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Discretionary Investment Management Services – Sector Insights 2024

This report provides insights from the FMA's 2022-2024 monitoring of the Discretionary Investment Management Service (DIMS) sector. It identifies some key risks to investors and sets out how we would like to see these risks managed by those who operate or advise on DIMS.

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Executive summary

A Discretionary Investment Management Service (**DIMS**) is where a provider manages an investor's portfolio on their behalf and is authorised to make investment decisions in line with authority granted by the investor. Anyone providing a DIMS service in New Zealand must be licensed by the Financial Markets Authority – Te Mana Tātai Hokohoko (**FMA**).

In 2022, we surveyed DIMS providers to find out how their governance, policies, processes, systems, and controls are used to meet compliance obligations and mitigate the risk of investor harm. We followed this up over 2023 and 2024 with monitoring of nine licensed DIMS providers.

This report provides an overview of insights from these monitoring engagements, across key risk areas identified by the survey.

What we found

Providers generally strive for positive investor outcomes, but there is still room for improvement in their processes and controls. These measures are crucial for effectively managing risks, and ensuring providers meet their obligations and deliver the level of professional care expected by investors.

While we did identify potential issues, we are confident that, following engagement with us, providers have taken or are taking appropriate action to ensure compliance. In line with our risk-based approach, we consider these issues did not warrant a more formal regulatory response or enforcement action, and that the risk of investor harm arising is low.

Where issues were found, poor disclosure, and a lack of internal policies and/or procedures were common themes. Managing these risks does not need to be overly complicated; providers should consider how they can effectively manage risks appropriate to the size and nature of their individual service.

Our monitoring identified areas where improvements could be made to services. We have given this feedback to individual providers and set out in this report areas of improvement we would like to see.

This report also highlights examples of good practice such as proactive management of turnover, avoidance of incentives linked solely to the amount of funds under management, and asset allocation limits aligned to long-term investment goals.

Future focus

We believe that more can be done to ensure compliance and improve service quality, and our future monitoring will continue to explore how providers address the risks and issues identified in this report. If we do identify that providers are not meeting key obligations, we may consider taking supervisory or enforcement action using the regulatory tools available to the FMA.

We thank all DIMS providers engaged in our review work and look forward to working further with the sector to continuously improve practices and investor outcomes.

Overview of the DIMS sector

DIMS is a large and well-established segment of the wealth management sector in New Zealand. DIMS involves investors giving the provider authority to make decisions about buying and selling financial products on their behalf. This relationship demands a high degree of trust and confidence.

Licensed DIMS providers' legal duties require that they act honestly in providing the service, act in the best interests of investors, provide the service in accordance with a client agreement and investment authority, and exercise the care, diligence, and skill of a prudent professional.

Regulatory return data shows that as of June 2024 there were 49 active licensed DIMS providers who collectively managed 47,330 retail accounts with funds under management (**FUM**) of \$48.3 billion. The average DIMS investor portfolio value as of June 2024 was \$1,021,005.

The following illustrates the scale and concentration of providers within the DIMS sector.

FUM per provider	Number of providers	Total FUM	% of sector FUM
<\$100m	15	\$785,339,591	2%
\$100-\$250m	14	\$2,580,402,824	5%
\$250m-\$1bn	11	\$5,764,912,805	12%
>\$1bn	9	\$39,193,522,747	81%

DIMS providers generally manage portfolios as either '**personalised**' or '**class**' DIMS. These terms were taken from the Financial Advisers Act 2008 (now repealed), and while the legal distinction was removed in 2021 these terms are still recognised and applied by many DIMS providers as a useful way to distinguish between the two broad service offerings:

- **Personalised DIMS** – where the investment is designed for a specific investor, taking their specific financial situation and goals into account
- **Class DIMS** – where investments are standardised for a class of investors. Class DIMS are offered either as model portfolios or model asset allocation¹ investment strategies.

