MANAGED ACCOUNT

PERSPECTIVES

ONWARDS AND UPWARDS

KELLY POWER AND THE FUTURE OF ADVICE

ALSO: ROYAL COMMISSION REVIEW / ADVISER ROADSHOW 2019 / MARKET RISKS / MARKETING MANAGED ACCOUNTS / FINTECH AND YOUR BUSINESS

VOLUME 3 ISSUE 1 AUTUMN 2019

We help financial services businesses manage their regulatory, corporate and commercial challenges.

Another year, another ASIC enquiry. Hot off the heels of the Royal Commission, surveys, benchmarks and information gathering by ASIC's Wraps & Platforms Taskforce will shine an unprecedented spotlight on the managed accounts ecosystem in 2019.

Key issues for managed account providers, advisers and platforms in 2019 include:

- Client engagement and renewals
- Fee and remuneration models
- Independence disclosures
- Best interests duty and client priority rule
- Product design and distribution obligations
- Product replacement recommendations

Speak to The Fold today about how we can help future proof your managed account business.

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IMAP

PERSPECTIVES

REGULAR

4 Chair's message
6 News
9 Investment Forum
39 Events

FEATURE

17 **Moving to the mainstream**
With modern technology, high quality governance and well-structured investment models, managed accounts could fast become the default option for high quality advice practices around Australia, says **Thomas Bignill**.

24 **Onwards and upwards**
For **Kelly Power**, the last 18 months have been a challenging time for the industry, but now that the Royal Commission's recommendations are in, it's time to move forward. **Jayson Forrest** reports.

27 **The Kodak moment for fintech**
Whether it's fintech or techfin, both sectors place severe pressure on traditional businesses in the financial services industry. Ignore them at your peril, writes **Gihan Perera**.

29 **Adviser Roadshow 2019**
How will financial advice and services stand up in a post Royal Commission world?

30 **Market risks: the unknown unknowns**
Steven Tang and **Matthew Cho** consider the investment outlook for 2019 and the possible risks that could sideswipe markets.

34 **Marketing a new managed accounts program**
When implementing a new managed accounts program, there are a number of steps required to effectively communicate and market this program to planners and clients, says **Toby Potter**.

24

17

27

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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SUSTAINABLE ADVICE BUSINESSES BUILT AROUND MANAGED ACCOUNTS

It's been a month since the Royal Commission handed down its final report and thousands of words have been written on the potential impact of those recommendations on the conduct of advice.

With a clearer view, it's time to think about the viable business models that might emerge as the dust settles. And - given this is IMAP – how does this affect the use and form of managed accounts?

Firstly, and most importantly, the key influences on successful advice models weren't the Royal Commission's recommendations directly. In my view, the key factors that will determine what a successful advice business looks like will be:

- FOFA – old news but really impacting on business design, as payments between participants kicks in; and
- ASIC's response to the Royal Commission. This is all about how ASIC interprets its mandate to ensure the integrity of advice and good investor outcomes.

What is likely to occur will be the combined impact of the following three factors on the way in which financial advice is delivered to investors.

- Product issuers – from industry funds through to fund managers – will continue to have substantial resources to deploy all the traditional marketing techniques to oversimplify investment decision-making and diminish the role of advice.
- Revenue models will need to be precisely aligned to the clarity of the service offering.
- Flowing from this, vertical integration will continue to be an inescapable part of the advice model, as advice businesses use managed accounts as a key tool for implementing the investment component of their advice.

But like all financial products, creating and managing managed accounts is neither simple nor without cost. Creating managed account programs in a way which both delivers the client outcomes promised and also creates the efficiencies that make advice an effective and scalable business, needs scale and a set of professional skills equivalent to creating managed funds.

What does this mean for the sustainability of advice business models over the medium-term?

At the licensee level, we see three business models that will survive:

1. Smaller, self-licensed practices will base their business model on their personal capacity to engage and service clients. They will partner with managed account providers, and portfolios may reflect the adviser's philosophy or may be drawn from the menu that the managed account provider offers. The cost to client is likely to be where each element of the service is priced separately.
2. Multi adviser groups, which seek to support advisers who are essentially running individual businesses, will need to offer broad, competitively priced managed account programs as part of a menu of approved options, along with coherent information and client engagement. Portfolio management costs are likely to reflect the scale they can achieve with underlying managers.
3. Large organisations with 'natural' client bases will rely primarily on salaried advisers providing advice on in-house products, including managed accounts. While they bring substantial resources to the task, they also have to contend with the diseconomies of scale that are often associated with institutions. However, they will have more pricing flexibility, as more of the service is likely to be created and executed internally.

The challenges each business model faces will reflect the way they need to allocate resources between the tasks of finding and serving clients. And then, to ensure they meet their clients' expectations, the resources they are able to bring to the task of delivering a managed account service that lives up to the expectations they create.

Toby Potter
Chair

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Peter Chun

MANAGED ACCOUNTS SIGNIFICANTLY IMPROVE FINANCIAL ADVICE SERVICES

Managed accounts are driving better client engagement and improving the delivery of financial advice, according to the findings in a whitepaper released by Colonial First State.

In releasing the whitepaper, the General Manager Distribution for Colonial First State, Peter Chun, said: "Our whitepaper, *Managed Accounts: Building your future business*, takes what we know anecdotally and provides insights and clear data into how managed accounts are supporting the evolution of advice practices.

"The whitepaper shows that advisers who use managed accounts are reporting reduced manual administration, more regular communication with their clients, and improved risk controls in managing client portfolios."

As a result, Chun said these advisers also report having more time to spend with their clients, have higher levels of client engagement, and are achieving better business outcomes.

Some of the key findings of the whitepaper include:

- 87 per cent of managed account users surveyed reported reduced administration within their business;
- 73 per cent benefit from improved client engagement;
- 73 per cent report improved client investment outcomes;
- 70 per cent benefit from improved risk control of client portfolios; and
- on average, advisers using managed accounts are spending approximately 23 per cent more time in client appointments each week.

The analysis for the Colonial First State whitepaper was conducted by Business Health, with insights from the IMAP Business Health Check diagnostic tool. It covered 30 managed account practices benchmarked against 226 financial advisory firms and 45,000 clients.

According to Terry Bell from Business Health, the key benefit of managed accounts is in improved client engagement.

"Financial planning practices using managed accounts are now able to spend more time with their clients, whether it be through face-to-face meetings or simply communication touch points. This results in higher levels of client retention," he said.

"It's also clear from the research that these benefits accelerate over time as managed accounts are embedded into an advice practice."

Recep Peker

AUSSIE INVESTORS BEARISH FOR 2019

Australian retail investors ended 2018 with a bearish market outlook. As at December 2018, investors on average expect the All Ordinaries Index to grow by +0.3 per cent over the course of the next 12 months, excluding dividends.

According to research firm, Investment Trends, these expectations are well below what the market saw at the end of 2017, where investors expected capital gains of +4.8 per cent for calendar year 2018.

"Q4 2018 stands out as investors' most bearish quarter since the GFC, with the average investor closing the year expecting no capital gains from domestic shares in 2019," said the Research Director at Investment Trends, Recep Peker. "Despite this, they still believe in the income potential of Aussie shares, expecting a yield of 4.1 per cent over the next 12 months."

Peker was referring to the results of Investment Trends December 2018 Investor Intentions Index, which found that investors' return expectations were being dragged down by their mounting concerns with the current state of the world's financial markets.

According to Peker, on a scale of 0 to 10, where 10 is 'extremely concerned', the latest readings placed the average investor concern level at 6.6 – the highest level since February 2012.

When asked what they were most concerned about, top of mind for investors was tension between the world's major economies (cited by 55 per cent, up from 40 per cent in October), followed by the current White House administration (53 per cent, up from 46 per cent) and a slowdown in China's economy (41 per cent, up from 32 per cent).

From a domestic perspective, 30 per cent of respondents were worried about property prices, on par with concerns of share market volatility.

"The last few months has seen investors take an increasingly global perspective when considering what factors may affect their portfolios. Recent market falls have helped confirm their fears, dragging down the

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average investor's outlook for 2019," Peker said.

"However, where some are fearful, others see opportunity, with nearly a quarter expecting strong returns from domestic equities in 2019."

The Investment Trends December 2018 Investor Intentions Index results are based on monthly surveys, which were answered by 2,195 Australian investors over the last 12 months.

BT EXPANDS MANAGED ACCOUNTS OFFERING

Rodney Greenhalgh

BT has launched six active diversified managed portfolios, which are available on BT Panorama Open and Compact menus as part of its CoreSeries portfolios.

According to BT Head of Investment Product, Rodney Greenhalgh, CoreSeries is structured as a separately managed account (SMA), offering portfolio transparency, trading efficiencies, and a straightforward fee structure.

Greenhalgh said BT had seen very strong growth in managed accounts on BT Panorama, with a 121 per cent increase in funds under administration (FUA) for the 12 months to 30 November 2018. More than 15 per cent of FUA on BT Panorama is now invested in managed accounts.

"CoreSeries offers advisers and their retail clients access to a range of high quality investment managers with several strategies not otherwise available in Australia to retail investors," he said. "We have utilised our institutional portfolio construction capabilities and scale to deliver a purpose built SMA with a range of benefits to our clients and their advisers."

According to the Investment Trends May 2018 Planner Technology Report, when selecting between features, cost and support as drivers for platform selection, advisers rate support as the most important driver, with 50 per cent of advisers citing this.

"Adviser support is a key focus of CoreSeries, with advisers having access to a dedicated support team of investment specialists, as well as comprehensive reporting, research and tools. This includes access to a comprehensive self-service web portal containing regular reporting, commentary and insights," Greenhalgh said.

BT Panorama currently provides a broad managed accounts offering, with more than 100 managed portfolios across 20 investment managers. In June 2018, BT added three Australian equity portfolios managed by Antares, Lonsec and Pendal, and six new diversified portfolios managed by Morningstar.

The CoreSeries Portfolios are now available and BT intends to add more than 20 other managed accounts to BT Panorama in the next 12 months.

Designed to meet the core investment needs of a wide range of clients, Greenhalgh said the CoreSeries caters to different risk profiles, with no portfolio level investment management fees and a low underlying management fee between 50bps and 78bps, with the balanced option at 68bps.

SMAS ON MACQUARIE WRAP TOP $2 BILLION

Cameron Garrett

Separately managed accounts (SMAs) on the Macquarie Wrap platform have surpassed $2 billion in funds under administration, according to Macquarie Wealth Management's Head of Wealth Product, Cameron Garrett.

Garrett said the rapid increase in SMA funds under administration, which has doubled over the past year, demonstrated the continued growth in popularity of SMAs.

"We're continuing to invest in our wrap platform and are ensuring that we have a diverse range of investment options and products for advisers and their clients. This, combined with Macquarie Wrap's technology, scale and security, means we are at the forefront of the platform market," Garrett said.

"The structure of SMAs means that advisers and clients have greater transparency and control when managing their portfolios. SMAs also provide significant efficiency and functionality gains for advisers, enabling them to have more high value conversations with their clients."

