MANAGED ACCOUNT

PERSPECTIVES

THE RIGHT DNA
JULIA SCHORTINGHUIS AND MANAGED ACCOUNT EFFICIENCIES

ALSO: PORTFOLIO MANAGEMENT / GOALS-BASED ADVICE / TRANSITIONING FROM MODEL PORTFOLIOS TO AN SMA

IMAP
Institute of Managed Account Professionals

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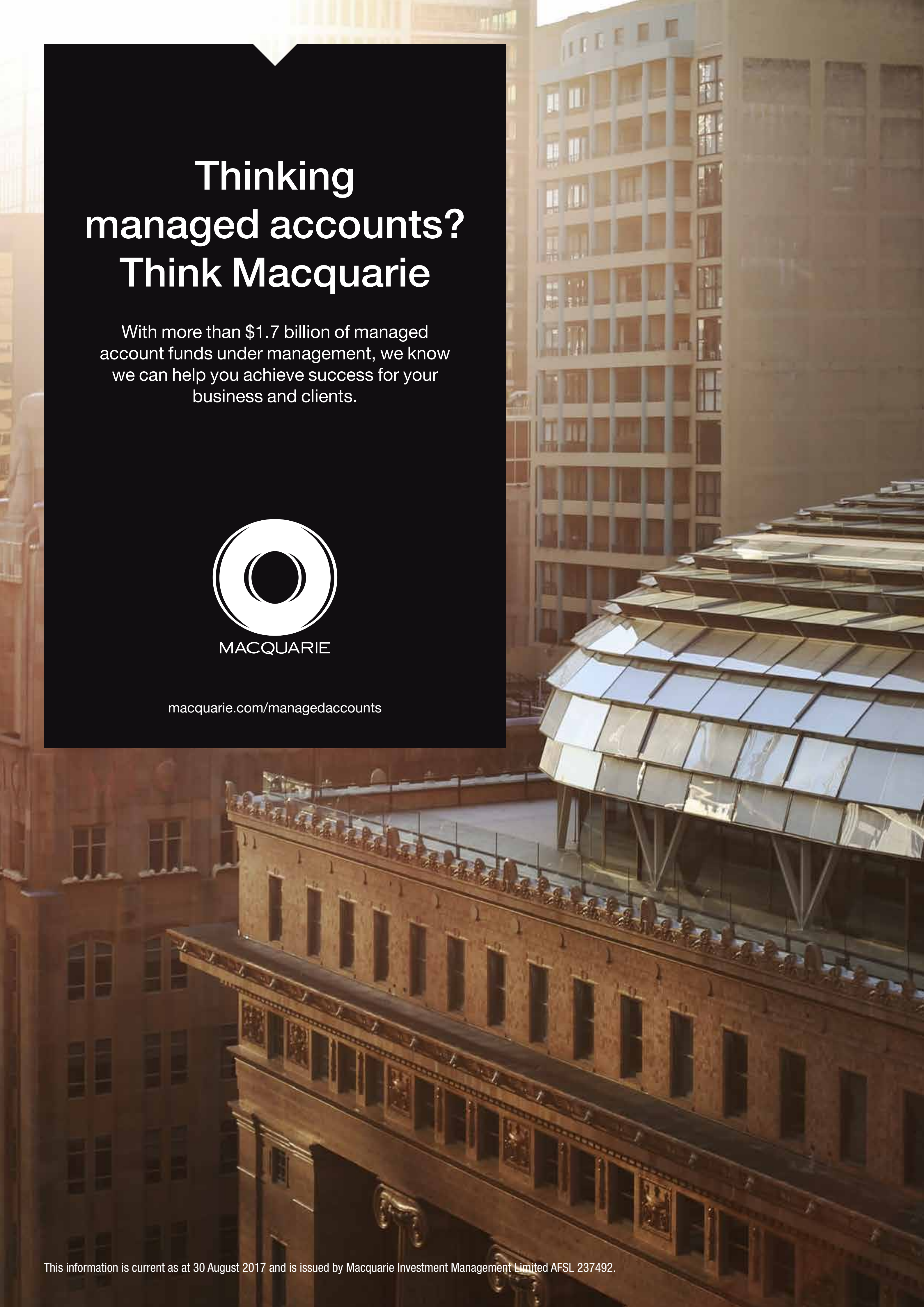
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PERSPECTIVES

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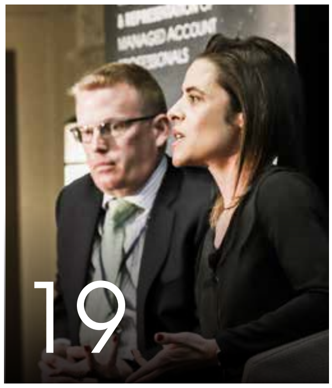

Managed Account Perspectives is the official publication of the Institute of Managed Account Professionals Ltd (ABN 57 125 794 274).
IMAP was formed to act as the nexus in this increasingly important part of the advice profession. Our aim is to bring together advisers, managers, platforms and other managed account service providers to help build a better industry.

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MANAGED ACCOUNTS APPROACH $50B – WHAT NEXT?

IMAP has just released its third study into the size of the managed accounts market. We counted $48 billion in FUM from the survey responders, made up of:

- SMA's – $14.3 billion;
- MDA services – $22.9 billion; and
- Other types – $10.7 billion.

This is an increase of $8.9 billion on the census we conducted in December 2016. Growth rates are currently 25-30 per cent, depending on the type of managed account.

So, managed accounts are a large market – and growing quickly. It seems they really are the next big thing.

What explains this relatively recent uptake in services that have been on offer for quite a long time?

Well, it's because managed accounts offer real benefits to both licensees and advisers. It's these benefits which are the underlying factors for creating this surge in demand. For advisers, this has been manifest in:

- Better client outcomes from portfolios that are subject to continuous monitoring and review, and which allow direct beneficial ownership;
- Practice efficiency that comes from not having to issue ROAs for every transaction; and
- Cost reductions for clients, partly from market pressures and partly from the increasing use of lower cost investment options, such as ETFs.

For licensees, in addition to better advice practices and the benefits that brings, there have been two other main drivers:

- Fewer problems with compliance and operational error; and
- Revenue opportunities arising from charging for the portfolio management function.

We are still in the early days of the development of managed accounts. After all, platform assets are around $750 billion and managed accounts are less than 10 per cent of that.

Increasingly, it will be licensees and their business objectives that drive the development of managed accounts. Once adviser office efficiencies are achieved and advisers have confidence that recommending a managed account solution doesn't disenfranchise them with clients, licensees' objectives will shape the evolution of managed accounts in every way.

This will result in:

- Technology development that allows greater control to be in the hands of the licensee and makes them less dependent on one-size-fits-all solutions;
- More complete control of the investment process, in particular asset allocation and manager selection, through their ability to be certain that their decisions will be implemented; and
- Greater revenue certainty, accompanied by better resourcing of their businesses, which in turn will make more valuable businesses.

For licensees, managed accounts mean that taking control of the investment solution becomes a reality.

All the best.

Toby Potter
Chair

"Managed accounts are a large market – and growing quickly. It seems they really are the next big thing."

ADVISER USE ONLY

TURN COSTLY PAPERWORK INTO VALUABLE CLIENT TIME

WITH OUR NEW MANAGED ACCOUNT SOLUTIONS

Turbo-charge efficiencies and dedicate more time to growing your business with our new Managed Account solutions.

Our Managed Account solutions help streamline back-office admin, eliminating much of the time consuming 'paperwork' involved in making portfolio changes. As professional managers look after the day-to-day administration of your clients' managed account portfolios, you'll have more time to look after their financial wellbeing.

So, with long-term experience and over $6bn under administration in Managed Accounts, it's time to find out more about Colonial First State's enhanced range of retail and tailored solutions.

Talk to your BDM or visit colonialfirststate.com.au/adviser

FORWARD TOGETHER

Colonial First State

MANAGED ACCOUNTS GROWING OVER 25% P.A.

Funds under management (FUM) for managed accounts in Australia now stand at $47.97 billion – an increase of $8.88 billion or 22.5 per cent in the six months from 31 December 2017. This was the latest result from IMAP's *30 June 2017 Managed Accounts FUM Census*.

According to IMAP chair, Toby Potter, $4.1 billion of this increase has come from five new respondents to the latest census survey, with over half of the increase attributed as organic growth as "advisers increasingly view managed account services as their preferred service model for a certain client segment".

Managed accounts FUM

	30 June 2017 ($b)	31 Dec 2016 ($b)	Increase/ Decrease ($b)	Increase/ Decrease (%)
SMA/MIS	$13.90	$12.36	$1.54	12.46%
MDA services	$23.36	$16.72	$6.64	39.71%
Other services	$10.70	$10.10	$0.60	5.94%
Total	**$47.97**	**$39.17**	**$8.79**	**22.44%**

* *Total amounts have been rounded out.*

Potter said IMAP's recent Portfolio Management conference highlighted the varied nature of managed account services and business models that are able to be offered by financial advisers, making managed accounts a "very dynamic market".

IMAP analysed the increase in FUM for managed accounts using the S&P ASX 200 market movement index over the past six months of 1.0 per cent as an indicator, and $0.39 billion of the growth is likely the result of market movement.

"This means that $4.4 billion of the growth in FUM comes from existing participants growing their managed accounts business, compared with $2.5 billion in the previous six month period," Potter said.

Thirty-seven companies participated in the latest *Managed Accounts FUM Census*, ranging from major platforms and banks, to smaller MDA providers.

LMDA ADVISERS FACE A DROP DEAD DATE

When ASIC released the update in the Class order in September 2016, it gave advisers who had been using the No Action letter, a two year transition period to move to an alternative approach to providing their services to advisers.

For many advisers, 24 months would seem like plenty of time to transition, but half of that time has now been used up and it's only now that many advisers are seriously considering their preferred course of action.

The choices available to them are varied and below are the questions that advisers and licensees should ask themselves when assessing the options. Of course, some options require organisational expertise, which may not currently be available to every adviser or licensee.

Managed Account Options

- **Dealer models on your preferred platform** – Can your portfolio models be duplicated by your preferred platform's SMA program in a licensee specific program?
- **MDA Provider** – Do you have the organisational competence to be authorised as an MDA Provider? Can your preferred platform support the operation of an MDA with your models?
- **Platform SMAs** – Do you want to increase your APL with a number of SMAs on your preferred platform? Can you construct models of these?
- **New Platform** – Would a new platform that provides the managed account service you want, be better for your business?
- **Dealer MDA Models** – If your licensee adopts an MDA approach, are the models they offer consistent with the advice approach you want for your clients?