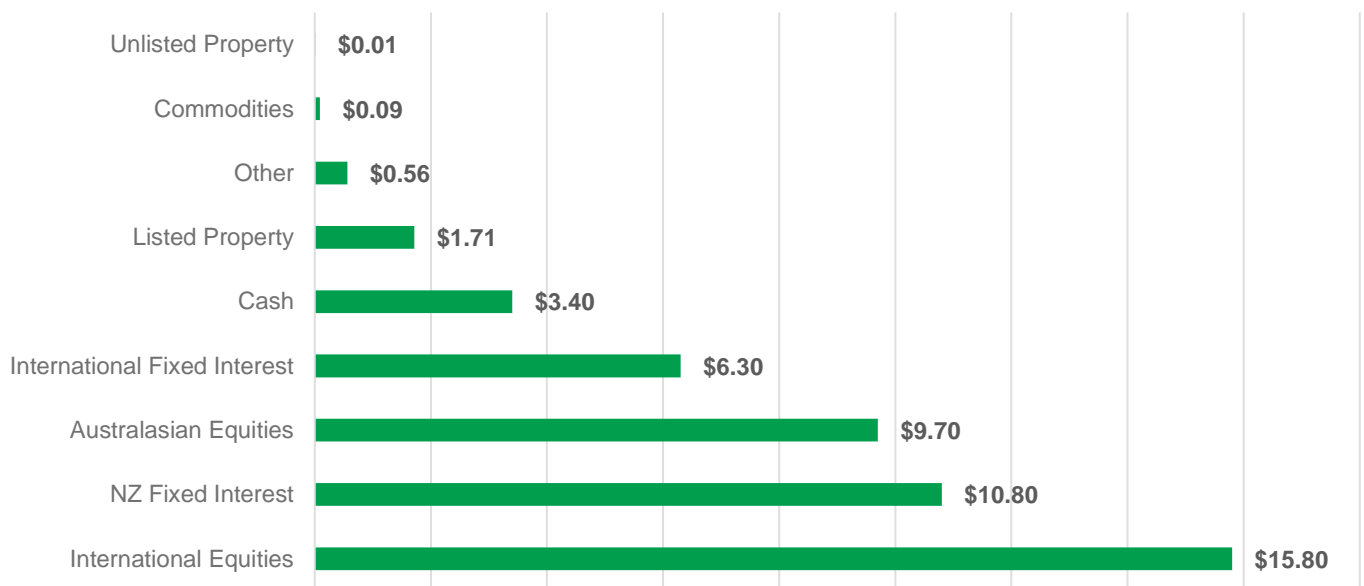
Our 2022 survey found that 37% of DIMS FUM is managed as personalised and 63% as class, however providers may not be using these terms consistently.

¹ A 'model portfolio' identifies specific assets and their proportions, designed for investors who meet a set of characteristics such as risk-return appetite. A 'model asset allocation' specifies the proportion of different asset types (or 'asset buckets') for investors meeting a particular set of characteristics.

The survey found that investment assets held by DIMS providers commonly include externally managed funds, and that 35% of providers hold these exclusively (as opposed to managing assets themselves). Smaller providers (FUM under \$250m) more commonly manage assets directly.

Larger providers (FUM over \$250m) more commonly hold specialised asset classes (including international fixed interest, commodities, and unlisted property), potentially reflecting that it is inefficient for smaller providers to access these asset classes. The following shows the value of each asset class held by DIMS providers as of June 2024:

Assets held by DIMS (\$bn)



What we found

Our 2022 survey sought to understand how licensed DIMS providers' governance, policies, processes, systems and controls are used to meet compliance obligations and mitigate the risk of investor harm. The survey identified the following areas of potential risk, which were the focus of our subsequent monitoring:

- Conflicts of interest
- Investment management
- Investment strategy
- Investment performance monitoring
- Fee disclosure and transparency

We discuss each of these risks in the following sections.

Conflicts of interest

What we want to see: Conflicts of interest are appropriately managed and communicated to investors

A conflict of interest (COI) is a financial or other interest, a relationship or any other association that would, or could reasonably be expected to, materially influence a DIMS provider's choices of financial products to acquire or dispose under the service.

A DIMS provider must exercise the care, diligence and skill that a prudent DIMS provider would exercise, including in relation to managing COIs². This includes disclosing the steps that have been or will be taken to manage any conflict of interest³. Where there is no such disclosure, this may indicate there are no conflict management policies employed by the provider.

Examples of COIs that might impact DIMS:

- Allowing investment decisions to be influenced by revenue-generating opportunities for the provider.
- Making investment decisions that benefit a related party at the expense of investors, such as:
 - participating in capital raising via related parties acting as underwriter or lead manager
 - paying brokerage commissions or custodial fees for activities with related parties.

Licensing minimum standards require DIMS providers to maintain efficient procedures to identify and manage COIs (or potential conflicts)⁴ and to notify the FMA when a related party transaction is entered into⁵.

The 2022 survey found that 4% of DIMS providers did not have a COI policy, and 18% had not reviewed their policies within the last year. It is unlikely these providers are exercising appropriate care, diligence and skill relating to COIs compared with the significant majority.