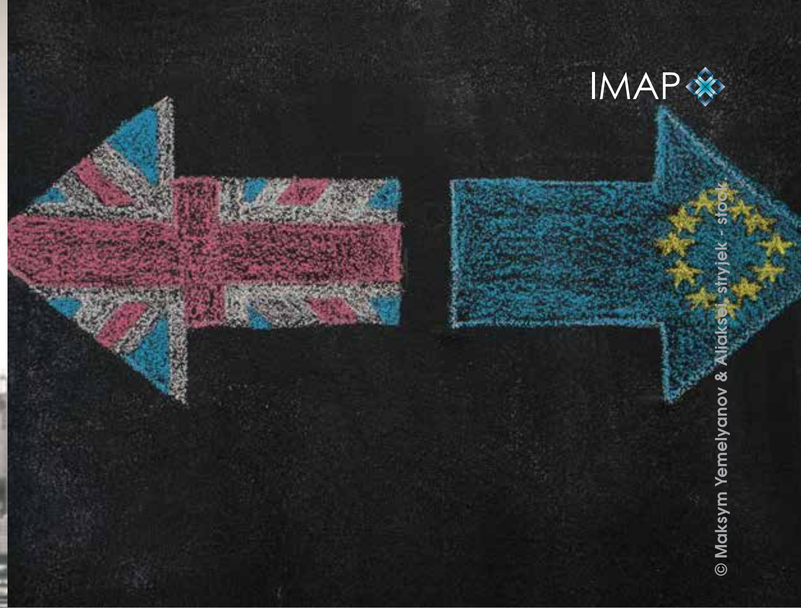
Garrett added: "We're seeing that a larger proportion of flows into the Macquarie Wrap platform are being directed into SMAs, as advisers increasingly appreciate the value these products provide to clients."

Macquarie has over 35 SMA investment managers across more than 150 SMA models, complementing a suite of more than 850 managed funds.

SMSF Managed Accounts Central

From 20-22 February, IMAP rolled out its Managed Accounts Central to industry professionals attending the annual Self Managed Super Fund Association (SMSFA) conference in Melbourne.

Managed accounts are becoming a key tool for advisers to implement their advice recommendations - particularly for the larger portfolios that are common among SMSF investors. Delegates showed great interest in managed accounts, with JBWere, Soteria Capital, Philo Capital Advisers and Watershed Funds Management, all showcasing their capabilities to conference attendees.



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Charles Stodart

Chris Willaton

WHAT DO MARKETS HOLD IN 2019?

With risk aversion spiking in Q4 of 2018 and global markets closing out the year in negative territory, volatility is again increasing, presenting planners and their clients with potentially more investment risks than they have experienced over the past few years.

This was the shared view of Charles Stodart – an Investment Specialist at Zurich Investments, and Akambo Financial Group Director and Head of Investments, Chris Willaton.

Speaking at the IMAP Investment Forum in January, Charles said the market was at the "ebb tide" of the economic cycle, with slow global growth, inflationary surprises, trade escalations, Brexit, benign bond yields and ongoing geopolitical concerns, all risks that investors, advisers and portfolio managers must carefully consider throughout 2019.

The Fed has indicated that it is essentially on hold this year with rate rises, but I think this is optimistic. Given the strong growth in jobs and wages, I believe the Fed is likely to hike interest rates once or maybe twice this year. – CHARLES STODART

"According to the IMF, global growth expectations will moderate in 2019 to 3.5 per cent, with GDP growth forecast for the U.S. at 2.5 per cent, the European Union at 1.6 per cent, China at 6.2 per cent and Australia at 2.8 per cent," Charles said.

Specifically, Charles believed when it came to portfolio construction, there were six key issues that portfolio managers should pay closer attention to throughout the year. These are:

1. What path will the Federal Reserve take?

According to Charles, the key fundamentals for continued growth in the U.S. was good, with employment strong and wage growth hitting 3.2 per cent. However, with inflation starting to rise in the U.S., the Fed was becoming less accomodating to holding interest rates.

"The Fed has indicated that it is essentially on hold this year with rate rises, but I think this is optimistic," Charles said. "Given the strong growth in jobs and wages, I believe the Fed is likely to hike interest rates once or maybe twice this year."

2. What is the price of money?

While the European Central Bank, Bank of England, Bank of Japan and the Reserve Bank of Australia were likely to hold their official cash rates throughout 2019, the U.S. Federal Reserve may be forced to raise its cash rate to deal with increasing inflationary pressures on the economy.

3. Earnings growth slowing

Charles believed that the continued pressure on wages growth would put additional pressure on companies to deliver real increases in wages. As a result, he said company earnings were likely to slow down this year.

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4. How quickly will China's GDP growth slow in 2019?
With China still recording an impressive growth rate of about 6 per cent, Charles said the Chinese Government was seeking to re-stimulate its economic growth back into double digits.

"But that's a big ask," Charles said. "At some point in time, projects that the Chinese Government invests in need to be economical and show some profit. And there's no doubt that the U.S.-China trade war has been damaging to China.

"Based on these factors, I believe China's GDP growth will likely stay around 6 per cent."

5. What's in store for Australia?
Charles said there were many factors affecting the local market that portfolio managers needed to consider in their portfolio construction. These included:

- The fallout from the Hayne Royal Commission, including its recommendations for the industry;
- Banks tightening their lending criteria, which has already been felt in the housing market;
- The outcome of the upcoming Federal election, and the implications that a Labor victory might have on investment policy, like negative gearing and franking credits.

"These are the types of issues portfolio managers and investors need to think about," Charles said. "Banks have forecasted falls in housing prices of 10 per cent, whereas others think this is more likely to be in the order of 20 per cent. And while Australia's unemployment rate is very good at 5 per cent, nonetheless, I feel the first six months of 2019 will be difficult from a GDP perspective for Australia."

Banks have forecasted falls in housing prices of 10 per cent, whereas others think this is more likely to be in the order of 20 per cent. And while Australia's unemployment rate is very good at 5 per cent, nonetheless, I feel the first six months of 2019 will be difficult from a GDP perspective for Australia. – CHARLES STODART

6. Geopolitics
Charles emphasised the importance that geopolitical events can have on the global economy, and believed there were four in particular that currently stood out for Australia. They were:

- The recent **U.S. Government** shut down pitted President Trump's will against Congress, which highlighted the difficulty Trump may have working with a Democrat majority Congress.
- The **U.S.-China trade war** is continuing to negatively impact market confidence.
- **Brexit** has created a lot of uncertainty, both at a political and economic level.
- **President Trump** remains a wildcard on the global stage. His unpredictability and volatility is unsettling for markets and global confidence.

What's in store for 2019

Akambo Financial Group Director and Head of Investments, Chris Willaton agreed with Charles' six key issues currently dominating the market from a portfolio management perspective.

And while agreeing that increased volatility will be a feature of the market throughout 2019, Chris outlined his seven trends for the Australian market. They were:

- There are opportunities in equities, but be selective;
- Expectations for risk asset re-set;
- The importance of an active approach to manage risk-reward;
- Low absolute returns from bonds and cash;
- Expect more volatility as the investment cycle matures;
- Heightened volatility means more investment turnover; and
- The Australian regulatory landscape will change.

The IMAP Investment Forum is a community of interest for dealer group researchers, investment teams and independent researchers, where they can hear and learn from specialist portfolio managers and chief investment officers of advisory businesses. These experts and advisory professionals provide their insights on the practical issues involved in implementing managed accounts in an advice business.

Royal Commission offers blueprint for reform

Perspectives provides a round-up of the key recommendations in the Final Report of the Royal Commission into *Misconduct in the Banking, Superannuation and Financial Services Industry.* This analysis concentrates specifically on the impact the recommendations will have on the financial advice sector in relation to managed accounts.

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After 68 days of hearings, 130 witnesses and over 10,000 public submissions, the Royal Commission into *Misconduct in the Banking, Superannuation and Financial Services Industry* officially released its final recommendations to the public on 4 February 2019.

The IMAP Regulatory Group met two days later to review the Royal Commission's Final Report, with an emphasis on how the 76 recommendations handed down by Commissioner Kenneth Hayne will impact the managed accounts sector.

Some of the key takeouts emanating from the Royal Commission recommendations include:

- annual opt-in advice provisions;
- disclosure of 'independence' in the advice process;
- the removal of grandfathering provisions;
- a new disciplinary system for financial advisers; and
- no structural separation of product and advice.

Structural separation

Before dealing with the impact of the individual recommendations on advisers or managed account providers, IMAP believes that the Royal Commission's treatment of 'structural separation' should be considered.

Throughout the Royal Commission, Hayne stated that the most obvious conflicts of interest affecting the provision of financial advice were the conflicts between an adviser's duty and his/her financial interests, although he accepted they were not the only conflicts.

In fact, in the Royal Commission's Interim Report, Hayne asked: "How far can, and how far should, there be a separation between providing financial advice and manufacture or sale of financial products?"

He suggested three models for separation:

- Requiring all advisers to be 'independent', as defined by section 923A(2) of the *Corporations Act*;
- Requiring separation between any AFSL holder authorised to issue financial products and any AFSL holder authorised to provide financial product advice; and
- Banning any adviser who is not an 'independent' adviser from recommending a related party product.

Clearly, had the Government accepted any recommendation from Hayne on any of these, there would have been a significant impact on any advice firm that was also a managed account provider or had a financial or other interest in a managed account service.

Hayne observed no one, including ASIC, supported the enforced separation of product and advice; and the changes already underway with the industry, including improved education standards, disciplinary procedures, and the sale by large banks of their wealth management divisions, would achieve the desired effect.

He added: "Enforced separation of product and advice would be a very large step to take. It would be both costly and disruptive. I cannot say that the benefits of requiring separation would outweigh the costs… (or) likely to prove an effective regulatory response to competition concerns in the financial system."

However, this issue is likely to be revisited on a five yearly basis by the Australian Competition and Consumer Commission (ACCC).

IMAP believes there is an excellent case for a more

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nuanced approach to statements about independence. An adviser could be "not independent, impartial and unbiased" in regard to the managed account service – for example, because their licensee acts as a portfolio manager – but "independent, impartial and unbiased" in regard to any of the investments which it might contain.

Following each applicable Royal Commission recommendation is IMAP's position.

Ongoing fee arrangements

Recommendation 2.1 – Annual renewal and payment

'Ongoing fee arrangements (whenever made):

- *must be renewed annually by the client;*
- *must record in writing each year the services that the client will be entitled to receive and the total of the fees that are to be charged; and*
- *may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement.'*

IMAP: This recommendation should only have a minor impact for existing full advice clients, who will now have to opt-in annually instead of biennially. This opt-in provision will typically be covered off at the annual client review.

MDA providers or platforms offering SMAs that include fee deduction as part of their administrative service, are likely to be more vigilant about client authorisations for ongoing advice fees.

Lack of independence

Recommendation 2.2 – Disclosure of lack of independence

'A financial adviser who would contravene section 923A of the Corporations Act by assuming or using any of the restricted words or expressions identified in section 923A(5) (including 'independent', 'impartial' and 'unbiased') must, before providing personal advice to a retail client, give to the client a written statement explaining simply and concisely why the adviser is not independent, impartial and unbiased.'

IMAP: To conform to this recommendation, IMAP expects that the 'independence statement' will be included in the FSG, as this is provided to the client before personal advice is provided. The issue here is whether clients actually read the FSG to ascertain whether their adviser is independent or not.

IMAP also believes there is an opportunity for ASIC to achieve real clarity about 'independence'. An adviser or licensee may not be independent in relation to the provision of the managed account, but may be considered independent in regard to the investments selected for inclusion, or the platform or administrative service it is offered through.

This would materially assist clients in understanding the potential conflicts in the advice they receive.

Quality of advice review

Recommendation 2.3 – Review of measures to improve the quality of advice

'In three years' time, there should be a review by the Government, in consultation with ASIC, of the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice. The review should preferably be completed by 30 June 2022, but no later than 31 December 2022.

The review should consider whether it is necessary to retain the 'safe harbour' provision in section 961B(2) of the Corporations Act. Unless there is a clear justification for retaining that provision, it should be repealed.'