Improved Advice Service Options

- **ROA Automation** – What are the automation features of your approved platforms? Do they offer sufficient automation of the ROA process?
- **New Licensee** – For advisers, whose choice of managed account service is controlled by their licensee, should they change to a licensee whose investment choice better suits their advice model?
- **Standard Advice** – Can you or your advisers revert to an 'advice only/ROA' service model? This might include SMAs.
- **Wholesale** – Does your client base support a 'wholesale only' approach?
- **MDA Adviser** – Can you partner with a specialist MDA Provider to offer your models and advice on their service?
- **Third Party SMA RE** – Is there an external RE for an SMA program on your preferred platform? What would this require of you?

IMAP has prepared a workshop on the choices that LMDA advisers face and the best way of assessing those options. To register your interest in the LMDA Workshop, contact IMAP at Support@imap.asn.au

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PLANNERS ENTHUSIASTIC ABOUT MANAGED ACCOUNTS

A new study has found that 40 per cent of financial planners believe managed accounts are appropriate for lower balance clients, with 53 per cent of independent financial advisers saying they used managed accounts compared with 47 per cent of aligned planners.

The *2017 Planner Direct Equities and Managed Accounts* research, a joint report by National Australia Bank (NAB) and Investment Trends, surveyed 474 financial planners regarding their views and use of direct shares and managed accounts.

The report found that while planner appetite for direct shares was declining, there was growing enthusiasm for managed accounts, which saw their use by planners increase for the fifth year in a row, with the largest year-on-year growth in the report's eight-year history occurring over the past 12 months.

Commenting on the report's findings, Investment Trends chief executive officer, Michael Blomfield said managed funds provide flexibility to the investor that "really allows them to see a true portfolio view of their investing".

"I think once you can do that for them and do good reporting around that, around asset allocation, the mix of assets and the exposures, then I think people really start to feel engaged with their investing."

Blomfield said that among those planners who had recommended managed accounts, 62 per cent indicated their clients had become more engaged as a result of this investment solution.

Also commenting on the report, NAB General Manager – Strategic Accounts, Susi Collas said managed accounts formed a key part of NAB's focus, with plans to add a number of direct equities SMA model portfolios to its MLC Wrap and Navigator platforms over the coming months.

ANZ WEALTH ADDS SMAS TO GROW WRAP PLATFORM

ANZ Wealth has introduced Separately Managed Accounts (SMAs) as part of its Grow Wrap investment platform, which it says will provide greater flexibility for investors.

Under the move, ANZ Wealth will introduce 13 new SMAs to professionally managed portfolios of direct equities and exchange traded funds.

Commenting on the introduction of SMAs, ANZ Wealth Head of Wrap, Dean Faglioni said: "This latest enhancement to our wrap platform responds to investor and adviser feedback on the need for greater flexibility to succeed in changing markets."

Faglioni added that the SMAs will offer investors the benefits of investing in traditional managed funds, including professional investment management, but with greater transparency and tax advantages.

"This can reduce the complexities associated with direct share investment selection, trading and administration. For advisers, the availability of SMAs means less time spent on administration and more time managing their clients' overall investment strategies," Faglioni said.

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TECHNOLOGY STRUGGLES TO KEEP UP WITH PLANNER NEEDS

Financial planners' needs are evolving, but technology providers are struggling to keep pace. This was one of the key findings to come out of the Investment Trends *2017 Planner Technology Report*, now in its 14th year.

Despite the significant investments being made by technology providers, planners feel their support needs are still not being sufficiently met. And planners are becoming increasingly unsettled with their product suite as a result.

According to the report, 75 per cent of planners are open to switching their primary platform, either for lower administration fees (47 per cent) or a wider platform feature set (28 per cent). Even among the 47 per cent who are seeking lower administration fees, functionality enhancements remain a significant driver of potential switching – with 82 per cent of this cohort enticed to switch platforms for functionality enhancements.

"While planners traditionally use platforms for their efficiency benefits, the vast majority are open to alternative solutions that play a greater role in advice delivery, from the back-office to the front," said Recep Peker, Research Director at Investment Trends.

"Planners envision the next generation of platforms to be feature rich, providing them support with plan production, modelling tools and interactive client review tools," Peker said.

The study found that CFS FirstChoice (32 per cent) and BT Wrap (29 per cent) were the two most widely used platforms among planners for new client inflows. However, the newer platforms – Netwealth, HUB24 and BT Panorama – were steadily extending their market share.

"Netwealth, HUB24 and BT Panorama are among the most technologically advanced platforms in the market, delivering not only efficient admin and online functionality, but also a wide ranging proposition that includes good portfolio management tools and a wide product range," said Peker.

Netwealth and HUB24 also achieved the joint highest overall platform satisfaction score, with both platforms rating significantly higher than their peers across service areas relating to BDM support, mobile access and user interface.

The top five platforms by overall satisfaction were:

1. Netwealth and HUB24 (joint first);
3. CFS FirstChoice;
4. BT Wrap; and
5. Macquarie Wrap.

XPLAN maintained its dominant position in the planning software space (with 54 per cent of planners using it as their primary software), while AdviserLogic secured top spot in overall software satisfaction. Coming in second was Midwinter, followed by XPLAN. AdviserLogic also leads the industry across the majority of service elements measured, particularly relating to quality of training, navigational efficiency and user interface.

According to the report, the average financial planner uses 3.2 separate systems to collect data required for client reviews. If given the opportunity to consolidate to one single system, planners overwhelmingly prefer their planning software to fulfil this role, ahead of their platforms or third party standalone solutions.

The Investment Trends *2017 Planner Technology Report* is a study of Australian financial planners and their technology needs. The study is based on a survey of 533 financial planners concluded in May 2017.

INVESTTECH 2017 – IMAP's focus on portfolio management technologies and connectivity software.
WHERE: Dockside Conference Centre, Cockle Bay Wharf, Darling Park, Sydney
WHEN: 5 December 2017
REGISTER: imap.asn.au/events

ALADDIN POWERING RISK MANAGEMENT

An end-to-end investment platform is powering the risk management of BlackRock's model portfolios.

Speaking at the August IMAP Dealer Investment Forum, Josh Persky – BlackRock's Head of Model Portfolios and Solutions Australia – provided an informative presentation on risk management and how BlackRock uses its risk analytics tools in monitoring and managing multiple risk parameters within its Australian managed account model portfolios.

According to Persky, when it comes to defining what risk management is in a model portfolio, planners and investment committees need to properly understand: "What it is you own and why you own it."

"This is fundamental to your investment philosophy," Persky said. "And along with cost, which can eat away at investment returns, it's vitally important that the right people sit on your investment committee. The committee needs to be able to optimise each of your model portfolios individually."

Underpinning BlackRock's approach to risk management is its proprietary risk management platform that it uses for its model portfolios – Aladdin.

Aladdin (which stands for Asset, Liability, Debt and Derivative Investment Network) is an operating system for investment managers that seeks to connect the information, people and technology needed to manage money in real time. The system is currently used by 25,000 investment professionals around the world.

According to Persky, the Aladdin platform combines sophisticated risk analytics with comprehensive portfolio management, trading and operations tools on a single platform that enables informed decision-making, effective risk management, efficient trading and operational scale across asset classes.

"Running model portfolios is difficult… This is not a 'set-and-forget' strategy. It requires constant monitoring."
- Josh Persky

"This tool enables planners and investment committees to make more informed decisions around the whole investment process," Persky said.

He added that Aladdin is used to "stress test" portfolios, which helps to mitigate shocks to portfolios, similar to what occurred with Brexit and the US Presidential elections.

And while the system has been widely effective in safeguarding against portfolio shock, Persky admitted that even using the Aladdin system as part of its approach to risk management didn't mean BlackRock always got its investment decisions right.

"We actually missed the market bounce with the Trump election, but so did most investment managers. The bounce was very unexpected," he said.

Other important factors as part of BlackRock's model portfolios are 'implementation' and 'monitoring'.

"Running model portfolios is difficult," Persky said. "That's why our investment committee can override model portfolios if required to do so. This is not a 'set-and-forget' strategy. It requires constant monitoring."

Persky also confirmed that BlackRock was currently in conversations with a number of "interested parties" to make the Aladdin tool available to more investors.

PI INSURERS: PUTTING YOUR BEST FOOT FORWARD

IMAP's MDA Forum in August provided managed account professionals with interesting insights from a lawyer and insurer in relation to professional indemnity (PI) insurance for MDA providers working in the managed accounts sector.

Addressing the forum in Sydney were Mike Herron – National Practice Leader, Professional and Financial Risks at Arthur J. Gallagher, and Cain Jackson – Partner at Wotton + Kearney. And in Melbourne, Stephen Hughes – General Manager Professional Services at Arthur J. Gallagher addressed the forum.

Both speakers set the scene for PI renewals, which has become increasingly difficult for MDA providers post GFC.

"Following the GFC, a number of insurers left the PI market, which has reduced competition. So, what was a highly commoditised market only a few years ago, has now become a highly contested market," Herron said.

Speaking from a PI insurer's perspective, Herron added that some of the big issues for PI insurers today remain around hybrids, and this concern should not be ignored by the industry.

Jackson agreed, saying that prior to the GFC, there was a "rogue element" in the financial services industry that was mismatching products and asset allocations with client risk profiles.

"However, post GFC, we have seen greater regulation of the financial services industry, which is also creating a better, more regulated insurance sector," Jackson said. "So, the real challenge now is to move on from the bad experiences post GFC and encourage more insurers to return to the PI market."

Herron believed the key to this, particularly for MDA providers, was for the sector to better explain what managed accounts were and to proactively take PI insurers on a "journey of explanation". He said by being able to articulate a strong narrative to PI insurers, MDA providers could ensure they get the most advantageous terms from them.

Herron said being able to differentiate your operating model from high risk operations can make a significant impact on the PI terms available to MDA providers.

"The most significant risk for PI insurers is the retail advisory sector. So, from an MDA perspective, you need to actively talk to PI insurers about the type of model you are using for your clients and business, including the due diligence process around this model."