Our monitoring found that some providers had not disclosed all conflicts, and some did not have policies or procedures to identify or maintain COI disclosures.

We found providers applying elements of good practice, including some who charge flat management fees that exclude additional brokerage expenses, which removes turnover incentives. Some DIMS providers also pay portfolio managers/advisers a salary and avoid commission-based incentives linked to the amount of FUM.

Recommendations

Consistent with licensed DIMS providers' legal obligations, all investment decisions should be in the best interests of investors, and providers should clearly disclose all conflicts and their implications. Providers

² Section 433 of the [FMC Act 2013](#), DIMS licensee's duties

³ Clause 14 of Schedule 21 to the [FMC Regulations 2014](#): Disclosure statement & investment proposal for DIMS

⁴ [DIMS Provider licensing application guide](#), page 18, minimum standard 6

⁵ Regulation 236 of the [FMC Regulations 2014](#): DIMS licensee must provide quarterly report to FMA that includes certificates

should have COI policies and procedures that are regularly reviewed to ensure they reflect any changes in the organisation and any business arrangements that might result in conflicts.

Investment management

What we want to see: Turnover controls to manage overtrading in commission-based portfolios and inactivity in fee-based portfolios

A lack of turnover controls may result in excessive transactions (churn) in commission-based portfolios where providers charge brokerage or receive commissions. Conversely, portfolios managed under simple fee structures (with fees based on FUM, and transactional commissions designed to simply cover costs) may be excluded from transactions where providers are not incentivised by fee structures to participate. Either situation can lead to poor outcomes for investors, i.e. excessive charges or poor portfolio performance.

The 2022 survey found that most providers who manage assets directly (as opposed to exclusively investing via funds) do not limit, monitor, or report portfolio turnover. This is a significant risk to investors, as it makes it more difficult to manage issues relating to unnecessary transactions or static portfolios.

While our monitoring did not identify any significant turnover issues, there were higher total fees associated with some providers who charge brokerage.

We identified some good practices in this area, including monitoring against turnover expense ratio limits. We would like to see this practice more widely adopted by DIMS providers.

Recommendations

Licensed DIMS providers should carefully consider the appropriate approximate level of turnover for portfolios, having regard to the investment strategy and investment authority, then monitor transactions and identify any material departure from that level. Providers that monitor volume, frequency and timing of turnover, carefully considering the rationale recorded by portfolio managers for transactions, will be best placed to manage this risk. Where there are any indications that investment decisions may have been influenced by incentives or other factors that are not relevant to the best interests of the investors, the provider can then take appropriate action.

What we want to see: Effective portfolio liquidity management and stress testing

Managing liquidity risk is fundamental to portfolio management and should be considered when selecting assets and setting position limits, so investors can readily access their funds without negatively impacting asset values. This is particularly important where DIMS portfolios are managed collectively in a class service, and transactions for one investor could impact others in that class by altering asset values.

Our survey found most providers had limited liquidity controls in place, and some had no controls. It also found that 42% of DIMS providers did not stress test portfolios and only 5% plan to conduct stress testing in the future.

Our monitoring found that providers' liquidity controls were commonly limited to ensuring they maintained sufficient cash or only invested in markets with liquid securities. We also found that most providers did not have a stress testing policy or procedure in place.

Recommendations

DIMS investors will expect to be able to readily access funds in accordance with their investment agreement without creating liquidity problems to the detriment of other investors. Beyond holding a minimum cash balance, providers should consider additional measures to improve liquidity management that take account of aspects including:

- portfolio-level liquidity (as opposed to asset-level liquidity)
- sector risk and concentration risk in a portfolio
- trading volumes for listed assets
- customers' circumstances and liquidity risk tolerances
- how liquidity will inform the investment strategy going forward.

Through stress testing, providers can identify an appropriate range of adverse circumstances and consider portfolio sensitivity, across varying time periods. Although intended for MIS managers, our 2024 Liquidity risk management guide is a useful reference for liquidity and stress testing principles⁶.

Investment strategy

What we want to see: Investors clearly understand the nature of the DIMS service provided

While there is no longer a legal distinction between class and personalised DIMS, providers often apply these descriptions in their marketing material and disclosure to investors. Unclear promotional statements and poor disclosure may mislead investors about the nature of the service they will receive. Where the value proposition is unclear, there is the risk of adverse outcomes for the investor.