IMAP: Managed accounts have been an important tool for advisers and licensees to manage the risk of individual investment recommendations, but concentrating the test on the service rather than each individual security.

Best Interest Duty is an issue which all advisers using managed accounts appear to take extremely seriously, and IMAP is aware that many explicitly seek legal advice on this issue to ensure they comply. The removal of the Safe Harbour provision, if enacted, will encourage licensees and advisers to demonstrate an even greater awareness of alternative options considered in the provision of personal advice.

From a managed account provider's perspective, IMAP believes advisers will need help when articulating the benefits of the recommended service, compared to other managed account services, and adviser/client directed investments.

And while demonstrating quality of advice will be beneficial from a managed accounts standpoint, it will require increased training of advisers in relation to the products and services offered by providers.

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Conflicted remuneration

Recommendation 2.4 – Grandfathered commissions

'Grandfathering provisions for conflicted remuneration should be repealed as soon as it's reasonably practicable.'

IMAP: The removal of grandfathering provisions will have a significant impact on many advisers and advice practices relying on traditional advice models. It is unlikely to have any impact on advisers using managed account services.

Recommendation 2.5 – Life risk insurance commissions

'When ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should consider further reducing the cap on commissions in respect of life risk insurance products. Unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.'

IMAP: This is not relevant to managed account services.

Professional discipline of financial advisers

Recommendation 2.7 – Reference checking and information sharing

'All AFSL holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers.'

IMAP: This recommendation should have little additional impact on managed account advisers or providers.

Recommendation 2.8 – Reporting compliance concerns

'All AFSL holders should be required, as a condition of their licence, to report 'serious compliance concerns' about individual financial advisers to ASIC on a quarterly basis.'

IMAP: ASIC needs to properly define what 'serious' means, in order for licensees to decide what compliance concerns are appropriately 'serious' to report to the regulator. This recommendation may affect the amount of training and product knowledge required by advisers to ensure they adhere to their Best Interest Duty obligations.

Interestingly, in respect to advice, one of the key outcomes of the Royal Commission's Final Report is the increase in compliance obligations.

To the extent that managed accounts minimise the likelihood of individual pieces of advice being inappropriate or failing a step-by-step procedure test, then licensees are more likely to prefer a managed account recommendation as being less likely to lead to non-compliance.

Recommendation 2.9 – Misconduct by financial advisers

'All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):

- *make whatever enquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct; and*
- *where there is sufficient information to suggest that an adviser has engaged in misconduct, inform affected clients and remediate those clients promptly.'*

IMAP: This recommendation should have little additional impact on advisers.

Recommendation 2.10 – A new disciplinary system

'The law should be amended to establish a new disciplinary system for financial advisers that:

- *requires all financial advisers who provide personal financial advice to retail clients to be registered;*
- *provides for a single, central, disciplinary body;*
- *requires AFSL holders to report 'serious compliance concerns' to the disciplinary body; and*
- *allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body.'*

IMAP: It's expected that all advisers would be required to join this disciplinary body individually. AFS licensees would still be required to monitor and discipline their advisers, however, this new body would provide an additional layer of oversight, absorbing the disciplinary roles currently undertaken by ASIC, adviser associations and the FASEA code-monitoring bodies.

As yet, no detail has been released about the funding of this new body and whether it will be a cost borne by the Government or industry. However, IMAP expects it will be a cost borne by the industry.

Superannuation trustees' obligations

Recommendation 3.2 – No deducting advice fees from MySuper accounts

'Deduction of any advice fee (other than for intra-fund

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advice) from a MySuper account should be prohibited.'

IMAP: There is likely to be no impact on managed account advisers or providers.

Recommendation 3.3 – Limitations on deducting advice fees from super accounts

'Deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited, unless the requirements about annual renewal, prior written identification of service and provision of the client's express written authority (Recommendation 2.1) are met.'

IMAP: Superannuation trustees are likely to be much more stringent, than has been the case in the past, on the scope of services required to entitle advisers to charge a fee in super.

Because managed account services are precisely investment services, advice fees related to the recommendation, review and ongoing monitoring of the service against the client's goals, would be expected to be allowed under this recommendation.

Hawking super products

Recommendation 3.4 – No hawking

'Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme.'

IMAP: No impact for managed account advisers or providers.

One default super fund

Recommendation 3.5 – One default account

'A person should have only one default super account. To that end, machinery should be developed for 'stapling' a person to a single default account.'

IMAP: No impact for managed account advisers or providers.

Regulators

Recommendation 6.1 – Retain twin peaks

'The 'twin peaks' model of financial regulation should be retained.'

IMAP: No impact for managed account advisers or providers.

Recommendation 6.14 – A new oversight authority

'A new oversight authority for APRA and ASIC, independent of Government, should be established to assess the effectiveness of each regulator in discharging its functions and meeting its statutory objects. The authority should be comprised of three part-time members and staffed by a permanent secretariat. It should be required to report to the Minister at least biennially.'

IMAP: Essentially, this is a regulator to regulate the regulators. A new oversight authority should not impact advisers, unless the Government decides to fund it through an industry levy.

IMAP encouraged by recommendations

While the Royal Commission's Final Report was scathing in many respects of the Australian financial services industry, it offered 76 recommendations as a potential blueprint of reform for the industry, which both sides of politics have agreed to take action on.

Treasurer Josh Frydenberg has announced the Government will act on all 76 recommendations made by the Royal Commission, including specific measures to implement recommendations that relate mostly to banking and insurance issues.

IMAP Chair, Toby Potter also welcomed the report's recommendations, saying they were a "sensible and measured" outcome to dealing with systemic issues within the industry, but added that some of the recommendations were open to interpretation.

"There were many considerations for advisers and providers of managed accounts from the Final Report. It's incredibly positive to see the provision of managed accounts will not be adversely affected as a result of these recommendations. Vertical integration is not banned or structural separation required," Potter said.

"And while existing conflicted remuneration provisions will continue to apply, some advisers will choose to adopt 'completely independent' business models. Others, who have a related party interest in a managed account or any service/product, will need clearer statements of their role and interests, as a result of the 'why we are not independent' statement to clients before giving advice."

IMAP thanks all participants of the IMAP Regulatory Group who took part in analysing the recommendations of the Royal Commission's Final Report.

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KEY RECOMMENDATIONS AT A GLANCE

The following is a summary of the Royal Commission's key recommendations and how they are likely to affect financial advisers and providers of managed accounts.

Table 1: Recommendations at a glance

Royal Commission recommendation	Impact of advisers use of, or likelihood of recommending, managed accounts	Impact on managed account providers
2.1 – Annual renewal and payment of advice fees	• Minor impact for existing full advice clients, who will now have to opt-in annually instead of biennially. No impact on new client acquisition.	• Minor impact, as it aligns with the annual review cycle for MDAs. • Providers more reliant on advisers providing prompt client advice authorisations.
2.2 – Disclosure of lack of independence	• Advisers recommending a managed account service in which they have an interest (financial or otherwise) must clearly set out and disclose they have conflicts and why they recommend this service. • Managed accounts reduce the instances of 'personal advice'. • Notion of independence needs to be carefully considered in the provision of advice.	• Advisers will require assistance in formulating their statement. • Limitations on the ability of advice AFSLs to receive a share of revenue.
2.3 – Review of measures to improve the quality of advice	• Greater need for advisers to demonstrate the consideration of alternatives in the advice process. • Greater need for advisers to conduct their own research. • A preference for outsourcing investment management decisions to avoid the situation where every recommendation is a risk for advisers. • Potentially some impact on the amount of training required for advisers.	• Need to help advisers consider the benefits of the recommended service in relation to other managed account services and relative to advised/client-directed investments. • Positive for managed accounts as risk reducers. • Increased training and CPD requirements.
2.4 – Grandfathered commissions	• Will have a significant impact on many advisers and advice practices. • The transition to a fee-for-service model will need to be made quickly and has the potential to dramatically impact the revenue and value of financial advice businesses. • May lead to more people being unadvised.	• No impact.
2.5 – Life risk insurance commissions	• Currently unclear whether insurance commissions will be abolished entirely or reduced.	• No impact.
2.7 – Reference checking	• Adoption of the Australian Banking Association's reference checking and information sharing protocol to be made compulsory for all AFS licensees.	• No impact.
2.8 – Reporting compliance concerns	• Little expected impact, although it may have a marginal impact on the amount of training and product knowledge required. • ASIC needs to define what 'serious' means in terms of compliance concerns. • Managed accounts less likely to lead to non-compliance issues.	• No impact.

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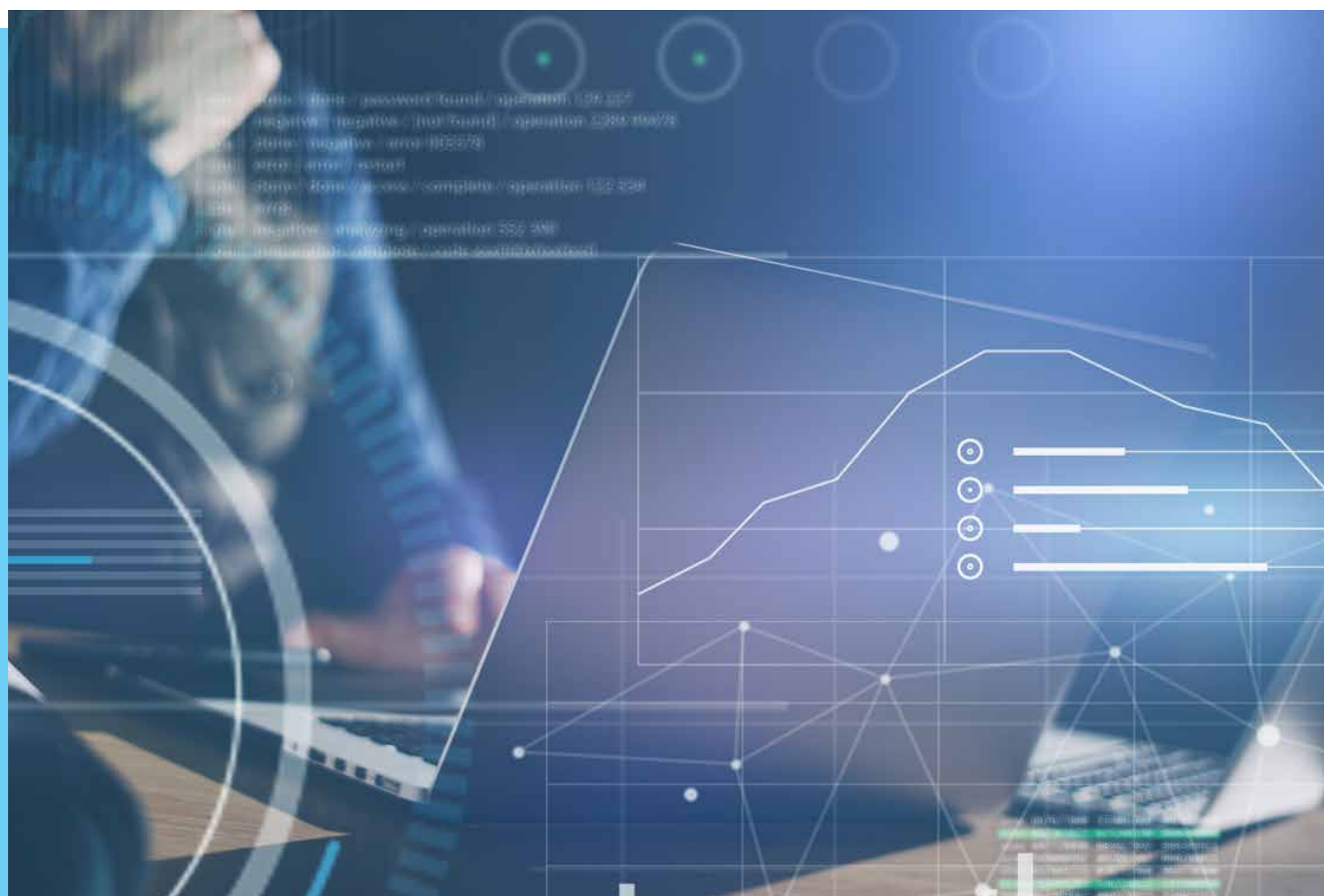
2.9 – Misconduct by financial advisers	• Little expected impact.	• No impact.
2.10 – A new disciplinary system	• Little expected impact. • No details have been released regarding the funding of the new body and whether the cost will be carried by the Government or industry.	• There may be funding costs.
3.2 – No deducting advice fees from MySuper accounts	• No impact.	• No impact.
3.3 – Limitations on deducting advice fees from super accounts	• See comments in 2.1 but in addition, as already applied by some platforms, advice fees may only be deducted for advice related to super. • This might create a significant change that is not limited to managed accounts.	• As generally adopted now, managed account fees are a cost of investment consistent with the sole purpose test.
3.4 – No hawking	• No impact.	• No impact.
3.5 – One default account	• No impact.	• No impact.
6.1 – Retail 'twin peaks'	• No impact.	• No impact.
6.14 – A new oversight authority	• Advisers may be required to fund.	• Providers may be required to fund.