As such, Herron said it was important that PI insurers understood how various models stacked up against each other, such as:

- retail vs wholesale;
- advisory vs non-advisory;
- custodial vs non-custodial;
- less customised; and
- diversified and compatible.

Jackson agreed. "There is a perception that removing the non-advisory function removes risk. That's wrong, because risk remains. There's risk in relation to compliance, investments, processes, resources, governance structures and operational framework."

However, he added that the long-term impact of any claim/incident history can be mitigated by MDA providers improving their risk management. Jackson said that had been particularly evident over the past few years, where there had been a trend for civil liability to extend beyond the adviser to any other party involved in the investment/advice process, such as investment managers, MDA providers, as well as the MDA adviser.

"Increasingly, from a legal standpoint, where multiple parties are involved in misleading or deceptive conduct, we're seeing liability for all these parties," Jackson said. "If you misrepresent what you are presenting or delivering, it does not obviate you from liability."

Jackson added that improved risk management and the tightening up of "grey areas", including the 'duty of care' provisions in an MDA contract/agreement, was something PI insurers found appealing, as this reduced the chance of misinterpretations from a legal standpoint.

He believed this was one of the better ways MDA providers could ensure they get the most advantageous terms from PI insurers.

The key lessons learnt

Perspectives asks two industry professionals the following question:
Q: What are the three key lessons you have learnt from establishing and running a managed accounts business?

CHRIS WILLATON

Director and Head of Investments
Akambo Private Wealth

1. Points of differentiation
We established our managed accounts offering to provide a better client experience through building efficiencies and scale into our business. And whilst it has done exactly that, competition, technology and consumer expectations continue to evolve quite rapidly.

This means we need to keep refining our offering to maintain points of differentiation, and strive to provide a superior client experience – otherwise, someone else will.

2. Don't lose sight of what the client wants
Offering a managed accounts solution has brought efficiencies to our business and a better client experience (investment choices, efficient execution of trades, and a more qualitative focus in the client interaction).

But most clients also want to feel special – whether through a bespoke investment approach and/or a genuine personal engagement with their financial adviser. A product alone does not do this.

3. Performance matters
Whilst a 'better client experience' can enhance the client relationship, most clients still need to see measurable results – relative and absolute.

A managed accounts platform has given us greater flexibility and more tools to deliver this.

We have been able to leverage our successful performance (particularly with our international portfolio) to differentiate our offering.

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STEPHEN ROMIC

Principal, Head of Research and Investment Committee member DFS Portfolio Solutions

In 2008, DFS made the decision to adopt a managed account solution across the entire business. This was a pivotal point in the firm's history, launching us into a brave new world. When asked what key lessons we learnt through the process, the following comes to mind.

1. Clients are much more receptive to change than you think

We learnt that clients expect us to be more innovative and deliver progressive solutions to improve their overall experience. In order to improve, change is inevitable and the challenge quickly turns to how to best manage change. Engaged clients are more likely to support any change, and clear and succinct communication is key to managing client expectations.

2. Preparation pays rewards.

Recognising that the change in business model was a major decision point for both the firm and our clients, we deliberately invested time in the pre-advice phase. We embarked on:

i) creating a structured narrative to ensure consistency of our message;

ii) rolling out information and updates on a staggered basis; and

iii) informal communication to directly engage with clients.

By the time the client was presented with the formal SOA, setting out the transition to a managed account, they were already familiar with the proposed recommendation.

3. Delivering positive experience is crucial

Once clients experienced the managed account regime, they openly confessed their appreciation of not having to consider and formally execute ROAs and SOAs whenever portfolio changes were being proposed; real time portfolio summaries were welcomed as a much less obtrusive way to communicate portfolio changes, compared to the conventional IDPS regime.

INVESTTECH 2017

Join us at **InvestTech 2017** – IMAP's inaugural technology event that will bring together technology providers, financial planners, investors, administrators and MDA providers.

This full day event highlights the central role technology is playing in the development of managed accounts and the transformation of advice.

In a unique and engaging 'quick fire' presentation style, providers will showcase their technology capability for professionals working with managed accounts.

Discover new technologies and systems that will provide:

- efficient portfolio management of client accounts across many investment strategies;
- control of how investment management decisions are implemented;
- efficient trading for investors when rebalancing and adjusting portfolios;
- compliance management; and
- connectivity between managers, platforms, custodians and planners.

When: Tuesday 5 December

Where: Dockside Conference Centre, Cockle Bay Wharf, Darling Park, Sydney

For more information and to register, go to imap.asn.au/events

Maximising the managed account opportunity

Sherise Mercer shares her insights on how to build managed accounts into a financial advisory business.

SHERISE MERCER

Head of Macquarie Virtual Adviser Network

As managed accounts continue to experience significant growth, advisers are thinking about how they can be incorporated into their business to drive growth, build scale and bring greater efficiency to the way they work.

We know from Macquarie's recent *Accounting and Financial Services Benchmarking* report that the top challenge reported by advice firms is feeling overwhelmed by paperwork and rigorous compliance demands.

While compliance obligations and paperwork will rightly always be part of doing business, managed accounts offer significant benefits to firms looking to overcome the tactical and administrative challenges that come with managing client investments.

The inability to scale manual processing is also a major challenge for businesses. Some say their operating processes haven't evolved significantly in the last 10 years, making the effective management of investments highly dependent on key staff. The disruption to the business of losing those critical team members presents a real risk to achieving growth.

Other significant risks concerning practice principals and causing inefficiencies include the time involved in seeking confirmations for investment decisions, and the significant risks associated with incorrectly executing client instructions, or not being able to do so in a timely way.

With managed accounts offering a scalable solution where advisers can execute efficiency for clients en masse, and reduce risk, costs and administration, they have become a very compelling proposition. It's no wonder the conversations we're having with advisers often tend to move to 'how quickly can we implement a managed account solution?'.

But before pushing ahead with implementation, it's vital to pause and consider what impact the change will have

> "In preparation for having conversations with clients, it's important to consider the changes that need to be made inside the business to ensure the smooth integration of managed accounts."

CONTINUES >>

> "Overwhelmingly though, clients place value on attributes beyond investment outcomes: namely, they're looking to their adviser to educate them, connect them with other relevant experts based on their unique circumstances and build a proactive, trusted personal relationship."

for your clients, how you will explain this to ensure they appreciate the full range of benefits they will receive, and prevent the transition becoming a pain point for your business.

Talking to clients about managed accounts

Our recent advice client research revealed that the overriding driver of satisfaction is the perceived personalisation of their advice experience. Of course, clients want confidence their adviser is managing their portfolio to achieve the best risk and return outcomes to meet their life goals.

Overwhelmingly though, clients place value on attributes beyond investment outcomes: namely, they're looking to their adviser to educate them, connect them with other relevant experts based on their unique circumstances and build a proactive, trusted personal relationship.

If advisers are going to be able to truly deliver on the areas of the client experience most valued by clients, they need to be systematising aspects of doing business like administration and compliance, to free-up time to focus on customising relationships based on their individual client's needs.

Here, managed accounts become a key enabler, as they allow the adviser value proposition and focus to move from being the 'expert in investment management' to 'manager of investment experts and expert in the client's needs'.

Therefore, when it comes to introducing managed accounts as a solution for clients' investment needs, the value proposition clients will find most compelling is the broader coverage of all aspects of their financial life that will support them reaching their goals and a specialist, more efficient approach to managing their investments.

Building managed accounts into your business

In preparation for having conversations with clients, it's important to consider the changes that need to be made inside the business to ensure the smooth integration of managed accounts.

We place significant emphasis on working with advice firms on what we see as the four business areas that need to be reviewed during the process.

Firstly, what is your strategic vision for the business – and how will you build value in the practice in three, five and 10 years' time? How will you ensure managed accounts support the direction of your business over this period?

Consider the service offering you currently provide clients. If you were to put a greater emphasis on building enduring relationships and serving a wider range of client needs, what resources and skills do you need to add to your existing proposition?

In line with this, what does your resourcing approach currently look like and how could you expand your service offering for clients? Would this involve partnering, outsourcing non critical tasks or administration, upskilling or adding to your in-house capabilities?

Finally, team capabilities. Developing your team's expertise in uncovering clients' broad set of needs, so they are able to have valuable, informed conversations is vital. How will you support your team in providing solutions to those broad range of needs, what training will you offer and how might this alter your approach to recruitment and retention?

Ultimately, managed accounts offer a significant opportunity to maximise the future success of your business.

At Macquarie, we're working closely with our clients to ensure that the decisions firms are making today, using managed accounts as a springboard, are right for their business both today and into the future.

For more information on managed accounts with Macquarie, go to: www.macquarie.com/au/advisers/solutions/managed-accounts

MDAs: The right DNA

Managed accounts are part of the DNA of Lighthouse Capital. **Julia Schortinghuis** talks to **Jayson Forrest** about the efficiencies and time-savings that managed accounts have brought to the business.

Lighthouse Capital isn't your average financial planning practice. You could say it's one of the few practices that has pioneered managed accounts from its very inception in the year 2000, and even further back to 1993 with the genesis of the practice's original business. Today, an impressive 98 per cent of its client base operates under an MDA arrangement, making managed accounts part of the business' DNA.

"We've actually been operating MDAs right from our beginning and the reason for that is because of the style of business we run," says Lighthouse Capital principal and financial planning specialist, Julia Schortinghuis CFP®. "MDAs really do enable us to drive the type of business efficiency we want, while allowing us to operate with lower overheads overall."

One of the main advantages of offering clients a managed accounts solution is that it has opened up capacity for Lighthouse Capital, which has been ideal to service the high level of direct equities in client portfolios.

"Where it's relevant and appropriate for parts of a client's portfolio solution, we will use direct equities. This is where MDAs are essential, as it allows us to make changes quickly and execute trades without having to speak to the client first," Julia says.

She adds that the other advantage of using managed accounts is that the business can more easily handle corporate actions and participate in IPOs, enabling the practice to efficiently allocate and implement them across its client base.

"So, that does allow us to open up opportunities in an efficient and streamlined way that you might not be able to do otherwise."

PRACTICE

Lighthouse Capital is a full service planning practice, operating out of two sites in Western Australia - Perth and Bunbury. There is a team of 18 staff, including five financial planning practitioners, with its service offering ranging from superannuation, SMSFs, investments, retirement planning, estate planning, budgeting and strategic advice and Centrelink, with a specialisation in aged care.

