Typically there are five risk profiles from low to high but some organisations use only three or a few use four. Some clients and some investment advisers use non-standardised portfolios. Some clients dictate their investment requirements to some extent. Most clients are provided with and follow the recommended model portfolio.
20. Most investment advisers appear to take the view that the performance of individual client portfolios cannot be compared. This view is based on the concept that performance is individualized to the client's particular goals. This view differs from the view of consumers who must make the decision to invest or not.
21. The principal source of information for consumer investors who consider the option of using investment advisers is to review adviser websites. These generally give no performance information. Rather,

they generally focus solely on a financial planning process (usually a 6 step process) which is about achieving personal financial goals.

### **Investment advisers are not responsible for lack of information**

22. Investment advisers are however not responsible for the lack of performance comparison information. By analogy, car manufacturers supply their own product performance information but it takes an Automobile Association of subscribing members to prepare a performance comparison which is available to consumers monthly.
23. Well-performing investment advisers should want to be able to provide proof to their clients that their performance is rated well or the question arises as to whether they are afraid that assessment may find them wanting.
24. The Financial Advisers Act Section 3[2] charges investment advisers with arranging an increase in the level of trust and confidence from consumer investors by Disclosure, Competence, and Accountability. Competence is proven by performance. The question is whether or not investment advisers should disclose their performance so that a comparison can be provided to consumers.

### **The role of government**

25. The Financial Markets Authority [FMA] is limited in its powers to dealing only with individual authorised financial advisers in this context. This market and its regulation is still in a state of evolution. The FMA has started to ask questions and seek answers from investment advisers about performance, but the FMA cannot require advisers to publish historic performance information or arrange for comparisons to be made. The investment advisers themselves do not possess information about competitors in their market.
26. Nevertheless the FMA could perhaps relatively easily change its industry prescriptions to require actions by investment advisers which support the creation of a performance comparison. The absence of such activity could involve repercussions in terms of scrutiny of investment advisers. The exact nature of such new prescriptions would need consideration. There are opportunities for improvement to this regulatory area.
27. Many consumer investors would then have the option of approaching investment advisers with confidence and trust. Consumer investors cannot at present realistically plan such a course.

28. A comparative performance ranking report is the missing piece of information for the investment market to operate efficiently. Without it, most consumer investors are repelled from the investment adviser market and forced to choose alternatives, one of which is the fully transparent and much promoted residential investment option.
29. Many details about what a comparative performance ranking report would entail are omitted for the sake of brevity. For example the methods of ensuring like with like comparisons based on risk profile analysis requires significant explanation. The effects of not having a like for like comparison are experienced regularly now in the industry but only anecdotal evidence can be supplied. Significant other industry issues are also omitted for the sake of brevity.

Submission ends.