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Moving to the mainstream

With modern technology, high quality governance and well-structured investment models, managed accounts could fast become the default option for high quality advice practices around Australia, says Thomas Bignill.

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THOMAS BIGNILL
Managing Director of Adviser Services
Mason Stevens

The adoption of managed accounts continues to grow, with take-up occurring more broadly than ever before. While some thought pressure on the sector would come post the Hayne Royal Commission report, in reality, the opposite may be playing out.

As advisers increasingly appreciate the benefits of managed accounts for clients, as well as generating practice efficiency and scale, it is arguably fast becoming the default option in managing clients' money.

As the Royal Commission tornado swept through 2018, we were all shocked with the headlines of examples of poor advice and best interest conflicts; the upshot being more regulation, tighter controls and greater scrutiny. These lessons simply reaffirm how a well-constructed managed account service could assist in strengthening your business and value proposition.

From my perspective, the key takeaway on managed accounts that came out of the Royal Commission was around the regulatory environment in which they operate and who is enforcing the various facets of a service.

There is no doubt about the fact that advisers can create their own managed account service for the benefit of the client and the benefit of their business, but how they charge and the governance of how they manage the investments is the critical question.

The governance parameters are clearly aligning between an MDA provider and an RE (responsible entity for managed funds), and most leading managed account services have already had comparable governance structures in place for some time.

What was possibly lost on many people was the global equity market rout in the last quarter of 2018, where global markets crumbled, led by growth concerns, combined with over-valued technology stocks.

This is a clear example of how advisers using managed accounts can take advantage of such weaknesses, with real time changes to portfolios across an entire client base. This may be to either reduce risk in a portfolio or seize investment opportunities as markets rebound. Either from a defensive standpoint or an offensive position within a traditional advice practice, this type of flexibility and nimbleness is hard to replicate.

Tailored

At its core, a well-structured managed account service offers investment choice and diversification for clients, and practice efficiency and scale for advice practices of all sizes.

Driving this change has been a combination of improving technology that allows highly efficient managed account services to be created, and the demands of clients looking for better investment outcomes and more engagement with their advisers.

With financial advice certainly not being a one-size fits all service, and the increasing focus on best interest, a managed account service has the ability to improve advice practices into the future.

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This revolution is in its early days and will be a key feature of successful advice practices as the pace of change accelerates.

Transparent

An increasing focus for investors and regulators is on the level of information that can be easily accessed by investors on their investment portfolios and the degree to which these investments are being managed. Gone are the days of 'set and forget' investment strategies with annual reviews.

A managed account service gives clients beneficial ownership of their investments, with complete visibility of all underlying constituents. A well-structured mandate, with well-articulated governance and decision-making (including all relevant fees and costs disclosure), allows clients to not only view each of their investments, but ultimately helps them appreciate each of the investment opportunities within the overarching mandate objectives.

This can then be linked to the strategic planning objectives of the client, creating the opportunity for a higher quality dialogue between adviser and client, where the conversation moves from a 'backward looking' review of investments, to a forward looking, strategic conversation.

Compliance

A well-structured and rigorous compliance regime is one of the most important considerations for any advice practice. A managed account service underpinned by great technology, can be a way in which high compliance standards are achieved and maintained.

Whether a practice is a small business, or a large multi-office enterprise, a well-thought-out managed account service can be of great benefit.

Having a consistent investment methodology, a robust investment governance framework for decision-making, and a variety of investment solutions for clients, is a compelling risk management tool for compliance functions.

Add to this, the ability to have investment decisions implemented in real time, plus full underlying visibility of all client investments, means compliance functions have the opportunity to ensure high practice compliance standards.

For the practitioner, this framework is scalable, efficient and effective.

> A well-structured managed account service offers investment choice and diversification for clients, and practice efficiency and scale for advice practices of all sizes.

Scalable

A modern managed accounts service offers significant scalability benefits for practices of all sizes, without compromising the ability to offer bespoke solutions and tailored outcomes for a range of clients.

The efficient and streamlined process that underpins a modern managed accounts strategy means the adviser spends less time on day-to-day administration, and more time creating value for existing clients, and developing relationships with prospective clients and referral partners.

Expertise

An effective managed accounts service built on leading technology, allows advice practices, and therefore clients, to access the benefits of experts within asset allocation and underlying investment markets. With investment decisions able to be implemented in real time for all clients, the ability to leverage this expertise is unparalleled.

Accessing this expertise is best done through a formal investment committee structure that articulates the framework through which this expertise is delivered. Asset allocation specialists, investment models and underlying investment managers, should all form part of the regular investment committee decision-making process, which can be documented and recorded for later reference.

By accessing experts in this way, advice practices can focus on what they do best, which is the provision of high quality financial planning advice.

Conclusion

There are many benefits for both clients and advice professionals in implementing a managed accounts service. With modern technology, high quality governance and well-structured investment models, managed accounts could fast become the default option for high quality advice practices around Australia.

Thomas Bignill is Managing Director of Adviser Services at Mason Stevens.

IMAP

Closing in on data standards

Robert Corben provides the latest update on the IMAP Data Standards Group, including the work being done on performance standards.

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Robert Corben

With the rapid growth of managed accounts in the financial services Industry, model data is being electronically distributed between all participants. However, currently no standard is in place for the definition or format of this data.

While platforms and other managed account structures have developed proprietary approaches to the provision of model data to them, investment managers report finding it difficult to meet these varying data requirements.

These challenges will only increase as the number of managed account services increases.

Other industries have already developed standard data transfer formats, with planning software being an example of widespread adoption of a single industry wide standard.

Since managed accounts are still a relatively new market, this seems the right time to establish a common standard.

IMAP has convened a representative working group from interested parties in order to deliver efficiencies to the industry. Representatives from approximately 21 organisations have been participating in meetings, have supplied relevant information and documentation, and have been actively reviewing working papers from this IMAP initiative. Each member of the working group is able to ensure that the business use of model data within their organisation is considered in the development of the standard.

While the standard will not be binding, it will provide a useful incentive to prevent further proliferation in proprietary specifications.

Objective

The objective of the Data Standards Working Group is to gain agreement from key industry participants – including platforms, research providers, investment managers and technology providers – of common data specifications and processes relating to managed accounts.

January 2019 status

Data Standard

The working group has reviewed the latest round of changes for the data standard. The working group is in agreement that we are now ready to move into specification development.

A version 1 specification is currently being drafted and will be presented to the working group in our next general meeting. This is currently scheduled for early February 2019.

Performance Standard

A number of participants in our data standards group expressed a desire to meet to discuss the benefits of collaborating on performance standards. The framework (objectives) of this is currently quite open and we are looking for the group to formulate the objectives, with IMAP being the facilitator. Currently, there is a lot of feedback around defining objectives relating to the platform implementation of models.

A formal request for participants has been forwarded to IMAP's wider industry partners. The initial working party should consist of 6-8 firms. These span investment managers, investment platforms and research houses.

Confirmation of the participants and the working group's objectives, will be announced in February 2019.

Robert Corben is the co-ordinator of the IMAP Data Standards Group.

Regulatory Group in key discussions

The Chair of the IMAP regulatory Group, Adam Seccombe, provides a review of the work done by the group and looks ahead at the work to be completed.

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The IMAP Regulatory Group was established in the second half of 2019 with its purpose and goals as follows:

i) Deliver on the aspirations of IMAP regarding its core intention of 'representation' for the managed accounts sector; and

ii) Provide a key forum for IMAP corporate members to have regulatory issues properly identified and prioritised.

Membership of the group is nationwide and includes a range of specialised compliance, legal and commercial skill sets that has enabled the group to discuss a broad range of regulatory issues that currently affect retail managed accounts in Australia. Our considerations have typically included the perspectives of managed account issuers, their suppliers, financial advisers and their clients.

In its first four months of existence, the IMAP Regulatory Group has convened three times, and also visited with ASIC twice. Foremost in the issues for discussion by the group have been: disclosure documentation, the ASIC Managed Accounts Project, and the Royal Commission.

Following is a review of these three key discussion areas.

IMAP Regulatory Group members

At the beginning of 2019, the IMAP Regulatory Group comprises of:

- Adam Seccombe – Chair
- Toby Potter – IMAP
- Mark Oliver – Macquarie
- Jesse Vermiglio – Holley Nethercote
- Claire Wivell Plater – The Fold Legal
- Mat Walker – Praemium
- Stewart Chandler – AFSL Compliance

Disclosure Documentation

1. RG 179: For MDA providers since October 2017 and for those relinquishing the former 'LMDA' conditions, since October 2018, it has become well recognised how difficult it is to both meet all the new obligations for MDAs in a manner that is 'clear, concise and effective'.

ASIC has been sympathetic to these difficulties and the workarounds that some members have adopted, but it has not been willing to revisit the legislative instrument nor the regulatory guide. Our understanding is that this may get included with the outcomes of the ASIC Managed Accounts Project (see below).

2. RG 97 and CP 308: Following the changes made under the Stronger Super Reforms in 2013 and the modifications to the Corporations Act Schedule 10 (CO 14/1252), ASIC released the draft RG 97 in 2014, to become effective 1 February 2017. However, ever since this time, industry reaction has been strong, with criticisms about complexity, cost of implementation, not meeting consumers needs and so forth.

In November 2017, an independent report was commissioned (REP581). This involved a round of industry feedback and consultation sessions. Subsequently, the independent consultant, Darren McShane, made 34 recommendations.

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ASIC has now considered which of these recommendations it wants to adopt and what additional steps it intends to take. In proposing to reissue RG 97, CP 308 is now seeking to validate its reaction to the recommendations, with responses due by 2 April 2019.

IMAP will shortly convene an open webinar session, where members of the IMAP Regulatory Group will summarise the key impacts of this. We will then seek feedback as to whether IMAP members have a need for IMAP to compile a response.

ASIC Managed Account Project

As foreshadowed in ASIC's Corporate Plan 2018-2022, on page 21 in the section titled 'Action 2018-19', ASIC is initiating a new project on managed accounts.

ASIC has noticed the significant growth in the managed accounts sector and expects this to continue, with managed accounts becoming mainstream in Australia.