And with 98 per cent of its clients operating under an MDA structure, the average client at Lighthouse Capital has around $880,000 in investable assets. The practice manages just over 440 clients across the five planners.

"I think we're a little bit different and unique," says Julia.

"Our MDA service fits a particular market segment. We find that a lot of high-net-worth individuals are referred to us by

accountants. These clients are looking for a more direct hands-on approach to the management of their portfolio. So, rather than working with a broker, they want to work with a team of professionals who can offer them the type of holistic advice they need."

Lighthouse Capital uses XPLAN as its primary technology system, but beyond that, the business has custom built a lot of it's own proprietary systems, including its MDA register and 'brokers' orders' tool.

"Our systems are all centralised, they're easy to use and you can access information easily. But if there is one area where we are looking to for further efficiencies, then it's definitely from XPLAN."

According to Julia, MDAs have always been part of Lighthouse Capital's DNA, which includes the practice's strict adherence to professional standards and compliance obligations.

"Because of the additional layer of trust between client and planner that is embedded within an MDA, we have a much tighter compliance regime with our licensee, Godfrey Pembroke. So, we have twice as many audits, which is a process that we welcome because we want to ensure that our compliance is absolutely first class.

"We renew the MDAs annually in bulk and we operate an in-house MDA register, which has all of the pertinent information relating to our MDA clients. This information is easily located in the one place, which is critical for ensuring that everything is kept in order."

CONTINUES >>

"MDAs really do enable us to drive the type of business efficiency we want, while allowing us to operate with lower overheads overall."

According to Julia, the MDA register, which is a licensee requirement, has actually been operating since the early 1990s by the founding partner of the practice. Overtime, this MDA register has been developed and enhanced by the practice.

PHILOSOPHY

Over the last couple of years, Lighthouse Capital has started to increasingly incorporate SMAs, ETFs, LICs and other diversified instruments into its suite of services.

"The SMAs are great because we've found that for some clients, it does enable us to give them access to a professionally managed solution with the benefits of direct share ownership, which sits quite nicely with that client base."

But in what ways does Lighthouse Capital's MDA offering reflect its approach to investment selection?

In answering, Julia refers back to an MDA's two main advantages: efficiency and time-savings.

"One of the key benefits of operating MDAs is the efficiency and time-savings they provide, which enables us to reinvest that time back into the business. So, it allows us to spend a lot more time on the research side of the business, through our investment committee on the portfolio construction side, and on tailoring customised solutions for clients in a way that is still affordable and appropriate for them."

Lighthouse Capital has an internal investment committee, comprising of seven members. It meets at least fortnightly, where it reviews macro-economic conditions, asset allocation settings and individual company news.

"We regularly have economists, leading fund managers and investment professionals feed into our investment committee process," Julia says.

Part of that also includes sourcing additional information utilising a 'brokers' orders' research tool made available via the practice's licensee. This research tool provides the business with an overarching view of broker recommendations across the major stockbroking houses. This is updated fortnightly.

Lighthouse Capital also uses Morningstar and Lonsec research. And over and above that, it does its own due diligence, which includes trawling through company announcements and balance sheets.

"Our investment committee has developed a robust model that ensures ongoing, active management," Julia says.

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However, while she concedes this process can be onerous, it's nonetheless a necessary one, which is fundamental to the practice's client value proposition.

"For certain clients, it's this attention to detail that they value. It's what they are looking for, and they really like to know what they own, why they own it and where it fits strategically in their investment portfolio. So, having this hands-on approach does allow us to offer a more specialised solution for our clients," Julia says.

"So, for me, the real benefit of a managed accounts solution is the time it saves you, and it's this time-savings that you can reinvest back into the business."

COMMUNICATIONS

Part of that "reinvestment of time" is the practice's approach to client communications.

"One of the things we do whenever we make an adjustment to a portfolio, is we take a proactive approach by writing to our clients to explain what we've done and why we've done it for them. This is not a requirement under the MDA, but it's a conscious decision on our part to enhance the client experience. It's an approach that our clients appreciate."

However, while client communication is important for the business, Julia points out they are careful not to inundated clients with too much information.

"We are very selective in what we tell our clients," Julia says. "Any adjustments we make that are specific to a client's portfolio, we will write to them personally to explain what is happening. So, we average between eight to 15 client communications per individual per year."

And what of generic newsletters or bulletins for clients?

"Again, we are very selective with client newsletters. In fact, we don't do a monthly newsletter," Julia says.

"Instead, we only send out newsletters when we think there is something pertinent and important to share with clients, like the recent 1 July changes to superannuation. By being selective in our client communications strategy, it means that when our clients receive correspondence from us, they know it's worth their time to stop and read what we've sent them."

Julia adds that in terms of the time-savings achieved by running a managed accounts solution, the business is also able to invest more energy into ensuring that the client annual review process is more detailed than would otherwise be the case.

"It provides us with the time to gather more information and detail around our clients' progress, including how they are tracking against their goals, thereby delivering a service experience that the client truly values."

FUTURE

Julia doesn't foresee any dramatic changes happening to the business anytime soon, but she admits the business is increasingly using SMAs and other diversified direct investment solutions to satisfy the growing appetite of clients.

"I can honestly say that I wouldn't change anything we've done with our managed accounts offering," Julia says. "We're really comfortable with our processes and how we implement and manage them. We certainly wouldn't have the return on equity in our business without them."

And it looks like Lighthouse Capital has cracked the winning formula.

In 2011, the practice was nominated for Godfrey Pembroke's National Practice of the Year, and went on to win the award for excellence in financial planning and contributions to the financial advisory community.

And in line with the practice's commitment to ongoing education and professional development for its staff, Julia was invited to attend Stanford University's Executive Leadership Course in 2013.

Completing this prestigious program was a catalyst for Julia to implement further enhancements into the practice, which saw it take out the 2015/16 Godfrey Pembroke Premier Practice award, with the Godfrey Pembroke Adviser of the Year award going to Julia herself.

"These were all wonderful achievements that validated the direction our practice is heading, and the processes and procedures we have developed. Our MDA solution is an important part of that," she says. "So, we must be doing something right!"

Indeed, for these sandgropers, it would appear they're doing a lot right.

"I can honestly say that I wouldn't change anything we've done with our managed accounts offering. We're really comfortable with our processes and how we implement and manage them. We certainly wouldn't have the return on equity in our business without them."

Through the managed accounts lens

The managed accounts sector enthusiastically supported **IMAP's portfolio management conference** in July, with over 220 delegates ensuring this inaugural event was sold out. **Jayson Forrest** reviews some of the highlights of this conference, including in-depth reviews of two panel discussions.

Daniel Toohey: Managed accounts to hit $60 billion by 2020, but this figure "probably too conservative".

MANAGED ACCOUNTS: $60B BY 2020

In officially opening IMAP's Portfolio Management conference on 24 July, IMAP chair **Toby Potter** said the theme of the conference – Through the Managed Accounts Lens – was chosen to reflect the rapid growth and interest in managed accounts by the financial services sector.

Potter confirmed that funds under management (FUM) in the managed accounts sector in Australia was closing in on the $50 billion mark. He believed this figure would be supported by the results from the latest 'Managed Accounts FUM Census'.

Interestingly, in a keynote presentation by Morgan Stanley executive director, **Daniel Toohey**, he actually predicted the managed accounts sector to hit the $60 billion mark by 2020, and this figure, he believed, was still "probably too conservative".

Morningstar Chief Investment Officer (Asia Pacific), **Andrew Lill** provided delegates with some interesting insights on the managed accounts sector from a client perspective. These insights were gathered from research Morningstar had conducted in this space.

According to Lill, Morningstar identified eight core client needs of what a managed account should like. These included:

- Be professionally managed;
- Be transparent, enabling clients to see exactly what is in their portfolio;
- Have beneficial ownership;
- Be flexible, including access to investment tools;
- Have fewer holdings, so clients know what that are holding;
- Have a tax-effective structure;
- Have reduced administration; and
- Have optimised portfolio reporting.

However, Lill said that despite these core requirements, there were still a number of challenges that the sector had to deal with to address these client needs, in order for more consumers and planners to take up managed accounts. In particular, Lill identified the following five challenges confronting the sector, which he said were also opportunities:

1. A limited ETF product range;
2. Market cap based;
3. Consumer education (what is a managed account and why would would a client use it);
4. Slow take up (dealer groups not incentivised to offer them); and
5. Most SMAs were Australian equities focused.

"By understanding the needs of clients and properly responding to the challenges faced by the sector, managed accounts will continue to grow," Lill said.

"The key to survival for planners is their client value proposition, differentiation, a focus on costs, repeatable investment processes that generate consistent returns, compliance and best execution processes, and adaptable business models. This is where managed accounts come into their own.

"The managed accounts sector needs to do a better job of communicating this story to the advisory community and end clients alike, and that's where technology can help."

