Response by Vance Arkinstall, CEO, ISI
to Gareth Morgan's article in Dominion Post on 10 July

15 July 2004

Response to Gareth Morgan's Article on Managed Funds
By Vance Arkinstall, CEO, Investment Savings & Insurance Assn

Recent articles by Gareth Morgan commenting on managed funds raise points that require a response.

The managed funds industry encourages quality financial analysis to both educate investors and also to keep the industry on its toes but the latest column (10 July) which draws upon recent Consumers Institute items does a disservice to readers.

The NZ managed funds industry competes in a global market along with fund managers from UK, Europe, USA and Australia. At 31 December 2003, worldwide assets of managed funds rose to US$13.96 trillion. Globally managed funds are a major and rapidly growing sector for individuals world-wide. In the face of fierce international competition claims that the fees and charges contained in managed funds are anything less than competitive simply cannot be sustained.

Managed funds are widely recognised as flexible, effective and cost effective for many investors, from mum and dads to seasoned investors, which cater for a range of individuals who in many cases are below the threshold of funds available for investment that individual portfolio managers would be prepared to consider.

Fund managers and financial advisers incur costs in providing a service, as does any business. If anyone else thinks he/she can provide a better service for a lower cost they should front up and advertise their wares directly to investors. Like any fund manager they will have to compete with the returns from a range of other products. If the costs are too high relative to the returns a fund manager will rightly be in trouble. That is what competition is all about.

Any argument that the industry is making itself fat at the expense of investors is ludicrous. Nowhere is it shown that fees are excessive in relation to costs. Nor is any evidence provided that fund managers or professional advisers are widely making excessive incomes. Yet the call is made for Government to add a layer of regulatory costs to the inflation and tax costs that already exist. The additional costs will fall in part on mum and dad investors.

In terms of investment performance, the recent Consumer article compares the performance of 20 international equity funds (with 10 years performance – 30 April 2004) against the Morgan Stanley Index. Nine funds beat the index, five were about equal and six under-performed the index. That seems to be a reasonable distribution given the turbulence and volatility of equity markets over recent times. Suggestions that fund managers have under-performed do not stand scrutiny. Many managers have provided excellent returns in testing markets. Certainly results vary but that is the nature of a competitive market.

Criticism is on occasions directed at the industry association for self-interest in its comments around taxation. We make no apology for working hard to correct taxation deficiencies that exist in the NZ taxation system. Mr Morgan has written papers for the industry on these points. For years savers have been over-taxed on the investment return achieved by managed funds. Further, managed funds have been taxed on realised capital gains. Within the past week Government has acknowledged the industry's concerns and announced a review to report on ways to remove these inequities. The benefit of any change will flow through to the accumulated funds of existing and new savers. True managed funds will benefit from any increased levels of private savings that result – surely this is the type of market reaction that an economist would encourage.

The 10 July article refers to the 'new fund' phenomenon and notes that in the 1950s, 10% of funds failed to last 10 years, now that's up to 50%. In the 1950s, foreign exchange trading, derivatives, mortgage securitisation, hedges etc., were virtually unknown. The shorter life span of funds is the result of a global industry responding to consumer demand, increased market sophistication, changing tax treatments and the rapidly escalating pace of change that society faces.

Mr Morgan has the opportunity to use his column to raise the quality of debate and understanding about capital markets in the country. He does a disservice to himself and his readers by using this opportunity to make emotive, sweeping and irresponsible attacks on an entire industry.

The interests of mum and dad investors are best served when fund managers, portfolio managers and financial advisers compete for their business. Investors are protected by competition, choice, variety, sound laws prohibiting fraud and regulation ensuring transparency. They are also protected by the investment in reputation by professionals whether acting alone or collectively through organisations like ISI. Of course that is not fool proof, but neither is government regulation.

Vance Arkinstall
CHIEF EXECUTIVE