ASIC is now in the process of undertaking research and engagement regarding managed accounts. The scope of the project will be broad and encompass platforms, advisers and managed account issuers, including SMAs, MDAs and IDPS'.

A research survey to advisers has been conducted, along with a benchmarking study into functionality and comparative advantages of platforms. Several platform operators were issued notices in December 2018 to gather specific information that will encompass a review of the types of structure, fees, risks and conflicts of interest, and how these are managed, as well as other relevant issues.

In early 2019, another group, comprising advisers, will be approached by ASIC to gain insights into conduct across the ecosystem of advice development and delivery relating to managed accounts. ASIC will also ask for client files that illustrate live examples.

ASIC has three objectives in this initiative:

1. Surveillance may identify harms or concerns, in which case ASIC will take action.
2. Awareness of such potential harms or concerns will be raised.
3. A high level review of the regulatory landscape for managed accounts may flow from this project, including an industry consultation process.

The IMAP Regulatory Group will be liaising closely with ASIC during the project to see how we can support its efforts and

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continue to represent the interests of managed account professionals.

Royal Commission

At the end of September 2018, the Royal Commission into *Misconduct in the Banking, Superannuation and Financial Services Industry* released its interim report and following consultation with IMAP members, IMAP submitted a response.

We wanted to stress that well-developed managed account programs lead to better advice outcomes for clients, and better, more sustainable businesses for advisers. We also took the opportunity to clarify the four legal structures under which retail managed accounts are currently offered in Australia (see below).

With the prospect of a final report in February, what is uncertain is the identity of the next Federal Government, which may or may not adopt the Royal Commission's recommendations. However, what is more certain is that the debate about conflicts of interest and profit motive will continue.

Developing legislation, including the proposed design and distribution obligations, will likely lead to more fiduciary burdens on issuers and advisers to ensure that products being sold to consumers do meet their needs and are appropriate.

Adam Seccombe is Chair of the IMAP Regualtory Group.

Four Legal Structures

The following is an extract from IMAP's submission to the Royal Commission that outlines the four legal structures under which retail managed accounts are currently offered:

1.Unregistered managed investment schemes called 'Managed Discretionary Accounts' (MDA)

Investors make application to these schemes via MDA contracts issued by MDA providers and, as part of the client subscription, specific investment programs are requested. MDA providers in some cases may outsource some services, including administration services, personal financial advice or custodial services. Where the arrangement involves an External MDA Adviser/ Custodian, the adviser/custodian is contractually responsible directly to the client.

2. Unregistered managed investment schemes called 'Investor Directed Portfolio Services' (IDPS), with standing instructions.

Investors make application to these schemes via an IDPS guide, which are issued by platform operators. Essentially, through the operational and investment efficiency of a platform structure, IDPSs provide benefits of netting, access to wholesale investments and cost efficiencies. As part of the client subscription, specific model portfolio(s) can be identified and customised as required. As with an MDA, an adviser is required to identify the appropriate investment strategy.

3. Registered managed investment schemes: Designed as 'Investor Director Portfolio Services like' (IDPS like).

Investors make application for an interest in the scheme via product disclosure statements issued by the Responsible Entity (RE).

IDPS like schemes operate in much the same way as an unregistered IDPS, however, the RE must meet certain additional regulatory compliance requirements, including investment governance. Further, being a registered managed investment scheme, investors can select model portfolios to suit their investment objectives and may be able to access the scheme without personal advice. Platform, custodial and administrative services are managed and procured by the RE.

4. Registered managed investment schemes: Designed as Separately Managed Accounts (SMA).

Investors make application for an interest in the scheme via product disclosure statements issued by the Responsible Entity (RE).

SMAs allow investors to select model portfolios, in line with their objectives, from an investment menu. An SMA builds further on the robustness of the registered managed investment scheme premise, since the RE is ultimately responsible for the effectiveness and governance of the investment options (model portfolios and customisations) that are available via the scheme, regardless of whether an external investment manager, dealer group or adviser is appointed. Whilst providing transparency and flexibility of investment decisions through the selection of model portfolios and assets within the investment menu, SMAs operate more like a financial product in and of themselves, rather than an investment service.

Investment Group seeking better client outcomes

The Chair of the IMAP Investment Group, Paul Saliba, outlines the objectives of the IMAP Investment Group.

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Paul Saliba

To ensure that IMAP remains at the forefront of thinking in relation to investment management within managed accounts of all types – including SMAs, IMAs and MDAs – IMAP has recently begun work to establish an Investment Group.

Objectives

This group will bring together some of the industry's leading minds to help develop content for the range of investment oriented IMAP conferences, as well as investment webinars, to provide IMAP members and managed account investment managers with the tools and knowledge required to deliver client outcome-focused investment portfolios.

The IMAP Investment Group will involve some of Australia's leading service providers in managed accounts, such as investment managers, consultants, researchers and fund managers. This enables the group to consider the full spectrum of issues that impact investment management within managed accounts, including asset allocation, investment selection, portfolio development and implementation.

Background

As the Chair of the group, I have worked closely with financial planners, practices and their clients since 2008. I have previously worked in roles that include: Chief Investment Officer of Lachlan Partners, Portfolio Manager at Mosaic Portfolio Advisers, and Head of Equities and Portfolio Construction at IOOF.

I have managed in excess of $6 billion at Mosaic Portfolio Advisers. At IOOF, I was the investment manager for the managed account (and model) portfolios across the group, which represented in excess of $2.6 billion under management. I was also a responsible manager on the AFSLs of the MDA provider and two of the advice businesses.

Paul Saliba is Founder and Managing Director of Evolutionary Portfolio Services.

This group will bring together some of the industry's leading minds to help develop content for the range of investment oriented IMAP conferences, as well as investment webinars, to provide IMAP members and managed account investment managers with the tools and knowledge required to deliver client outcome-focused investment portfolios. – PAUL SALIBA

Onwards and upwards

For Kelly Power, the last 18 months have been a challenging time for the industry, but now that the Royal Commission's report is out, it's time to move forward.

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Talk to Kelly Power about the Royal Commission's recommendations into *Misconduct in the Banking, Superannuation and Financial Services Industry*, and you're not left wondering about just how far-reaching these changes will be for the industry.

"The fact is, the Royal Commission has played a very important and necessary role in examining the financial services industry, and we believe it will make the industry better. The Government and Opposition have expressed their collective intent to take action on all 76 of the recommendations," says Kelly – General Manager Product at Colonial First State.

Kelly says it has also been a long-overdue opportunity to review, reflect and re-adjust processes.

"For us, changes are already underway, which includes implementing stronger policies and processes," she says. "And this will enable us to improve our products and services."

Fintech can be a part of the solution

As the industry continues to evolve, Kelly believes fintech (otherwise known as 'financial technology') will play a greater role for both providers and advisers.

"The businesses that will succeed over the next 2-5 years will include those that embrace technology," she says. "And when we look at how we anticipate advisers will be using technology, it will be in three key areas."

1. **Client engagement:** Kelly identifies client engagement as being the first key area, which includes advisers embracing technology to better support engagement with clients.
   "It's very clear that the expectations of clients are changing. The historic process of a once off review with lots of paperwork is gone. Now it's all about ongoing client engagement, servicing and regular interactions. Client expectations are now 24/7 and advice businesses need to respond to that," she says.
   But client engagement is not the sole responsibility of advisers. Kelly firmly believes client communication and engagement is just as important to platform businesses, which have a vital role in supporting advisers with the tools for that client engagement.
2. **Advice efficiency:** The second key area identified by Kelly is advice efficiency. And in the future, she says there is no question that compliance will increase for businesses.
   "So, in order for providers and advice businesses to manage their increased compliance obligations, they will need to work out how they can use technology to provide better and more efficient solutions to allow them to service their clients more effectively," she says.
   "And when we talk about advice efficiency, I believe managed accounts are a good fit. That's because managed accounts are an efficiency solution for advisers when it comes to executing their investment advice."

And the third key area?

3. **Business management:** This key area is all about implementing fintech solutions that can help advice businesses manage everyday tasks, such as marketing, reporting, client communications, and scheduling meetings.
   "Collaborative fintech tools are becoming increasingly essential for businesses, and the role of successful platforms will be to augment all these different tools from fintech providers and supply them in an ecosystem for advisers to utilise.
   "The end goal is to provide a great user experience that results in quality, safe and affordable advice."
   So, for Kelly, the future of technology for financial services professionals is about finding suitable ways to provide safe, affordable and quality advice, by managing the key areas of: client engagement, advice efficiency and business management.
   "Undoubtedly, advice professionals will increasingly need to embrace a whole variety of new technology, like client engagement, reporting and transaction tools. By partnering with platform providers, advisers will be able to tap into these tools, which will assist them to better service the needs of their clients."

And when we talk about advice efficiency, I believe managed accounts are a good fit. That's because managed accounts are an efficiency solution for advisers when it comes to executing their investment advice. – KELLY POWER

Demand for advice

Looking ahead, Kelly sees a number of opportunities emerging for advisers and advice businesses over the next 2-5 years. First among them is the ongoing demand for advice.

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The technology and solutions around managed accounts provide advisers with the ability to deal with a number of clients simultaneously, while also tailoring investment portfolios to the personal needs of individuals. It's all about customisation of investments at an individual level that works for clients. – KELLY POWER

"I have a fundamental view that there is demand for quality advice by Australians and that need for advice will continue. With all the changes we are seeing in superannuation and the retirement incomes space, advice is as important as ever.

"There is a genuine need for people – as they transition to retirement, as well as when they are in retirement – to seek quality advice. So, overarching everything else, that remains a big opportunity for the industry over the next 2-5 years."

In terms of actual advice processes, Kelly sees a "big opportunity" for advisers to provide more efficient advice, which includes embracing technology to do things more productively.

"I also think there is an opportunity for advisers to use technology to better engage their clients on an ongoing basis. I've actually seen some great technology that advisers have designed and implemented within their own practices to do that. And there are plenty of great examples of advisers using entrepreneurs to help them build these client engagement tools."

However, Kelly concedes that providing more efficient advice is only possible when that efficiency is ensured, which means automating key and repetitive processes.

"I feel that the days of having to rekey and verify data in multiple places will soon end. Instead, we will have an ecosystem where advisers can provide all their information in one place."

The future of managed accounts

And what of managed accounts?

With Kelly confident about the opportunities available for the industry over the next 2-5 years, she sees a positive role managed accounts will play in helping advisers and their clients take advantage of these opportunities.

"Managed accounts provide compelling benefits to both advisers and their clients," she says. "And it's these benefits that are driving the growth of managed accounts."

Reflecting on the question, Kelly recounts an example.

"There was recent speculation on what was happening with short-term fixed interest and bonds, and which particular cash category they should be. In the past, in order for advisers to implement a change like that and depending on what your view was, it could take six to 12 months. This would require letters to be sent out to clients, authorisations to occur, client review processes – there would be a lot of paper and back-office work involved in that process.

"And before you know it, six months has past and potentially you have lost your opportunity to move, or your view on the bond market may have changed."

However, Kelly says that is fundamentally different in a managed account, where advisers can respond and execute very quickly to those types of issues in a more efficient way.

"So, I believe the growth in managed accounts is all about the way advisers can help their clients," she says.

"The technology and solutions around managed accounts provide advisers with the ability to deal with a number of clients simultaneously, while also tailoring investment portfolios to the personal needs of individuals. It's all about customisation of investments at an individual level that works for clients."

For Kelly, that means managed accounts will continue to play an important role for advisers in supporting their clients, by providing them with greater efficiency and transparency of investment outcomes.