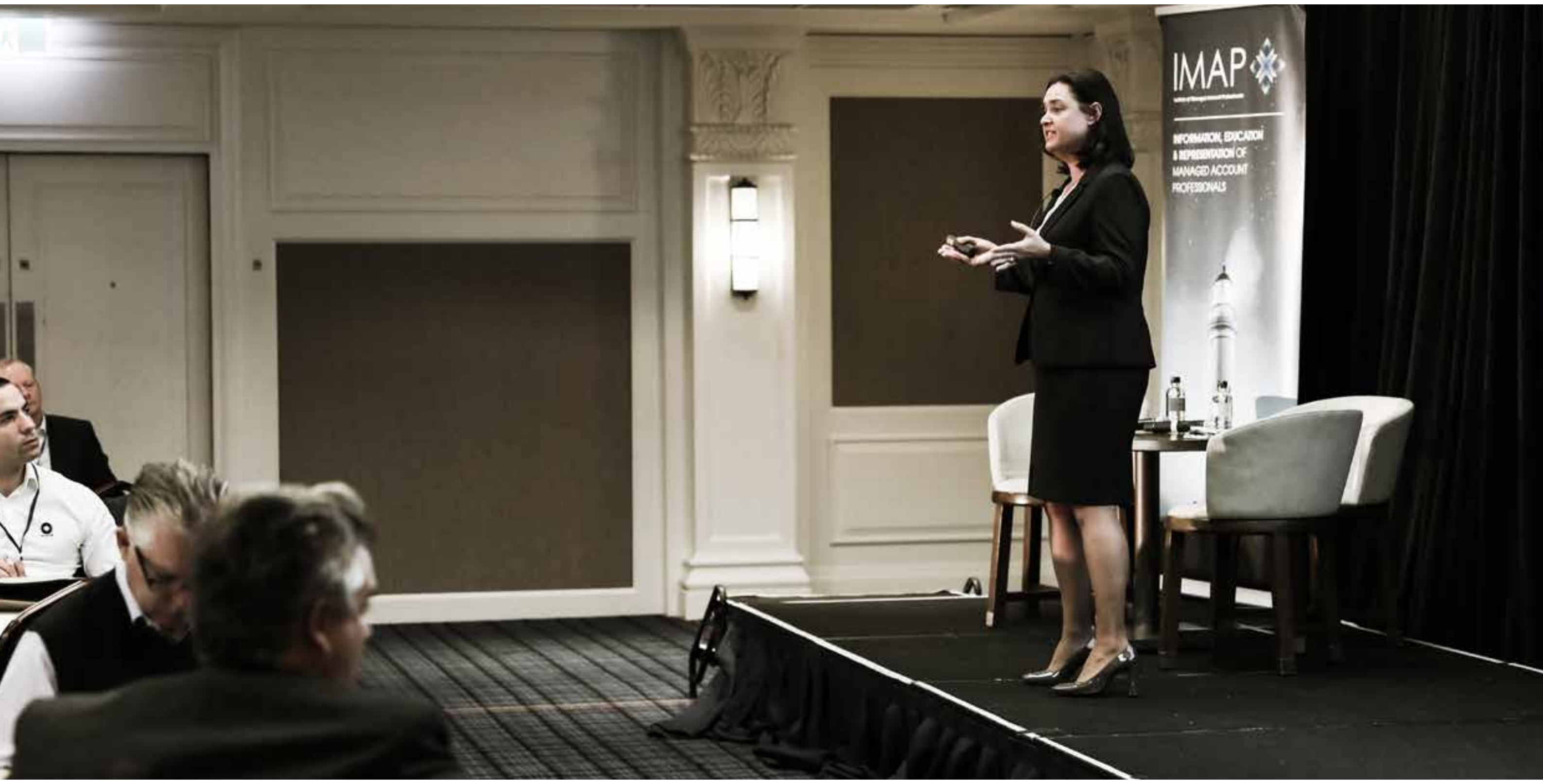
There were 28 speakers at this year's IMAP Portfolio Management conference, which included four keynote presentations and eight panel discussions. Throughout the conference program, there was a clear focus on portfolio management and managed accounts investing.

The following is a review of some of these sessions, including photos from the conference.

Best of breed: 1

Over 220 delegates attended the IMAP Portfolio Management conference. Attendees enjoyed the opportunity to network during the course of the day.

For more social photos, go to p25.



MAXIMISING THE MANAGED ACCOUNTS OPPORTUNITY

The preoccupation that planners spend on fees and pricing their advice model for clients, isn't a key driver of client satisfaction, according to the latest Macquarie Propensity Study.

In an absorbing opening keynote presentation on 'Maximising the managed accounts opportunity', Macquarie head of client strategy, **Sherise Mercer** said clients were more interested in the 'personalisation' of the advice service provided by planners than the fees they paid them.

According to Mercer, the five most valued drivers of client satisfaction are:

- My adviser manages my portfolio for risk and return;
- I receive the right level of information about my progress;
- My adviser uses other professionals as needed;
- My adviser proactively manages my affairs; and
- My adviser helps improve my financial knowledge.

"But planners need to remember that managed accounts are not a plug in, plug out solution," Mercer said. "When it comes to managed accounts, our research shows that 'personalisation' is where the value is; that the process is personalised for the client. It's this personalisation of the investment process that is most important for the client.

"However, personalisation doesn't mean the client's portfolio has to be customised. A portfolio can be systemised. What's important is that the client's experience with their adviser and portfolio is personalised."

Mercer added that the Macquarie 2015/16 AFS Benchmarking report also offered some significant insights on the six "pain points" holding planning businesses back from being more efficient. These included:

- Administration, emails, paperwork and compliance;
- Increased regulation;
- Scaleability of current processes;
- Managing risks;
- Cost and margin pressures; and
- Managing growth.

"These are all issues that planners face everyday. But we know, with Macquarie having worked with 80 high performing practices, that managed accounts can be the solution to these pain points," Mercer said. "Managed accounts can do this by effectively bypassing these pain points and thereby enabling planning practices to be more efficient and streamlined in their service offering and value proposition."

According to Mercer, a managed accounts solution is ideal for planning practices, as they offer:

1. Scaleable portfolio management;
2. Reduction in the total cost to clients;
3. Efficient and quality data feeds: and
4. Reduced corporate action management.

LISTED INVESTMENT CHOICES: TRANSFORMING MANAGED ACCOUNT INVESTING

Advancements in technology has been a "great enabler" for listed investment products, effectively making the ASX an ideal platform for advice solutions.

This was the key takeout from a panel discussion on how listed investment choices are transforming managed account investing.

According to BetaShares Director – Institutional Business and National Accounts, **Vinnie Wadhera**, technology is enabling managed accounts in a way it has never done before.

"Through regulatory innovation (MySuper) and intervention (FoFA), we're seeing a greater obligation placed on the industry for lower cost solutions for consumers. And this isn't just confined to Australia. Globally, we're seeing stock exchanges investing in their own technologies, to help streamline and deliver cost efficiencies to investors."

It's a view supported by Magellan General Manager (Distribution), **Frank Casarotti**, who points to the current size of the ETF market, which globally stands at $3 trillion.

"Magellan saw the potential of listed investments and jumped on board a couple of years ago," Casarotti said. "Our motivation for doing so was really client related. Our clients told us they didn't want to wade through 19 page documents in order to invest in a managed fund. They wanted a simpler solution.

"So, we talked to ASIC and the ASX about developing an active ETF that provided more exposure to active management and could be traded with live pricing. Two years later, and with $850 million FUM, we know it was the right decision to make."

With nine active ETFs available to Australian investors, including from the likes of Schroders and K2 Asset Management, both Wadhera and Casarotti were confident that actively listed investments will continue to create sustained interest amongst fund managers and investors alike.

MEETING RETIREMENT INCOME OBJECTIVES

With global populations ageing rapidly, and with one-in-four Aussies estimated to be over the age of 65 by 2050, there are tremendous opportunities for managed accounts to meet the specific retirement income needs of retirees in the years ahead.

This was one of the key takeouts from a panel discussion moderated by Nikko Asset Management Head of Product and Strategy, **Hendrie Koster**, and panellists **Lukasz de Pourbaix** (Chief Investment Officer at Lonsec) and **Will Baylis** (Multi-Strategy Portfolio Manager at Matin Currie).

However, de Pourbaix conceded that there were considerable challenges in building a retirement portfolio, which included addressing the three key risks in the drawdown phase: longevity risk, inflation risk and market (sequencing) risk.

"Building a portfolio designed for retirees, but being mindful of these risks, is complex," de Pourbaix said. "There are three elements you need to be particularly aware of: income, risk control and growth."

Baylis added that the dilemma retirees faced in their retirement portfolios was the chase for yield to generate an income, while safeguarding capital preservation.

"We have always advocated that a significant portion of a retirement portfolio should be growth, whilst being mindful of investment risks, to ensure that the portfolio is growing and so, provide a buffer against the retiree outliving their investments," Baylis said.

"So, the weighting in an optimal retirement portfolio should be half growth and half defensive."

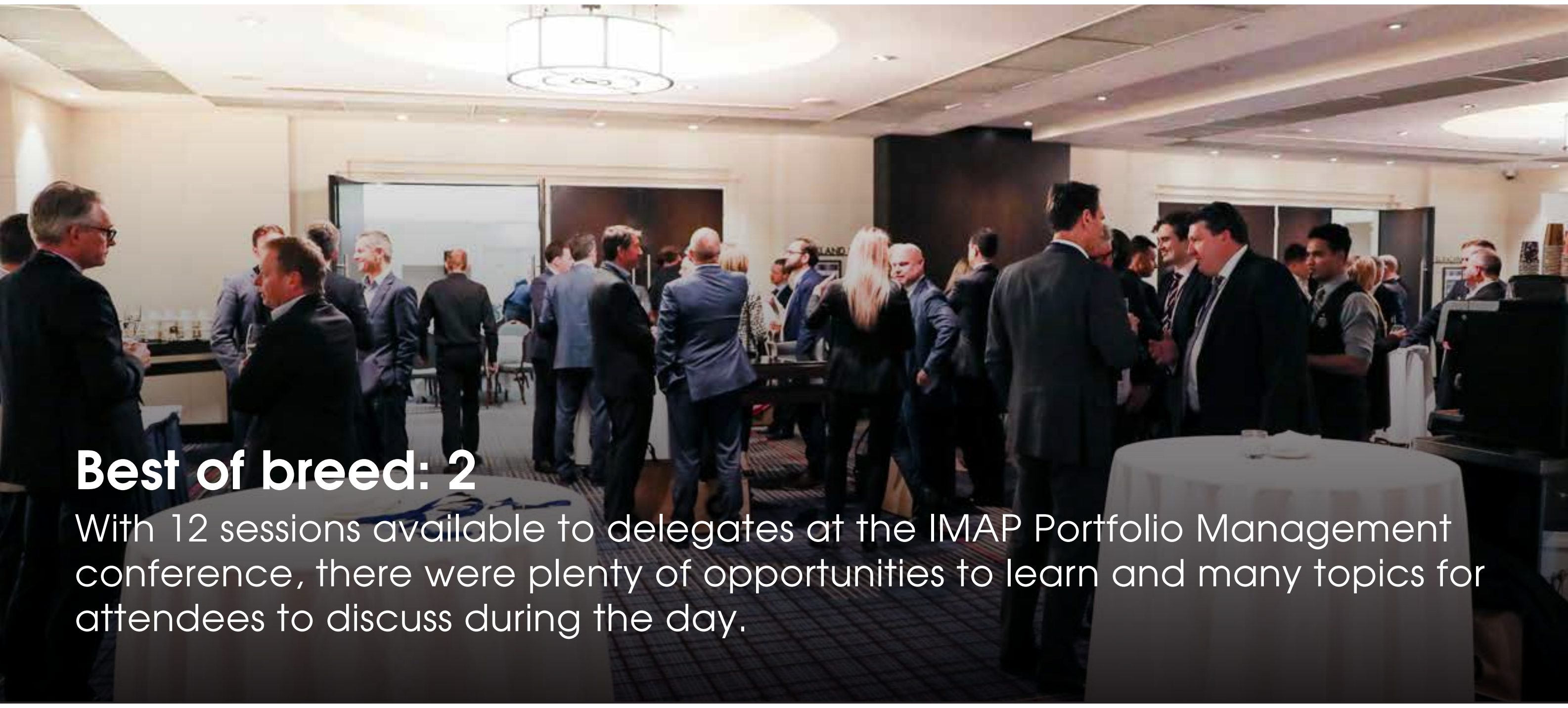
De Pourbaix agreed, saying the industry needed to think more about developing products that provided steady cashflow to retirees, rather than purely income.

