

# Investment Company Failures

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*Every day many of us approach professionals for advice in areas we don't have sufficient expertise in. We rely upon professionals for an objective and knowledgeable point of view. That's one of the reasons service businesses such as lawyers, your profession as accountants and mine as financial advisors evolved. We are in the business of giving considered, objective and expert advice and comment to help improve the position of our clients or, in certain circumstances, to help minimise the downside impact of an individual's situation.*

It is an important role and one I believe should be treated with respect. When a particular query is outside our area of core expertise, we must have the wisdom to take advice from other experts.

In the financial planning domain, members of the public ask us for advice on where to invest their money. Any recommendation we make must take into account the requirements of timing, individuals' goals and risk profile - to name some. Industry standards require us to go through a comprehensive planning process which has several steps and these guide us in making the best recommendations for the client.

But sometimes, even trained and qualified individuals give advice which is not appropriate for the client. When that advice is to invest in a finance company and that company fails, as has occurred too many times in the past year, the impact on the client can be massive.

These failed companies did not have an investment grade credit rating – the investments offered are frequently referred to as junk bonds. This lack of rating means that the investment has a high risk attached to it. Financial planners should understand these risks and ensure that they do not make recommendations outside their client's risk profile. In my view, properly qualified financial planners should not have directed investors to these finance companies as there were many warning signs and other, much safer, investment options available.

As a member of the financial planning community, it is with particular sadness, frustration and extreme disappointment that I learnt that some members of our profession had indeed made such recommendations. Whenever someone in our respective industries gives inappropriate advice or behaves unprofessionally, it reflects badly on the entire industry.

Reports have indicated that some individuals or couples had invested sums of \$50,000 or \$100,000-plus in just one finance company.

Of course New Zealand is largely a DIY environment and so some of this money will have been invested without advice. Sometimes, financial advisors will be asked to review investment portfolios. Where the investments don't fit the risk profile, or if there is no

cohesive strategy, they recommend a change but this advice may of course be ignored.

On the other hand, many financial planning companies have been successfully planning for over two decades without putting their clients' money into unrated finance companies. Further, for clients of those financial planning companies who advocate proper diversification, it would be uncommon for their clients to have such a large amount of money invested with just one company. Instead the funds of the vast majority of portfolios held would be well diversified (perhaps with as many as 500 or 600 securities of equities) even if the investor owned a portfolio of just \$50,000.

Part of the role of a good financial planner is to minimise the risk to the client, and diversification is one of the tools. First-rate risk profiling is another, as is investing in a responsible manner.

If you want to work with a financial adviser or planner, one of the challenges is how to select a good one. This lack of clarity is something that we financial planners as an industry need to take seriously. The following guidelines are designed to help with decision-making.

Find out if the planner you wish to discuss your financial affairs with:

1. is a qualified Certified Financial Planner and a member of the Institute of Financial Advisers (IFA)
2. is someone who has been in business for a number of years (choose someone who works with other advisers where there is peer review, a greater pool of expertise and someone who can take over your portfolio if your chosen adviser becomes seriously ill or dies)
3. has robust money handling processes in place and uses a custodial trustee
4. conducts a full financial plan before making recommendations
5. does a comprehensive risk profile
6. makes recommendations in line with Markowitz's nobel prize winning formula which, in a nutshell, means every investor should hold a diversified portfolio across the asset classes to increase their overall returns and minimise their risk
7. charges fees in line with the industry average (ensure you are satisfied with how they earn their income and it is reasonable for the service provided).

As with any industry, following these guidelines will not guarantee a favourable outcome, but it will definitely go a long way to ensuring that the chosen financial adviser is a good one. That means a significantly greater chance of not only getting a return on your money, but the return of your money.