Hear Kelly Power at the IMAP Adviser Roadshow
Kelly Power will share her views on managed accounts and advice businesses at the IMAP Adviser Roadshow in Sydney on 14 March and Melbourne on 19 March. For more information or to register your attendance, go to: imap.asn.au/events

IMAP

The Kodak moment for fintech

Whether it's fintech or techfin, both sectors place severe pressure on traditional businesses in the financial services industry. Ignore them at your peril, writes Gihan Perera.

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Gihan Perera

When inventor George Eastman registered the trademark 'Kodak' in 1888, he had no idea his small company would dominate photography for more than 100 years. A century later, at its peak, Kodak employed over 145,000 workers, had over two-thirds of global market share, and was the fifth-most valuable brand in the world.

Despite this success, Kodak fell spectacularly from its peak in 1996 to file for bankruptcy in 2012. It is often held up as the archetypal poster child for a company that was disrupted by the digital revolution.

There are many variations of the story, giving various reasons for Kodak's demise: it had too much invested in film; it had grown so big it had stopped innovating; the organisational structure couldn't cope with a digital world, and so on. There's even a dramatic story that the Kodak employee who invented the first digital camera was told by senior management to hide his invention because it would destroy Kodak's market.

The problem with these stories is that they aren't true.

The Kodak management weren't afraid that digital cameras would cannibalise their existing products, and they didn't deliberately try to kill off a threat.

The first digital camera was as big as a toaster, took 20 seconds to take a picture, and the resolution was much lower than a print. Kodak's management assessed it, but ignored it because they thought it would never be good enough to compete with film cameras. They didn't account for exponential growth, which meant technology improved much faster than they expected.

The same is happening with fintech.

There's nobody that understands exponential growth (as in, compound interest) as well as the financial services industry. Even so, many financial advice businesses underestimate its impact - especially when it comes to fintech.

According to EY (in its 2018 report, *The future of FinTech and financial services*), global fintech funding has grown at a compound annual growth rate of 34 per cent from 2013 to 2017.

In Asia, which started from a smaller base, the growth over the same period has been even more dramatic: about 85 per cent annually. China represents the lion's share of this growth with 80 per cent of fintech investments, followed by India with 12 per cent. That leaves just 8 per cent for everybody else, but even that isn't an insignificant amount.

In Australia, there's no doubt fintech companies already have a strong foothold in Australia. One of the most dramatic illustrations of this is KPMG's 2018 infographic, *The Australian Fintech Landscape*, showing the myriad fintech companies

Unlike fintech companies, which start small and hope to strike it big, techfin companies are already highly successful, and have deep pockets to invest in any new venture.

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jostling with each other to displace established businesses in the industry. KPMG shows fintech disruptors in lending, crowdfunding, back-office, data and analytics, insurance, personal finance, and more.

As impressive as this is, it's only the beginning. And if it grows exponentially, it's the beginning of a steep growth curve.

But will it really grow that fast?

History is littered with predictions of projected exponential growth that fizzled, but four factors give us reasons to be bullish about the growth of fintech in Australia.

1. Fallout from the Royal Commission

Publicity from the Hayne Royal Commission has eroded consumer trust in traditional players in the industry. The *Deloitte Trust Index – Banking 2018* reports only one-third of banking customers think banks are always looking to provide better customer services. Even fewer (one in five) think banks have customer interests at heart. For businesses, tighter lending rules might make finance more difficult to obtain.

Whether these are perceptions or reality, this fallout means consumers and businesses will explore alternatives – including fintech options – for their financial services.

2. Big Data and Artificial Intelligence

Our digitalised, highly-connected world – facilitated by the relationship people have with their smartphones – gives organisations more data than ever before about their customers. At the same time, artificial intelligence software is now powerful enough to turn this vast amount of data into useful predictions about individuals' behaviour.

Traditional financial services organisations have been slow to adapt, and often adopt this technology only as add-ons to existing services (such as AI for detecting suspicious credit card activity). But it's part of the DNA of fintech companies, that build their entire business model around data and software, which means they can exploit its exponential growth.

3. New generations of customers

Younger consumers, particularly Gen Y and Gen Z, tend to be more open to new technologies and less concerned about sharing personal data. It's easy to dismiss them as young, naive and irrelevant, but they make up a significant portion of the population.

Gen Y is already the largest group in the Australian workforce, and are already established in leadership, management, and decision-making positions. Their younger cohort, Gen Z, is already the largest group in the population, and will make up 25 per cent of the workforce by 2025.

These customers aren't well-served by the business models and operations of traditional financial services, which were designed to serve their parents. They want cashless, digital, real-time, app-based, decentralised, mobile and accessible services. In other words, everything that fintech companies offer.

4. Techfin

Not all of the competition for financial services will come from small, smart, savvy, start-up fintech companies trying to grab a tiny sliver of market share. Some of it will come from the big end of town – the *really* big end: tech companies.

Businesses like the 'FAGA' companies – Facebook, Amazon, Google and Apple – started providing technology products and services, but have such a strong presence in their customers' lives that they can now spin off other services, including lucrative financial services. Jack Ma, the founder of Alibaba – the world's largest e-commerce company – coined the term 'techfin' to refer to these companies: tech companies now offering financial services.

Unlike fintech companies, which start small and hope to strike it big, techfin companies are already highly successful, and have deep pockets to invest in any new venture. Whether it's fintech or techfin, both sectors place severe pressure on traditional businesses in the financial services industry.

This is the Kodak moment for fintech in Australia

It's easy to look back now and criticise Kodak for its lack of foresight in assessing digital photography. But it's difficult to really grasp the impact of exponential growth, even for people who work with compound interest every day.

As an analogy, consider the old puzzle about the lily pond: The number of lilies on a pond doubles every day, and it takes 30 days to completely fill the pond. When is it half-full?

The layperson's answer is 15, but the correct answer (which is obvious if you understand compound interest or exponential growth) is, of course, 29 days. But also consider this: Just three days earlier, the pond was just one-sixteenth covered. That means 95 per cent of the growth happened in the final four days.

That's where we are with fintech now. It has taken only a few years for it to establish a foothold, but even that is an eternity compared to how quickly it will continue to grow.

Ignore it at your peril! See you in the future.

Gihan Perera is a futurist, conference speaker, author and consultant who gives business leaders a glimpse into what's ahead – and how they can become fit for the future.

Adviser Roadshow 2019: Where to from here?

FINANCIAL SERVICES POST ROYAL COMMISSION

This year's annual IMAP Adviser Roadshow will delve deeply into the Royal Commission's key recommendations for the financial services industry, particularly in respect to how they will impact financial advisers, licensees and providers of managed accounts.

HIGHLIGHTS OF THE ADVISER ROADSHOW 2019 INCLUDE:

- What does the future of advice in Australia look like post Royal Commission
- Providing a long-term perspective on advice businesses
- How to give advice on a managed account
- Market risks in 2019 and how to address them in your portfolio construction
- Best Interests Duty post Royal Commission
- Why innovation is more important than ever
- Life outside the mainstream: Looking at alternatives to the mainstream platforms

For more on the IMAP Adviser Roadshow 2019, Perspectives magazine has published a white paper, including analysis that will be discussed at the conference. Read on.

ADVISER ROADSHOW 2019: THREE VENUES TO CHOOSE FROM

BRISBANE Hotel Grand Chancellor Brisbane / 23 Leichhardt Street (Cnr Wickham Terrace) / **12 March 2019**

SYDNEY Whiteley Ballroom, Amora Hotel Jamison / 11 Jamison Street / **14 March 2019**

MELBOURNE Marriott Hotel / Cnr Exhibition and Lonsdale Streets **19 March 2019**

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

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Market risks: the unknown unknowns

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Despite most expectations, 2018 proved to be a very disappointing and jarring year for investors. Not only did volatility return in abundance, particularly in the first and last quarters of the year, but almost all asset markets ended the year in negative territory.

The equity market darling for most the year, the US stock market suffered a double-digit decline in the fourth quarter, ending its worst year since 2008. Surprisingly, global and Aussie bonds were the only shining light, outperforming most developed equity markets, an outcome few would have predicted at the start of 2018.

Chart 1: Asset class performance 2018

Given this backdrop, what's the outlook for 2019 and what could sideswipe markets? The consensus is that the outlook has become more uncertain, with the tail risks to global markets now larger than they were 12 months ago. There are plenty of known risks, that have been well documented in the media, including:

- Brexit;
- Ongoing US-China trade war;
- China slowdown;
- Central Bank policy (US rate rises and quantitative tightening); and
- The large build-up in corporate debt.

However, while the outcomes of these risks aren't known,

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it could be argued that markets have somewhat priced in the possible scenarios.

But what about risks that aren't priced into markets? Former US defence secretary, Donald Rumsfield, famously referred to these as "unknown unknowns". That is to say, there are risks that few investors have factored in, for example, major Arab conflict. These are what generally sideswipe markets.

Amongst the perceived increasing level of uncertainty, investors are now more than ever seeking guidance as to the course of markets in 2019.

Forecasting – an exercise in futility

Many investors will look to 'so-called' experts, who will release their forecasts for markets over the coming year. However, are these forecasts worth the time and effort that investors spend pouring over them?

To help answer this question, let's reflect on the year just gone.

At the beginning of 2018, the median broker forecast for the ASX200 was 6,300, representing a calendar year return of 6.3 per cent. If an investor had taken this on board and invested wholly into the index, they would have generated a realised return of -3.07 per cent.

Table 1

Broker	ASX 200 forecast	Percentage change
Macquarie	6,500	8.30%
Goldman Sachs	6,500	8.30%
Citi	6,400	6.60%
Bank of America Merrill Lynch	6,300	5.00%
JP Morgan	6,300	5.00%
UBS	6,200	5.00%
Morgan Stanley	5,800	-3.30%

Source: Zenith

Commentators were also overly optimistic in the United States. For the S&P 500, the median forecast price at the end of 2018 was 2,950 points, for a 2018 calendar year return of 10.3 per cent. The realised return was -4.38 per cent.

Opinions in Europe were just as erroneous, with strategists expecting a 1.5 per cent annual return for the FTSE 100 at the beginning of the year, but the realised return was -12.5 per cent. For the EuroStoxx 50, the predicted return was 7 per cent and for a realised return of -14.24 per cent.

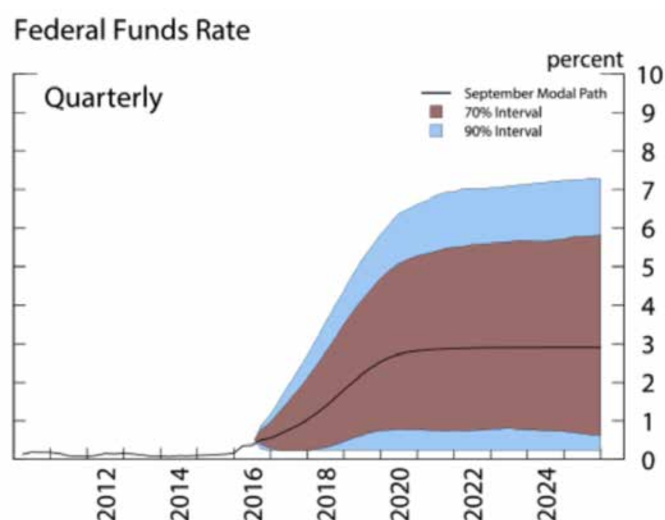
Moving over to fixed income markets, how do the experts fair in this domain?

Let's focus on Jerome Powell and his economics team at the U.S. Federal Reserve (Fed). Generally revered as omnipotent, how have they fared in terms of where interest rates might go?

Movements in the Fed's predictions (dot plots) make ripples in investment markets globally. However, the Fed – just like everybody else – has a poor record of forecasting outcomes. In fact, the Fed has been overly optimistic on the trajectory of interest rates for some time.