Our 2022 survey found that 37% of total DIMS FUM is classified as personalised DIMS and our monitoring sought to understand whether disclosures and promotion reflect the style of management.

Our sample monitoring found that providers often use terms such as “highly personalised,” “tailored,” or “bespoke” in promotional material and disclosure to investors. However, some investment strategies we reviewed were not personalised for each investor but were guided by a model asset allocation (defined by investment committee). Investors were given generic labels such as growth, balanced, conservative etc, and deviations to the investment strategy based on investor objectives and risk preferences were often minor.

⁶ [Liquidity risk management guide | fma.govt.nz](https://fma.govt.nz)

Recommendations

The law provides that DIMS providers must not make statements that are false or misleading and must clearly disclose the investment strategy⁷. Part 2 of the Financial Markets Conduct Act 2013 (**FMC Act**) is about fair dealing generally and is applicable to DIMS. Our guidance on advertising offers of financial products is designed to assist with compliance⁸. We recommend that providers regularly evaluate their investment strategy, to confirm it is clearly and accurately marketed and disclosed, and to ensure that investors can understand how their portfolio will be managed, including the degree of ongoing attention a provider will dedicate to their individual portfolio.

What we want to see: Strategic asset allocations (SAA) are reviewed and adapted to changing market conditions

The SAA determines portfolio weightings and should be regularly reviewed and adjusted where appropriate in response to changing market conditions. Our survey found that 24% of providers had not reviewed their SAAs within the last year.

As part of our monitoring, we explored how SAAs support long-term investor objectives and outcomes. We identified instances where providers had not clearly disclosed the limits to the SAA, or their ability to change those limits, contrary to FMC Act requirements⁹. We also found cases where SAAs had not been regularly reviewed, indicating that providers were potentially acting without adequate care.

Recommendations

DIMS investors' long-term objectives and outcomes can be supported by portfolios optimised to evolving market conditions. As part of exercising care, diligence and skill, we recommend providers review SAAs on a regular basis and consider any appropriate changes. Any changes that impact the investment authority will require investors' prior approval.

Investment performance monitoring

What we want to see: Asset allocation limits that effectively manage portfolio exposure

Our 2022 survey found that 13% of licensed DIMS providers have asset allocation limits with ranges of 0-100% of the overall portfolio, which is not a limit at all. While such wide discretion is permitted, there is a risk that managers may abuse this and seek to time their investment in markets, rather than adhere to a long-term allocation strategy. Attempting to time markets can lead to overtrading (and therefore increased costs) and may expose investors to additional risk through exposure to short-term volatility. Any providers that operate with such wide discretion should take care when disclosing their allocation limits to investors because there are effectively no limits.

It is unclear whether 0-100% 'limits' are in the investors' best interests or are designed to reduce the burden of compliance obligations, as portfolios with no asset allocation limits are easier to monitor.

⁷ Financial Markets Conduct Regulations 2014 clause 27, [Investment authority and strategy](#)

⁸ [Advertising offers of financial products | fma.govt.nz](#)

⁹ [FMC Act 2013, s437 Requirement for agreed investment authority](#)

Our monitoring identified unclear portfolio rebalancing processes, and that some large providers had not reviewed the appropriateness of asset class ranges. We also found that asset allocation breach reviews were not always performed at a frequency appropriate to the investment strategy.

Examples of good practice identified included providers applying a justifiable framework of asset limits (and not permitting 0-100% ranges), and the addition of soft limits applied to alert the provider to manage limit breaks before actual breaks occur.

Recommendations

DIMS providers should continuously manage investors' portfolios in line with the investment authority and investors' risk tolerances. Reviewing asset allocation limit ranges, ensuring they align to the investment authority and are disclosed and explained clearly and accurately to investors will help to manage this risk.

What we want to see: Breaches of investment authority do not persist longer than necessary

Breaches of investment authority occur when a portfolio manager acquires or holds assets outside the investment authority. Without controls, portfolios can drift away from agreed-upon allocations, either because of transactions (including corporate actions) or as valuations change, exposing investors to risks beyond their tolerance. Ideally, pre-trade controls, rather than post-trade controls, would be applied to manage this risk.

Our 2022 survey showed that some providers may not have robust controls to proactively manage potential breaches of the investment authority. Providers were found to employ a combination of controls, with 53% using manual peer review to pre-empt breaches, 42% relying upon compliance teams to check for breaches post-trade, and just 35% of providers using automated pre-trade controls where order management systems check position limits before transacting.