"When working with retirees in the de-cumulation phase, priorities for this sector shift. They are seeking income and specifically, cashflow, but are more sensitive to capital loss, which is challenging from a portfolio management perspective," he said.

"The traditional thinking is that you should reduce your risk in retirement, but faced with the risks of longevity, sequencing and inflation, you are still going to need to generate growth in your portfolio."

Increasingly, de Pourbaix said he was seeing a focus on retirement portfolios that had investment objectives and outcome-based solutions focusing on risk and return.

"While we are now seeing more products available in the market, we need to remember that products being all things to all people, tend to fail. So, it's reassuring that we're beginning to see more fit-for-purpose strategies coming to market."



Best of breed: 2

With 12 sessions available to delegates at the IMAP Portfolio Management conference, there were plenty of opportunities to learn and many topics for attendees to discuss during the day.

Learning the hard way

Paul Saliba and **Justin McLaughlin** share their insights with **Laird Abernethy** on the investment lessons learnt in establishing and running managed accounts in a business.

PARTICIPANTS

Laird Abernethy
Head of Retail Sales, Colonial First State

Paul Saliba
Head of Equities and Portfolio Construction, IOOF

Justin McLaughlin
Chief Investment Officer, Clearview

Laird Abernethy: Provide an overview of your business and how managed accounts are used to implement your firm's investment strategy and philosophy. Please also outline the key investment lessons learnt from running managed accounts.

Paul Saliba: IOOF, through the acquisition of the Shadforth business, brought in its own managed accounts solution. Within the Shadforth business, we run Managed Discretionary Accounts (MDAs) – they're not IMAs or SMAs. They are solutions through a service agreement between the business, the client and the platform provider that provides the technology.

We have two variants of the managed account offering. One is a full service offering, where everything is implemented and internal investment changes get implemented in client accounts in a timely manner.

The other solution is a semi-discretionary account. It still requires a record of advice (ROA) but by using MDA technology available at Colonial First State and BT, it means we have a solution that is between a full MDA and

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a traditional business model, where you provide advice on a regular basis. It has a six-monthly review process but it does require an ROA to be signed off by the client.

This solution is very popular with planners because, to clients, it looks like a traditional advice model – they get an ROA every six months that outlines the performance of their investments and any changes that are being proposed, and the client signs off on it. It's actually a very popular solution.

However, the problem we've found is that it's actually quite clunky when you've got thousands of clients and you're having to generate this centrally within a small team. Having to generate ROAs across a whole range of different risk profiles and portfolios is a very expensive process. More recently, we've implemented an email process to do this. But you've still got to wait for the ROA responses to come back.

So, in terms of what you're trying to achieve from an investment perspective, this process undermines the ability to implement a change when it's required, because invariably, clients are either on holidays or not answering their email or they never received their ROA in the mail.

But our managed account solution is being adopted through a full process that we're slowly rolling out to the rest of the IOOF business. So, with the Bridges business, we were able to identify the types of planners and clients who were more suitable to having their portfolio fully implemented.

There are three important elements that an AFSL is required to fulfil. The first two are to act honestly and efficiently. But the third element is: fairly.

I suggest that the traditional advice model of servicing only those clients based on their wealth or the fees generated, doesn't fulfil the requirement of an AFSL to treat clients fairly.

And so, the managed account solution rolling out through Bridges is being seen in two ways. Firstly, through business efficiency at the practice level, resolving issues around corporate actions in the equity and listed securities space, and providing a full portfolio solution.

Planners are slowly understanding the opportunity that managed accounts provide for their businesses and they are seeing the benefits that come to clients of having portfolios implemented in a timely manner for their particular risk or investment portfolio.

Justin McLaughlin: We run a suite of managed accounts on a couple on in-house platforms – a wrap and a master trust. And we now also have managed accounts on one external wrap, with this probably increasing to another one or two wraps in the near future. I suspect this is an emerging trend, where you can migrate your managed accounts across a range of platforms.

In terms of how we structure things, we have some managed accounts that are done through an older trustee authority, but that's largely an accident of history. The newer managed accounts are under the SMA authority, because we are the responsible entity.

One thing we decided on very early on in the process of using managed accounts was for them to be quite transformational for the financial planning profession. So, our managed accounts are multi-asset class and they're aligned to a planner's standard risk profiles of clients. At the end of the day, we have a managed account that suits the needs of a particular client. We see that as driving a lot of efficiency.

You can have managed accounts that are standalone equities, and while they work really well, that's only a 20 per cent solution.

We haven't quite gone down the same route as IOOF in terms of semi-discretionary and non-discretionary. We exercise full control over all our managed accounts.

However, the mistake we made initially was we tried to get a bit too granular and offer a number of these to a number of sub-groups within our business, but we have since backed away from that. We worked out that you do need to centralise back to a suite of models and can't get too granular, because the time you spend explaining and servicing multiple iterations just isn't worth it.

In our experience, once planners understand managed accounts, they tend to use them as their default solution. And while managed accounts are not suitable for every client, once a planner starts using them, you do get real engagement from them.

We get about 60 per cent of flows in in-house products into managed accounts, which is fairly high, but there is a lot of work involved in doing that. One of the lessons we learnt quite early in the process was the first thing you need to do is convince planners about this mode of investment solution. So, getting the investments right first is absolutely critical.

And the second thing you have to do is have deep engagement with the planner on the investment side. If you don't do that, you won't get take up of managed accounts.

So, from my experience, it takes about two or three years of fairly intensive effort to go out there, engage with planners and generate acceptance by them for managed accounts.

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LA: What are the key drivers for establishing a managed accounts solution?

PS: The investment solution has to be the right solution. However, there is a potential for planners to fall into the trap of believing they have to agree with every single investment within the portfolio. That's not the case.

It's a bit like when you buy, for example, a Magellan fund or a Fidelity fund; you don't go through the investment and say you agree with every single equity holding in the portfolio.

It's the same with a managed account. You don't necessarily have to agree with every single investment within the portfolio. What it means is that you agree that the investment management team is sufficiently well-structured, staffed and resourced, and has systems and processes in place, to enable it to manage the investment portfolio correctly.

I think that's one of the traps of a managed account. Because clients see each line item of their portfolio, planners feel compelled to agree with every investment.

So, you want an investment solution that gives the planner efficiency and provides clients with the types of outcomes required, but in a way that's better than what traditional advice models offer.

Now, you can do that in a number of ways. You can do that through a multi-asset class investment vehicle – buy a balanced fund or buy a growth fund. So, that is an alternate way of doing the same thing.

However, if you are wanting your client to have a more flexible portfolio, where they get transparency of the underlying investments, then that is a good reason to use managed accounts; where you get efficiency and where investment decisions are implemented at the time when the investment manager wants them implemented. They get the tactical tilt or hedging of currency when the investment manager determines it to be appropriate, which is not as easily achieved through a traditional advice model.

They are the reasons why you would use a managed account solution.

LA: Are there any additional risks or compliance requirements attached to running a managed accounts solution for licensees?

JM: For big institutions, the answer is no, because in a sense, it's just another investment product that sits quite neatly into their compliance regime.

Probably where there is a potential issue is if you are a smaller dealership. You may well use, for example, FirstWrap as your administrative platform, but you still need to recognise that you are responsible for your decisions. So, if you make a mistake, like entering the wrong number or something like that, it can be reflected across, say, 5,000 or 10,000 accounts.

So, if you are going to roll out managed accounts to a number of smaller dealerships, where they really don't have that much experience in running big accounts, it's probably a good idea for the likes of FirstWrap to have the appropriate callbacks, checks and balances in the system to at least reduce the chances of mistakes happening.

But, generally speaking, from a compliance perspective, managed accounts are great.

LA: In terms of portfolio construction in managed accounts, what assets do you typically use and how do you gain exposure to different asset classes?

PS: We do a standalone direct equity portfolio, we do a multi-asset class diversified portfolio managed fund solution, and then we have a combination of the two.

When you're modelling and thinking about portfolios, you're thinking about diversification and you're trying to get a certain level of risk and return.

However, one of the dangers in this scenario is if, for example, you suddenly get a highly concentrated fixed interest solution of direct securities, which is not the same as what you model when you use XPLAN or any other modelling tool.

The danger is if you do that in fixed interest and then you have a direct solution in global equities, that may have 15-30 equities, and then you do that in Aussie equities, all of a sudden, you've got an extremely risky portfolio.

In terms of the fixed interest solution, you have nothing like institutional fixed interest instruments within the portfolio. Instead, you've got hybrid securities. The reality is, you're not delivering what a fixed interest portfolio traditionally looks like. I think that is the danger you take by going down this path of trying to produce a portfolio with a whole lot of direct assets.

By all means, use some of those direct assets but understand the risk and return characteristics that creates, and then blend in other traditional funds to ensure that the portfolio in each asset class bucket is resembling the sort of risk and return characteristics that you model through XPLAN or other tools. I think that is a key to the investment piece.

You need to be aware of the assets, the blending of those assets, and the risk and return characteristics that are the outcome of what's put together. And you need

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governance and oversight around that, which is important in terms of the investments and how you build portfolios.

LA: As a result of introducing managed accounts, has the value proposition of your business tilted more to investment advice, rather than strategic advice around areas like superannuation?

JM: In terms of Clearview, the answer is probably yes, but investments in a fairly focused way, which is asset allocation and manager selection within a small subset of managers. At the moment, we're not doing direct equities. Of course, one of the issues is how much talent and time do you have within your own organisation to do everything.

By internally focusing on our investments, we have got a better partnership/relationship with our clients and planners. And it does refocus the client discussion on the value of advice.