To make matters worse, the Fed itself seems to have little confidence in its forecasts. Chart 2, produced by the Fed, demonstrates with how much confidence the Fed believes it can forecast rates at 70 per cent and 90 per cent intervals.

Chart 2: Federal Funds Rate



Source: Federal Reserve

Chart 2, produced in 2017, shows how little confidence the Fed has in its own predictions. While the Fed expects the long-term rate to be around 3 per cent, it can only assign a 90 per cent certainty that the Fed Funds rate will lie between approximately 0 per cent and 7 per cent. Given the wide range, investors should take the dot plots with a grain of salt.

What about economists?

Investors often believe that stock markets reflect the economic conditions of their respective countries. They hypothesise that if an economy is growing, output will be increasing and firms should be experiencing increased profitability, with the opposite also true.

Assuming this is true over the shorter-term, it would still

be necessary to have accurate forecasts to enable investors to take advantage of this hypothesis. So, how do professional economists fair in their predictions and can their forecasts help us navigate markets?

Unfortunately, the answer is most likely 'no' in terms of forecasting skill, as economists have shown limited ability to predict the direction and magnitude of growth. Even all the PhDs at the International Monetary Fund (IMF) have shown very little success. Over the past 27 years, the IMF has predicted on average that five economies would be in recession, when in reality the number has been 26.

Furthermore, they tend to have the greatest error when it matters the most. In October 2009, the IMF predicted economic expansion for the U.S. and Japan. However, instead, the U.S. contracted close to 3 per cent and Japan a whopping 5.4 per cent.

However, even if you manage to forecast with near perfect foresight, it's been shown that the short-term linkage between GDP growth and stock returns is weak. 2018 was a great example; the U.S. economy expanded at a rate of 3.4 per cent at the end of the third quarter and U.S. equities declined -4.38 per cent. A clear disconnect, as the U.S. economy continued to perform well and earnings growth remained robust, however, markets were plagued by macroeconomic and sentiment issues.

Similarly, in the years leading up to the GFC, economic conditions within the U.S. and globally were favourable. Economic growth was strong, rates of inflation were stable, and unemployment and wage growth were healthy. However, the catalysts that emerged were not apparent from these headline figures, and caught most economists and investors wrong-footed.

Table 2: U.S. economy in June 2007

U.S. Economy in June 2007	
GDP Growth Rate	2.1% p.a.
Unemployment Rate	4.5% p.a.
Wage Growth	4.0% p.a.

Source: Bloomberg

How to prepare clients for the period ahead

As humans, we love certainty, which is why we gravitate to 'so-called' expert forecasts, time and time again; even though we know they will almost certainly be wrong.

In saying this, we're not questioning the skill of these experts, merely pointing out that predicting the future is almost impossible, because it relies on numerous assumptions and a pre-determined series of events occurring.

More often than not, the unknown unknowns get in the way of the central thesis and take markets on a different path. You only need to think back to the decision by the U.K. to exit the European Union in June 2016 or Trump's victory in the U.S. elections in November 2016; and the markets' initial and subsequent reactions to these events to realise this.

More so, one of Warren Buffett's famous quotes, "In the short-run, markets are a voting machine but in the long-run, they're a weighing machine", that is, sentiment drives markets in the short-run and is a fickle beast.

Clients need to accept uncertainty is part of investing, as in life. The only certain return is cash (at least in nominal returns), and that's not going to give investors the returns they require over the longer-term.

It's interesting that people always believe there is less certainty at any given time, when in fact, there is never any certainty. No one can tell you what's going to happen tomorrow, next month or next year. The biggest challenge for clients is the behavioural aspect of investing – for example, not selling low and buying high, having the conviction and fortitude to stay the course.

Investors are often tempted to time markets; they employ tactical asset allocation to go to cash in times of market stress. However, doing so requires exquisite timing, not only on the exit but also on the re-entry (this ignores transaction and tax costs). Missing only a few days in the market can dramatically impact your longer-term returns.

Having an appropriate time horizon is the key to successful

As humans, we love certainty, which is why we gravitate to 'so-called' expert forecasts, time and time again; even though we know they will almost certainly be wrong.

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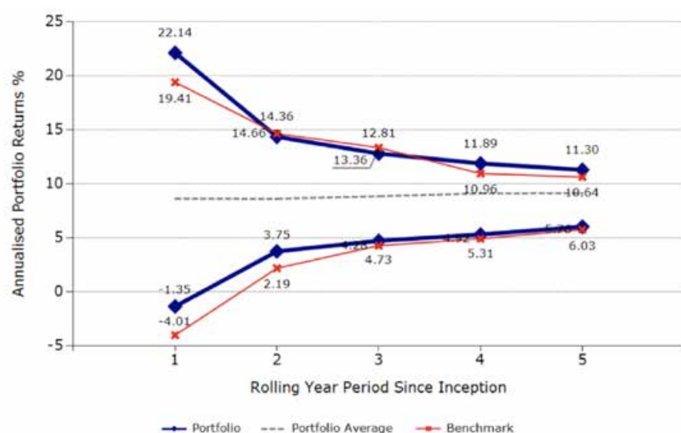
investing. While over the short-term, the direction of asset markets isn't predictable, over the longer-term, the dispersion of returns decreases dramatically. The return funnel in Chart 3 shows the dispersion on rolling annual periods for a balanced fund (60 per cent growth/40 per cent defensive split).

Chart 3: Rolling year



Source: Zenith

What does this mean for portfolios?

If we accept that there's no way to predict the direction of markets in the year ahead with much certainty, how should investors position their portfolios?

To borrow a line from Jacob Mitchell (Chief Investment Officer at Antipodes Global Investors), they need to embed "multiple ways of winning" in portfolios; one that is not reliant on a narrow outcome. That is to say, while it's prudent to remain vigilant to the risks in portfolios, the best defence against market weakness, is to have appropriate diversification.

Diversification can often be a throw away line but if executed properly, this can mean that portfolios are more resilient to lots of different scenarios and outcomes.

Investors should seek to understand how sensitive portfolios are to different economic conditions, which is where quantitative tools (optimisers, stress and scenario testing) can be very insightful. However, such tools have limitations and qualitative judgement should always be exercised.

This means that portfolios should be diversified not only across asset classes but within asset classes and across strategies. However, for this diversification to be an effective strategy, investors should remember that having an appropriate time horizon is key, preferably one that looks beyond 2019.

Steven Tang is Senior Investment Consultant at Zenith Investment Partners and Matthew Cho is Investment Consultant at Zenith Investment Partners.

IMAP

Marketing a new program

When implementing a new managed account program, there are a number of steps required to effectively communicate and market this program to planners and clients, writes Toby Potter.

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Toby Potter

So, you've weighed up the advantages and disadvantages of managed accounts, done your homework and research, and have finally decided that this type of investment structure is right for your clients and your business. Congratulations. That's the first step but there are still challenges ahead.

When licensees consider developing a managed accounts program as a replacement for the conventional advice/ recommendation-based process, they are often concerned by the challenges they expect to have in ensuring their planners are as committed to the project as they are.

Overcoming these issues requires licensees to address the issue in two ways:

- Overcoming planners' fears and objections; and
- Equipping planners to effectively communicate the benefits of the service to clients, particularly to existing clients who have previously been receiving a different form of service.

Dealing with planner concerns

Let's first consider the typical concerns that arise among planners when a new managed accounts program is discussed. These can be grouped into four areas:

1. Role perception

- *'Will this service undermine the way in which my clients regard me?'*, or
- *'What type of relationship will I have with my clients if they don't see me as the person who selects their investments?'*

2. Customisation of the service by client

- *'My clients have unique circumstances and lots of them have other investments or specific preferences, which need to be taken into account when their portfolio is being constructed.'*

3. Fee concerns

- *'The proposed fee structure will be hard to explain to my clients. They are used to seeing only my advice fees and the platform fees, and they understand that there are costs in the funds they hold.'*

4. Best interest issues

- *'How can I recommend an in-house service? Will this truly be in my clients' best interests?'*

It's clear that the answers to these legitimate questions will vary depending on the service structure that the licensee adopts.

For example, if the managed account service adopted is simply a decision to include a number of third party managers' SMAs from the licensee's preferred platform onto the APL, then issues of the planner's role, customisation and best interest are unlikely to be significant.

The planner will be recommending an SMA in the same way as they might have recommended a managed fund. Their role in portfolio construction is supported and

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If the managed account service adopted is simply a decision to include a number of third party managers' SMAs from the licensee's preferred platform onto the APL, then issues of the planner's role, customisation and best interest are unlikely to be significant.

the planner is able to explain the benefits of this structure, compared to pooled unit trusts.

The explicit cost may be an issue but again, pooled unit trusts and their indirect cost ratio (ICR) provide an appropriate reference point. Since the licensee is not earning a margin or other benefit from the SMA provider, questions of conflict are very unlikely to arise.

However, the 'role perception' question can arise when the SMA is directly equivalent to the type of portfolio that the planner typically includes in their advice.

For example, a direct equities SMA managed by an external manager. In this case, if directly held equities are common in a client's portfolio or a balanced multi-asset class SMA (often constructed by research houses using ETFs), there could be the perception by clients that this type of manage account is equivalent to the planner's investment approach.

The questions highlighted above can arise most acutely when the licensee is directly involved in the portfolio management and construction process of the managed account. This might be a set of SMAs that are specific to and branded for the licensee or it may be an MDA service where the licensee is either the MDA provider directly or has an arrangement to provide advice on a set of portfolios that the licensee manages through a third party MDA provider.

In this case, the roles of asset allocation and manager selection are taken on by the licensee and its investment committee, or by a research house or portfolio manager that it selects.

Client questions

This section on 'client questions' should really be called, 'Planner concerns about client concerns'. They are the concerns that a planner might think a client, particularly an existing client, might have when the planner recommends the use of managed accounts – SMAs or MDAs – instead of a purely advised portfolio. These might include:

Perceptions of the actual service offered

- *'I thought you were doing that already.'*

Cost concerns

- *'How will the cost compare to my current costs?'*

Investment concerns

- *'Will this still support my preference for (sustainability/ not selling this existing holding/ethical investing)?'* – Obviously, the actual issue the client raises will be particular to their circumstances.

Dealing with objections

In a service proposition, such as advice generally and managed accounts in particular, there are three key ways of responding to and dealing with objections. These are:

- **Rational responses** – Having an answer to the specific issue raised;
- **Emotional responses** – Coaching on behaviour change; and
- **Experiential responses** – Conduct over time that demonstrates that the issues raised are less significant than imagined and the benefits achieved are real.

So, in addressing the issues raised above in dealing with planner concerns:

1. Role perception: The licensee wanting to address this can concentrate on responding with answers such as:

- *'This will free you up to focus on those issues that really can make a difference to the client, such as strategic advice and good structures,'* or
- *'This moves your conversations with clients away from a focus on either a specific investment recommendation or the performance of your portfolio selections.'*

2. Customisation: Most managed account programs now support a greater or lesser degree of customisation, such as exclusions and substitutions or running advised assets and managed account assets in the same or linked accounts. The answer here will depend largely on the technology used for the managed account. However, a

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The best way to achieve behaviour change in your practice is by repeated demonstrations and making the experience of other planners available to those team members who remain to be convinced.

connected issue here is the desire of planners to reflect their own views in their clients' portfolios.

For example, a stock which has a good dividend yield may be avoided by portfolio managers because they believe it to be at risk of capital loss. There are a number of examples of this in the Australian market. Licensees will need to develop their policy on the extent to which they will be prepared to allow planners to depart from portfolio positions.

