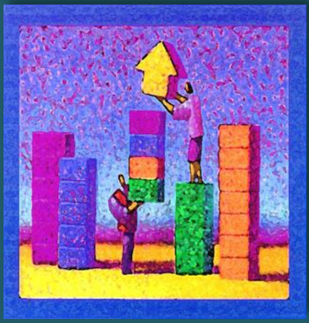

WEEKLY REPORT SEPTEMBER 2023

Private Asset Management Ltd

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DISCUSSING DIMS – Part 1

Whilst KiwiSaver gets all the publicity there is another sector of the funds management industry which is also significant in terms of total assets and it is known in the industry as DIMS – short for Discretionary Investment Management Services. Virtually all of the big players in the retail advisory space have a DIMS division including the private wealth divisions of banks, stock brokers and vertically integrated fund managers. The FMA advises that the sector had $42 billion under management as at June 2022 (latest available data) versus $97 billion in KiwiSaver as at August 2023. Today, and in two weeks time, we will have a close look at DIMS – how it works and the ups and downs of a DIMS service.

The Financial Markets Authority (FMA) website describes DIMS as follows: "You are providing Discretionary Investment Management Services (DIMS) when an investor gives you the authority to make decisions about buying and selling financial products on their behalf. To provide DIMS under the FMC Act you must hold a DIMS market services licence issued under the FMC Act."

The basic idea with DIMS is that if you don't have the time, inclination or skills to assess the investment advice you are given you can, for a higher annual fee, give your financial advisor discretion to make all the day to day investment decisions - things like "sell Fletcher Building shares to buy Spark shares" – without consulting you first.

Given the potential for this sort of arrangement to go wrong in the hands of an inexperienced, conflicted or dishonest advisor the FMA has put in place various constraints to try and limit the potential harm to retail investors, particularly after the Ross Asset Management ponzi scandal. Back in 2012 the FMA received complaints from various investors who had been unable to withdraw their money from the Ross Asset Management DIMS service. The subsequent investigation located only a fraction of the purported portfolio of $450m, held on behalf of more than 900 individuals, many of whom were wealthy and presumably experienced investors. That fiasco impressed on MBIE and the FMA how easy it was for a DIMS operator to operate a classic Ponzi scheme (using new clients funds to repay existing clients who wish to exit). MBIE thus moved to plug various gaps in the legislation including a licensing regime which specified that institutions providing a DIMS service had to satisfy various requirements from the Financial Markets Authority and a requirement that custodial arrangements must be independent of the advisor, unless specifically authorised by the FMA.

DISCUSSING DIMS – Part 1

So, post the Ross event, the FMA checks out potential DIMS providers to ensure that their staff, systems and training are up to it. The changes probably mean a large scale fraud is off the menu however, significantly, the regulator also puts a lot of the responsibility for guarding against less egregious bad behaviour, back on the investor. It does this by requiring DIMS advisors to disclose to their clients a huge amount of information each quarter.

"DIMS licensees need to make sure their retail clients have all the information about investment decisions, how the investments have performed, and what the fees are. Your ongoing reporting requirements are:

- **Transaction information**: record of all transactions, name of issuer, the price of the financial products transacted, the amount and date transacted.
- **Assets profile**: name of each class of financial product in the investor's portfolio, who issued the financial products, and the number of products held.
- **Portfolio administration profile**: record of all dividends paid, distribution or income received during the period, all percentage-charges paid, individual action fees paid, and other corporate information that might affect an investor's portfolio (eg, a bonus issue).
- **Portfolio valuation**: current and most-recent valuation of all financial products in the investor's portfolio; how and when the valuation is done (eg. The market price of the quoted product), and the total value of the financial products in the portfolio."

Therefore every three months DIMS clients will get a big folder recording transactions, performance, asset allocation profile etc. We don't currently offer DIMS but my firm produces exactly this sort of data for clients and I am aware that some don't bother to read what we send out. Others read it but don't understand it. If you assume that the advisor is acting in the client's best interest, embracing best practice and not churning the portfolio then that is not the end of the end of the world – people have got better things to do. As long as they implement any recommendations in a timely manner probably no harm done. However, relax the assumption that the advisor is acting in the client's best interests, and the reality that many clients are either not interested or don't have the skills to understand what's going on is a major weakness in regulators attempts to safeguard the interests of DIMS customers. Disclosure is thus a potential "get out of jail free card" for DIMS players on the basis that if you have disclosed to your client and the FMA that you do bad stuff and advise the client in detail of the bad stuff their opportunity for subsequent legal redress might be considerably diminished. That's not awfully satisfactory but the situation is actually even worse because, from looking at the specific information requirements and their deficiencies, it is clear that even professional trustees might still be left somewhat "in the dark". For example the law requires the performance of the portfolio to be advised to clients but there is no requirement to also detail the performance relative to an appropriate benchmark – thereby enabling the client to know whether the DIMS advisor's fees are providing "value for money".

Despite all of the above my take on DIMS is that, if you have an advisor you can trust working in a firm with no conflicts of interest and it doesn't cost too much, it should be good for clients for a couple of reasons;

- Firstly a DIMS agreement should reduce the lead time between making a portfolio decision and the execution of that decision - it can take a long time for some individuals or trusts to respond to an email and by that time prices can have moved and opportunities disappeared.

- Secondly, it means less administrative overhead for both the advisor and the client in that the advisor is not required to email the client seeking permission for a proposed transaction and the client doesn't need to reply.

But, contrary to the marketing by DIMS firms, a DIMS advisory agreement doesn't mean that the individual or trustees can ignore transactions or absolve themselves from responsibility for portfolio management. Indeed, I would think that if one's portfolio is being managed via DIMS an independent professional trustee is even more important, given the potential for adverse outcomes and possible constraints on recourse. By the way I would be interested to know whether any NBR readers have funds managed under DIMS and in particular the annual fees involved. I know of two firms managing DIMS portfolios and the fees charged, inclusive of safe custody, for a $1.5m portfolio are 0.85% pa and 1.08% pa respectively. If you wish to comment anonymously please do so or alternatively email me direct. I'm sure these details would be of interest to other NBR subscribers.

More DIMS discussions in two weeks time.