Our monitoring did not identify any providers who had formal policies or procedures to review position limits prior to transacting.

Recommendations

DIMS investors should not be unnecessarily exposed to risks beyond the bounds of the investment authority they have agreed to. We recommend providers use trade control policies and procedures to manage this risk by monitoring, preventing and promptly remedying breaches.

What we want to see: Portfolio performance is appropriately measured and disclosed

The law requires a DIMS provider to ensure a written investment authority provides for methodology to measure performance against investment objectives¹⁰. This is usually achieved by reference to a relevant benchmark.

¹⁰ FMC Act 2013, s437 Requirement for agreed investment authority

Our 2022 survey found that 11% of providers do not use benchmarks. We question how these providers effectively measure performance against investment objectives.

Our monitoring found that some providers did not report portfolio performance against a benchmark, and that some simply showed performance relative to the previous reporting period. Such comparisons do not allow investors to consider performance against investment objectives, and the return relative to the risk to the capital they have invested. This means they are less able to make informed decisions.

Where benchmarks were used, we found the methodology or the explanation for why the benchmark was appropriate for the investment objectives was not always clear. We also found that some fund managers did not review their benchmarks to ensure they remained appropriate for the investment objectives, which can change.

Finding a suitable benchmark that closely tracks portfolio performance may be difficult, particularly for personalised DIMS. However, having a measure of performance against investment objectives is required, along with methodology to develop and amend the investment strategy. This information is important disclosure to enable investors to assess the performance of the portfolio and make comparisons against alternative investment options.

Recommendations

Investment authorities granted by investors must provide for a suitable measure of performance against investment objectives that does not disguise poor performance. We consider a suitable benchmark is an appropriate measure of performance. We encourage providers to review any benchmarks applied to portfolios on a regular basis, ensuring they are clearly disclosed and remain appropriate to the portfolio's components and investment strategy.

Fees disclosure and transparency

What we want to see: DIMS fee disclosure accurately reflects the service provided

DIMS vary considerably and are often unique, which makes comparison of services difficult for investors. Our observations suggest providers could do more to help investors understand the service they are offering and the fees that apply.

Investors should be readily able to understand the basis upon which fees are charged. Fee disclosure should therefore consider how the nature of the service, the provider's role in investment decision making, and the impact of portfolio composition impact on fees. As part of this the provider should consider the time, effort and skill they apply to research and analysis, management strategies (i.e. active or passive), maintenance and oversight required for assets, buy/hold strategies etc.

Any impact on fees resulting from portfolio composition should be clearly stated in fee disclosures. Where portfolio composition does not impact fees and the provider charges a flat management fee, lower-cost (passive) portfolios can potentially subsidise higher-cost (active) portfolios, resulting in inequitable treatment of investors.

Our 2022 survey found that 35% of providers invest solely in externally managed funds, and 64% charge the same management fee irrespective of portfolio composition.

We also found that 9% of providers charge performance fees. Disclosure of performance fees should detail controls such as high watermarks, performance benchmarks, hurdle rates, or clawback provisions.

Our future monitoring of DIMS will consider fee disclosures in greater detail.

Recommendations

All DIMS providers should disclose all fees and services clearly and accurately so that investors can readily understand what they are paying for.

What we want to see: Providers clearly disclose fees, rebates and commissions

The law requires DIMS providers to include details of all fees and costs, including whether fees can be changed, in the investment proposal¹¹.

Our 2022 survey found that 8% of licensed DIMS providers did not communicate to investors about fees, rebates and commissions during the onboarding phase.

Our sample monitoring did not find material issues with the timing of disclosures but did identify that not all fees or their components were clearly disclosed to investors. In some cases, the disclosure of foreign exchange (**FX**) fees lacked transparency, as investors were only provided indicative fees. While FX fees may be subject to third-party costs and can vary dependent upon price spreads, providers often overlay their own FX charges or margins, which are quantifiable and should be clearly disclosed.

We also found that some providers had inconsistently disclosed fee information.

Recommendations

The law requires DIMS providers to clearly disclose all applicable fees, rebates and commissions during the investor onboarding phase and on an ongoing basis in investor reporting¹². Further, annual regulatory return reporting to the FMA requires DIMS providers to report all components of fees. We would like to see this detail around fees reported clearly and consistently.

¹¹ Clauses 37 to 42 of Schedule 21 to the [FMC Regulations, Fees and costs](#)

¹² [Regulation 210 of the FMC Regulations 2014, Ongoing reporting for DIMS](#)