3. Fee concerns: As an issue that has a demonstrable answer, the question of client cost will need to be addressed explicitly. Frequently, the introduction of managed accounts will be accompanied by a realignment of costs, which generally means clients are now paying more but are receiving a better service.

4. Best interest issues: Best interest issues can express themselves in a reluctance to recommend an 'in-house' service.

Appropriate responses will stress that the resources the licensee has implemented are to ensure the portfolios are as good as they are able to provide.

- *'The portfolios are our best views on the portfolios, which a client should hold.'*
- *'In this way, we can ensure that as our views change, we can implement those changes immediately and at least cost.'*
- *'We have outsourced those parts of the portfolio management process, such as security selection, to those managers we think are most likely to meet the portfolio objectives.'*

Behaviour change

The best way to achieve behaviour change in your practice is by repeated demonstrations and making the experience of other planners available to those team members who remain to be convinced.

The experience of client outcomes achieved through portfolio management and practice efficiencies, which other planners experience, needs to be captured and related at professional development days and in other regular updates on the managed account service.

Of course, the most powerful advocates for the managed accounts service will be the support of other planners.

Firsthand experience from other planners who have implemented managed accounts for new clients and then experienced the benefits that they (and their clients) achieve from not having to manage their client accounts on a one-by-one basis, is powerful.

Experiential responses

There's no doubt that the best support for the introduction of a managed accounts program can be achieved through:

- continuing to advocate for the service;
- providing good communication support on the performance of the portfolios and about portfolio changes; and
- ensuring that the experiences of early adopting planners are shared.

Summary

Making a success of marketing a managed accounts program to planners and clients is a result of understanding the issues that might be raised about the changes that it entails. Addressing these in a multi-layered way – with rational, behavioural and experiential elements – is key to gaining commitment from the key audience, the planners.

Toby Potter is Chair of the Institute of Managed Account Professionals (IMAP).

IMAP

Get off the fence

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DAVID BASSANESE
Chief Economist, BetaShares

David Bassanese

The Australian economy has been travelling along reasonably well over the past year or so, with inflation contained and the unemployment rate easing to what has been considered the 'full employment' rate of 5.0 per cent.

This performance is even more remarkable because house prices in our two major capital cities have been sliding for the past year and a half. China's economy has also slowed notably as credit tightening to reign in excess debt and the negative impact of the trade dispute with the United States took their toll.

So, what's been supporting the economy? It's been growth across several fronts.

Sector growth

The Federal and State Governments have opened their purse strings and splurged on a range of infrastructure projects to meet the demands of our rapidly growing population. Private construction of offices, warehouses and high-rise apartment blocks has also been strong.

In the services sector, the ongoing rollout of the National Disability Insurance Scheme (NDIS) has created an employment boom in the health and social support areas. And the education sector continues to benefit from the influx of foreign students.

In the resources sector, LNG exports are ramping up strongly, while global demand for Australian coal and iron-ore production remains firm.

Of course, it's not all been plain sailing. Not helped by falling house prices and (despite low unemployment) weak wages growth, consumer spending has waxed and waned – and more retail dollars are being directed online and away from traditional bricks and mortar establishments. Drought conditions in south-eastern Australia have caused farm output to drop sharply over the past year.

Up until recently, the Reserve Bank of Australia (RBA) has been able to project an image of 'confidence and stability', by forecasting persistent above-trend economic growth, falling unemployment and an eventual lift in wage and consumer price inflation.

Consistent with this outlook, the RBA had long maintained the line that the next move in official interest rates was "more likely up than down".

For what it's worth, I've long maintained a more cautious view. My main worry over the past year has been the risk that the ongoing slide in house prices (which I have expected to continue) would eventually have greater negative effects on the economy.

I've also been dubious that even an unemployment rate of 5 per cent would have much upward pressure on wage growth, given the still high level of underemployment in the economy and equally high level of work job insecurity.

My base case call for much of the past year has been that the RBA would not touch interest rates in 2018. It was a boring call, but eventually turned out to the correct one.

But I'm now getting off the fence.

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Off the fence

Indeed, I now expect the RBA to cut the cash rate this year, and twice by early 2020, reflecting a weakening in a range of economic indicators and the RBA's own acknowledgement of more downside risks.

Let's start with the economy.

As mentioned, a range of Australian economic indicators have turned notably weaker of late.

The National Australia Bank's Index of business conditions, for example, slumped nine points in December to a +2 reading. While the Index partly bounced backed to a modestly above-average +7 in January, there's been a clear broad-based weakening in sentiment since earlier last year. Most worrying, indicators of business investment intentions appear to have softened.

One generalised factor that may account for some of the slide in business sentiment is the tightening in credit standards in the wake of the Hayne Royal Commission. Many small businesses in particular appear to be finding it much harder to secure funding, even if secured against the family home.

Also apparent in recent months is an acceleration of the decline in home building approvals and home loan demand. With foreign buyers deserting the market, affordability levels still poor in Sydney and Melbourne, Hayne-related credit tightening and the prospect of a crackdown on negative gearing and CGT advantages should the Labor Party win the next Federal election, it's little wonder housing demand continued to slump.

Up until recently, actual home building activity has held up well, thanks to the high level of work still in the pipeline - but as that pipeline is worked through, fewer home building jobs will be apparent as the year progresses.

Also up until recently, consumer spending seemed to be holding up as well as might be hoped – but the ongoing slide in house prices now appears to be finally taking its toll. Retail sales volumes were flat in both the September and December quarter.

ANZ job advertisements declined in both December and January and appear to be finally 'rolling over'. Job ads are not usually too volatile, so recent weakness will likely indicate a shift in trend to a slower pace of hiring.

The best news is that the unemployment rate is still low at only 5 per cent. But this is a lagging indicator to a degree. Based on historic relationships, the recent weakness in building approvals – and especially given the chances of further weakness - suggests upward pressure on the unemployment rate is just a matter of time.

Interest rate cut

This sea shift in the economic outlook has not gone unnoticed at the RBA. Indeed, recent commentary from the Reserve Bank suggests it has moved to a 'neutral policy bias', conceding the next move in rates could be just as likely down as up.

In my view, however, the reality is that if local interest rates move anywhere this year, it's now more likely to be down.

Of course, I suspect the RBA remains very reluctant to cut interest rates, given they are already quite low and further declines might have only a muted effect on the economy. The RBA would also be loath to unduly interrupt what it likely sees as a necessary, albeit uncomfortable, ongoing housing price adjustment in Sydney and Melbourne.

That said, should the unemployment rate begin to head higher, and given the still quite low rate of local inflation, I also suspect the RBA will feel the need to respond by lowering interest rates. That's why I suspect the RBA will likely wait for the unemployment rate to actually rise (possibly to at least around 5.4 per cent) before acting, unless there is an even sharper deterioration in other forward indicators in the meantime.

All up, my base case view is that the RBA will cut rates if the unemployment rate rises above 5.3 per cent (i.e. prints 5.4 per cent or more) in coming months. I now also believe that the unemployment rate will breach 5.4 per cent by year-end given, especially, the depth of the recent downturn in home building approvals.

It's on this basis that I now expect the RBA to cut rates by year-end, with a move to a 1 per cent cash rate by around February 2020.

Subject to what else happens in the economy, this should be a positive for interest-rate sensitive sectors of the market and companies with high offshore earnings exposure, given the A$ could also weaken to at least my first target of US68c. Exposures that therefore may be worthwhile to consider in the event of lower local rates include long duration corporate bonds (e.g. via CRED – BetaShares Australian Investment Grade Corporate Bond ETF) and listed property/infrastructure exposures (such as via RINC – BetaShares Legg Mason Real Income Fund (managed fund)).

None of the above, moreover, takes account of global developments. But I suspect even if global growth surprises on the upside, it won't help the local economy all that much, given our most acute problems – housing and consumption – are home grown in nature.

And if the global economy does continue to slow, it will only make it even more likely that the RBA will need to cut rates.

David Bassanese is Chief Economist at BetaShares.

UPCOMING EVENTS

MARCH 2019

IMAP Adviser Roadshow - Brisbane, Sydney, Melbourne

BRISBANE
When: 12 March, 2019
Where: Hotel Grand Chancellor Brisbane, 23 Leichhardt Street (Cnr Wickham Terrace), Brisbane

SYDNEY
When: 14 March, 2019
Where: Whiteley Ballroom, Amora Hotel Jamison, 11 Jamison Street, Sydney

MELBOURNE
When: 19 March, 2018
Where: Marriott Hotel, Cnr Exhibition and Lonsdale Streets, Melbourne

With the Royal Commission having handed down its 76 recommendations for reform of the financial services industry, where do we head now?

This year's annual IMAP Adviser Roadshow will delve deeply into the key recommendations for the financial services industry, particularly in respect to how they will affect financial advisers, licensees and providers involved with managed accounts.

Some of the topics to be covered include:

- **What does the future of advice in Australia look like post Royal Commission**

IMAP Chair Toby Potter examines the state of the financial advice sector in Australia following a year of intensive review and scrutiny.

- **Providing a long-term perspective on advice businesses**

Colonial First State's Kelly Power will provide insights into what makes an advice business successful over the long-term.

- **How to give advice on a managed account**

Compliance managers from Praemium, Mason Stevens and a dealer group will address this issue for both MDA and SMA offerings.

- **Market risks in 2019 and how to address them in your portfolio construction**

An expert panel will discuss the key risks in the market this year to portfolio construction, and how to prepare clients for these risks.

- **Best Interests Duty post Royal Commission**

In the wake of the Royal Commission's recommendations for the industry, Greg Newman (Hub24), Claire Wivell Plater (The Fold Legal) and Jesse Vermiglio (Holley Nethercote) share their views on Best Interests Duty.

Note: Claire Wivell Plater will appear in Brisbane and Sydney only, and Jesse Vermiglio will be in Melbourne.

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

CONTINUES >>

- **Why innovation is more important than ever**

Netwealth's Andrew Braun discusses the need for innovation in advice businesses and provides insights for advisers from the innovation workshop held with Swinburne University.

- **Life outside the mainstream: Looking at alternatives to the mainstream platforms**

A discussion about the different types of alternatives available in the market to the mainstream platform models.

- **Meeting client objectives using diversified portfolios**

Portfolio managers explain how advisers can better meet their client objectives by using diversified investment portfolios.

The annual IMAP Adviser Roadshow is a specialist event for dealer principals, adviser group management teams and advisers. It focuses on the practical implementation of managed account programs in established advisory businesses and how to make this truly effective for advisers and clients.

For delegates attending the IMAP Adviser Roadshow, there will also be plenty of peer networking opportunities to discuss managed accounts in what is the fastest growing sector of financial services.

IMAP represents and works for the best interests of advisers, dealer groups, platforms, investment managers, service providers and all other participants in managed accounts. In addition, IMAP also works in the best interest of the clients of managed accounts.

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

2019 IMAP Events

Make sure you mark these events in your diary now!

April

- 10 April 2019: Webinar
- 17 April 2019: Investment Forum - Sydney, Melbourne, Brisbane

May

- 8 May 2019: Webinar
- 20 May 2019: Responsible Manager Masterclass

June

- 27 June 2019: IMAP Managed Account Awards

August

- Portfolio Management Conference – Sydney (date to be finalised)
- Portfolio Management Conference – Melbourne (date to be finalised)

November

- 6-7 November: InvestTech 2019
- 11 November: Responsible Manager Masterclass

Dates and events may change. Venues still to be confirmed.

For more information on these events or to register your attendance, go to imap.asn.au/events or contact Jenny Phimleut at jenny.phimleut@imap.asn.au

PERSPECTIVES

IMAP kindly acknowledges its 2019 sponsors

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