My concern is where you have a three person team doing bonds directly, Aussie equities directly and international equities directly, then that's a big ask for such a small team. You need to be humble about what you can and can't do.

PS: The way in which we deliver managed accounts is that we deliver our communication piece through the planner. Our investment team drafts a quarterly letter that talks about the changes within the portfolio, it talks about performance and talks about what is happening in the broader global market. We deliver that letter to the planner, who then sends it to the client with their own name on it. So, in that way, we don't impinge on how the planner has presented their client value proposition.

Some planners use this as an opportunity to acknowledge with their clients that they are not the investment specialist, and therefore, they can use what we provide them as a way of demonstrating the capability and scale of IOOF.

However, for planners who have traditionally positioned themselves as the investment manager, even though they are not, there's no need for them to articulate anything different. That's because the letter just talks about the client's portfolio and reasons for investment changes. If the planner presents that letter to the client, then they're not really breaking down that traditional value proposition.

From a corporate position, what we're doing is creating an open architecture structure. So, our managed accounts, along with our diversified funds and external solutions, is providing planners with a range of solutions to work with their clients.

JM: It's important to remember that the client still perceives the planner as the person delivering the service. So, one of our learnings is that when we deliver solutions to our planners, our brand is always low key. We're really trying to make sure we have a neutral look and not something that looks product orientated. And sometimes, planners actually do appreciate being able to say to their clients that they have a bigger team supporting them.

However, there are some planners who will cling to being the investment manager, because that's what they perceive their value proposition to be. Personally, I think it's a mistake in the longer term, but that's an evolutionary process they have to go through.

Goals-based advice and managed accounts

Gareth Jakeman and **Thomas Bignill** talk to **Rebecca Jacques** about how to make goals-based advice work with managed accounts.

PARTICIPANTS

Rebecca Jacques
General Manager, Association of Goals Based Advice

Gareth Jakeman
Chairman, Praescius Financial

Thomas Bignill
Managing Director, Mason Stevens

What is goals-based advice?

Rebecca Jacques: Goals-based investing is about the personalisation of investment management. Goals-based advice links a client's individual goals directly to the design of their portfolios, so the likelihood of achieving those goals is improved.

The traditional approach to building a portfolio is to use risk profiling to match a client's investment risk tolerance to a strategic asset allocation benchmark, which by definition is more backwards-looking and static in nature.

Goals-based advice is different. It seeks to look forward – using a more flexible portfolio design methodology and dynamic asset allocation. The primary aim is to achieve a specific outcome or goal. It may be to achieve a real return objective (i.e. above cash or inflation) over a given time period. It may be to manage 'risk' within certain parameters. It may be to ensure that capital is available at a specific point in time by using liability matching or liability driven investing.

Regardless of what the primary driver of a portfolio may be, there is usually a strong focus on downside risk protection. Indeed, there are many ways to provide goals-based advice depending on a client's different circumstances.

Rebecca Jacques: How did you go about implementing goals-based advice into your practice?

Gareth Jakeman: We left a major licensee in July 2016. I no longer wanted to run the type of business I had been operating for the past 15 years. So, when we were thinking about the whole concept of goals-based advice – and every planner does goals-based advice, but in slightly different ways – we started to think about it from a business perspective, and how we could deliver the best execution of our ideas for the benefit of our clients.

Typically, when clients use a planner, they are seeking

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your expertise and naturally assume you are technically competent. So, 30 per cent of the fee you are charging them as a planner is for technical competence, while 70 per cent is for the relationship. But when I thought about what I was doing in our advice business and all the inefficiencies that were in there, it made me think about how I could increase the time I spent on the business to execute best practice ideas.

The reason we rolled out goals-based advice with our managed account offering was partly due to transparency. It certainly allowed us to operate in a multi-currency environment. It was also about being able to make decisions efficiently and quickly, which is why you have a managed accounts solution in the first place.

We had to work out where we had internal capabilities and where we had to outsource. Part of that exercise was talking to Mason Stevens and to leverage some of their internal capabilities, whilst outsourcing to some other managers. We also started an investment committee and put in place a governance process.

So, because we are a small licensee, we needed to outsource some of our capabilities where we didn't have them in-house. That's absolutely essential, because you are looking after clients' money.

Thomas Bignill: And that's important. Outsource if you don't have the in-house capability, and none more so than an investment committee. For managed accounts and goals-based advice, this is where it all starts, whether it be asset allocation or different asset class experiences, or whatever the case may be. To have a well-rounded investment committee is vital, as it enables you to manage from an asset allocation and manager selection basis.

RJ: For many planners going down the path of personalising the investment management process into goals-based investing, how many portfolios should they end up with and is each solution customisable? How did you approach this and what were some of your key learnings?

GJ: Our investment portfolios are divided into managed accounts that deal with a specific risk profile for a specific timeframe. The reason for doing so was twofold.

Firstly, it went to the heart of the way we talk to our clients in a meeting. Planners know that one of the things you talk to a client about is cashflow and how much the client is going to spend over the next 12 months, particularly if they are in the retirement phase. That's money they don't want to take any risk on.

So, we created bucket portfolios. Cash was bucket number one. Low volatility was our second bucket.

The rough science behind this relates to the GFC and not wanting to repeat investment mistakes. As part of our client conversation, we would say: 'We're going to look after your next 12 months' worth of spending in the cash bucket, but then we want to take a separate amount and put it in the low volatility bucket, which is your next four years of spending.'

We actually then take that spending over the next five years and, indeed, over the client's life expectancy. This is netted out for inflation. We then work out how much capital the client will need over that period, and that's how we allocate into the different buckets.

One of the things we wanted to emphasise to clients, particularly coming out of the experience of the GFC, was that from an industry perspective, clients who tended to do better weren't in a position where they needed to sell down good assets at a bad time (i.e. managing sequencing risk). So, one of the very important parts of our offering was being able to actually separate investments and allocate into those buckets, thereby managing sequencing risk. This enabled us to then have ongoing conversations with clients about their goals around specific timeframes.

In our conversations with clients, we talk about things like the amount of capital they want to protect. This includes how much money does the client want to leave to the kids (apart from the house) when they die. This starts you talking about some of the important planning items that really develops the deep hooks of the planner/client relationship, and ensures that the planner has a long-lasting relationship with their client.

So, part of our planner developed managed accounts solution was to make sure that our process was designed in such a way that it incorporated the investment outcome. We were thinking about what was the client experience, what were the hooks that were going to make our client relationship deep and long-lasting, and how do we deliver that in an institutionally robust way.

RJ: How did you go about engaging with your planners to bring them along with you on this goals-based advice journey?

GJ: Along with my business partner, we had our first goals-based advice professional development session with our planners. Their initial reaction was, 'What am I going to do?'. So, here was the first problem; they were thinking about themselves, not the client.

Then we had to go through the process of saying it's not

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"You've also got to make sure that when the provider is telling you – 'Yes, we can do that' – it's not a case of 'sales writing cheques that operations can't cash'. That's really important." **- Gareth Jakeman**

actually that much different to what you've being doing before. But it was a challenging process because, by nature, humans don't like change. So, for some of our planners to change the way they now have their advice conversation with clients, even though it was slightly different, was a challenge.

All up, we've spent about 12 months with this process, which is ongoing. As part of this, we have spent 9-10 months where we really concentrated on educating our planners. And part of this was also getting our planners comfortable with the underlying investments and the bona fides of the investment managers that we have outsourced to.

RJ: How important is the back-office in delivering to your 'buckets' and ensuring that the planners are confident in your process?

GJ: It's very important to understand the ability of your managed accounts provider to execute your investment strategy. And there are different components of that. If you are outsourcing some of the compliance and governance functions, then you need to know how they are going to support you in that regard.

Basically, it gets down to things like: how they press the button and execute the trade, how they deal with currency, and even little things like how much they are going to charge you when you're crossing from A$ to US$. You've got to get down to that underlying detail and understand what you are buying.

You've also got to make sure that when the provider is telling you – 'Yes, we can do that' – it's not a case of 'sales writing cheques that operations can't cash'. That's really important.

TB: When we sat down and sketched out with Gareth and the team and the investment committee about what they wanted to do, there was a strong feeling about having a lot of it being direct – that is, investing across all the different direct underlying assets, where they could.

And of course, if you're investing in SMA models and you have three or four asset classes – international equities, direct fixed income, Australian equities and so forth – you're starting to look at buckets of 100 stocks. So, as you go across the asset class, you need to disseminate what you are going to invest in directly and what managed funds or ETFs you are going to use.

That took a bit of time to do, as we worked this through with the investment committee in respect to the outcomes it wanted.

So, execution is key and it's critical, particularly with such an enormous emphasis on the growth of direct equities and direct international having that live capability.

RJ: What has been your clients' experience rolling out your goals-based advice business?

GJ: The feedback from our planners, once they got comfortable with the whole process of goals-based advice, has been excellent. And the feedback from clients was along the lines of: 'Gareth, we trusted you when you said we were a balanced or a moderate profile, but we didn't actually know what that meant.'

So, when we got down to talking about goals, and we broke it down into those risk profiles, and had a discussion around the amount of volatility they wanted to accept in the portfolio for a specific timeframe, and the outcomes we thought were reasonable over the period we were talking about, they were able to relate to the process a lot more easily. It's easier to have conversations that focus less on the number that's generated based on a 'balance date' for a particular point in time.

We're also able to confidently talk about the income result that our particular portfolios are generating and that's one of the benefits we have as a managed accounts manager, because managed accounts provide us with the visibility, speed of execution and the ability within our mandates to protect our clients when they need to be protected.

So, we designed our offering around client best interest. I would say, make sure you design a really good process around filtering clients from a best interest perspective, with processes that are robust and are not simply a 'cookie-cutter' approach for clients. You really need to make sure there are some strong best interest filters in place that will govern the process.

"You really need to make sure there are some strong best interest filters in place that will govern the process." **- Gareth Jakeman**

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TB: You developed a strong communication strategy, which is critical from a managed accounts perspective, because you've got clients in different buckets. And so, regularly communicating to your clients, whether it's monthly or quarterly or whatever that is, means there are no surprises for them from an investment standpoint. I think that's very important.

GJ: Our communication strategy was also about making sure we didn't overwhelm our clients by providing too much information, too soon. Our clients already trusted us and knew we had their best interest at heart.

One of the potential downsides of managed accounts is that you are giving clients absolute transparency in what's happening, and this can be complicated for the client to understand. So, in terms of information, we didn't want to suddenly go from what we had traditionally provided them with, to an avalanche of detail.

You need to have a very clear communication process for clients around what they are likely to expect. That probably means not providing too much information, too quickly, in terms of what's happening in the underlying portfolios. You don't want to be telling clients the reasons for every single trade that's occurred. That's definitely overkill.

We have started our client communications strategy as half yearly and based on feedback, we will move to quarterly. So, we've started the communication process with less is more.

"To have a well-rounded investment committee is vital, as it enables you to manage from an asset allocation and manager selection basis." **- Thomas Bignill**

Transitioning from model portfolios to an SMA

LUKASZ DE POURBAIX
Chief Investment Officer
Lonsec Investment Solutions

Over the past few years, we have seen a material increase in the interest and take up of managed accounts, such as separately managed accounts (SMAs), by dealer groups and financial advisers.

There are a variety of ways in which financial advisers and dealer groups are implementing SMAs, whether by outsourcing their portfolio solution to a professional external SMA portfolio provider, or establishing their own SMAs under their own brand where they are the model manager.

There are a host of things financial advice firms need to consider when partnering with an external SMA model manager or operating the portfolio internally. Many practices I speak to have opted for what is known as a non-implemented approach, whereby they reference notional portfolios that may be developed by themselves or sourced from an external model portfolio provider, such as an investment consultant.

Under this structure, the financial adviser implements portfolio changes, such as switches and portfolio rebalancing, and issues a record of advice (ROA) to relevant clients.

The decision to go down the path of an SMA is often driven by the desire to make financial advice more efficient and scalable, and SMAs are an effective way of streamlining the portfolio implementation process across a client base and removing ROAs from the process.

CONSIDERATIONS

Whether outsourcing to an external SMA provider or operating an SMA internally, there are some key elements that need to be considered when transitioning to an SMA structure from a notional model approach.

Under an SMA structure, the level of external oversight governing the portfolios is generally more comprehensive, compared to operating a 'paper' model portfolio. SMA portfolios are issued by a platform with oversight of the investments by a responsible entity (RE), which may be the platform provider, an externally appointed RE or, in the case of superannuation, a trustee.

To satisfy the RE or trustee, the model manager needs to demonstrate that they have the relevant policies, processes, resources, governance structures and operational framework to operate the SMA portfolio.

The process will vary from platform to platform, however, as part of the initial due diligence process, the model manager will typically be required to provide extensive documentation covering areas such as policies relating to conflicts of interest management, documentation of the investment process, investment team experience, investment committee charters, and an outline of the operational framework governing the SMA portfolios (this will cover things such as separation of performance reporting functions and model management, as well as portfolio trade implementation).

In addition to documentation, the platform may also conduct a face-to-face model manager review meeting, which is akin to a research process, and covers things such as team, investment philosophy and process, risk management, portfolio construction, and performance. There are also ongoing reporting requirements by the platforms which form part of their ongoing oversight process.

Having a documented investment process is critical to operating any portfolio, be it a model portfolio, an SMA or a managed fund. As outlined above, SMA model managers need to be able to clearly articulate their investment process on paper, as well as providing evidence of adhering to and executing the process as part of the platform due diligence process.

INVESTMENT PHILOSOPHY

The investment philosophy is the core of any investment process, as it encapsulates the fundamental investment beliefs of the model manager, which ultimately drive the investment process, including asset allocation, investment selection and portfolio construction.

For example, a model manager may believe that a passive approach is optimal because they believe that markets are generally efficient or conversely, that they believe in active management because they believe markets or individual securities may be mispriced by the market at certain points in the cycle.

Irrespective of the approach, the investment philosophy needs to be clear and consistently applied at every stage through to portfolio implementation.

The investment philosophy should also feature in the investment committee charter, which is the document that outlines how the investment committee functions. The investment committee forms the core of the investment governance framework supporting an SMA portfolio program.

INVESTMENT COMMITTEE

There is no one-size-fits-all approach to constructing an investment committee. In our experience, investment committees operate well when they are well chaired, run to a clear agenda, made up of experienced individuals with complementary skill sets, underpinned by a clear investment philosophy and process, and include members from outside the organisation.

Once again, having a clear philosophy and process is important as it provides focus to the investment committee and sets out a clear framework within which committee members can make their investment recommendations.

The ideal number of committee members will vary from organisation to organisation. Ultimately, it is about ensuring that the committee is effective in its decision-making and that each member is contributing. It is also good practice to review the composition of the investment committee on an ongoing basis to ensure it remains effective.

VALUE PROPOSITION

The decision whether to operate an SMA in-house or outsource the model management to an external provider will fundamentally be driven by what an advisory business' value proposition is to their clients and what their core competencies are.

For financial planning practices conducting their own due diligence on an SMA model manager, the criteria outlined above will provide a solid guide. However, a good starting point is to determine whether there is an alignment in investment philosophy between the model manager and the financial advice practice, as the investment process and ultimate portfolio outcomes will be driven by the investment philosophy.

For advice groups looking to go down the path of managing their own SMA, conducting a gap analysis of your internal capabilities and resources is also a good starting point.

Lukasz de Pourbaix is the Chief Investment Officer at Lonsec Investment Solutions.

Upcoming Events

SEPTEMBER

WHAT TO LOOK FOR IN AN SMA: A MANAGER'S PERSPECTIVE

When: Wednesday 13 September – 12:30pm (AEST)

Where: This is a free webinar, sponsored by **IOOF**.

Description: 'What to look for in an SMA: A manager's perspective' is presented by Roger Walling from Ralton Asset Management. This webinar will explore the process that an investment manager undertakes when selecting an SMA.

OCTOBER

INVESTMENT FORUM

When: Monday 30 October – 4:30pm-6:00pm (AEST)

Where: Concurrent video conference

- Sydney, Macquarie offices – Level 10, 50 Martin Place
- Brisbane, Macquarie offices – Level 7, 825 Ann Street, Fortitude Valley
- Melbourne, Macquarie offices – Level 23, 101 Collins Street
- Perth, Macquarie offices – 235 St Georges Terrace

Description: IMAP's Investment Forum is a community of interest for dealer group researchers, investment teams and independent researchers, that provides a chance to listen to experts and those in other advice practices on the practical issues involved in implementing managed accounts in your advice business.

The 30 October forum will feature two presentations:

- **Portfolio Constuction in Direct Equity Portfolios:** James Louw from Morningstar talks about how to put together professional portfolios of directly listed shares.
- **The DFS Investment Apoproach:** Stephen Romic of DFS Portfolio Solutions, a Melbourbe-based advice business with over a decade of using managed accounts, talks about the benefits they have achieved.

This forum is your opportunity to share the experiences of other dealer investment teams moving into managed accounts.

The presentation will be followed by refreshments.

DECEMBER

INVESTTECH 2017

When: Tuesday 5 December

Where: Dockside Conference Centre, Cockle Bay Wharf, Darling Park, Sydney

Description: This full day event highlights the central role technology is playing in the development of managed accounts and the transformation of advice.

InvestTech 2017 provides a showcase for platforms and portfolio management technology providers and the connectivity between investors, advisers, managers, administrators and brokers. InvestTech 2017 will feature a unique `quick-fire' presentation style, framed around a common market structure concept. This is supported by an expo area for participants.

New technology solutions are central to the growth in managed accounts.

Emerging portfolio management technology on platforms and in adviser and investment managers' offices allows:

- Efficient portfolio management of many client accounts across many investment strategies;
- Control of how investment management decisions are implemented;
- Efficient trading and equity among investors when rebalancing and adjusting portfolios;
- Compliance management; and
- Connectivity between managers, platforms, custodians and advisers

This inaugural event will be held in Sydney at Docksoide, Cockle Bay Wharf, Sydney on December 5.

Who should attend:

- Adviser principals and management team members with technology responsibility;
- Investment managers;
- MDA providers:
- Advice groups undertaking their own portfolio management;
- Platforms:
- Custodians;
- Family offices; and
- Brokers.

For more information on these events to register your attendance, go to imap.asn.au/events

IMAP hosts leading managed account educational events, including webinars for dealer principals, advisers, advice roadshows, practitioner forums and the Responsible Manager Masterclass. For more information, go to imap.asn.au

PERSPECTIVES

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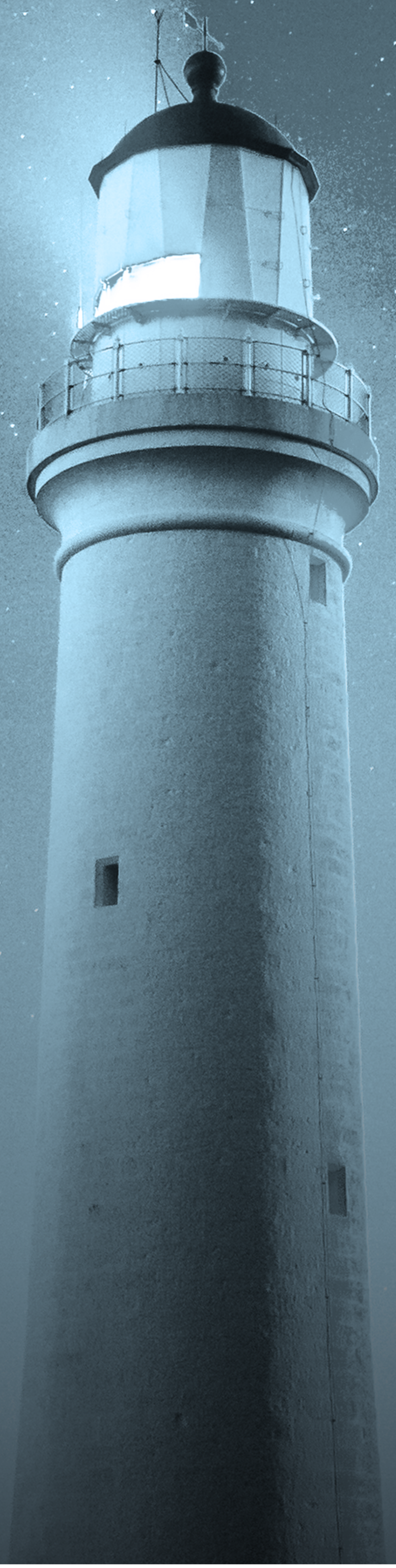

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IMAP

Institute of Managed Account Professionals