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Kick-off time for managed accounts

IFA Cover Story

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It has been tough going for much of the managed accounts industry over the past decade.

Many providers have struggled to attract dealer groups as their clients and funds under administration (FUA), and understandably so. Managed accounts are still a relatively fresh concept in Australia.

Many fund managers have found it difficult to offer their model portfolios in a managed accounts structure because of risks such as theft of intellectual property and concerns that the industry may falter.

Yet after showing signs of life recently, the sector may be on the cusp of a multi-year boom.

Deals are happening, more companies are forming, announcements are constantly flowing, mainstream platforms are taking an interest and managed accounts have been far more notable in the press than in past years.

Firms specialising in the sector have poured a lot of time and money into developing technology that can efficiently run managed accounts and make them easy to use for financial planners and their clients.

Fund managers have become more open to the idea of offering their model portfolios after realising their concerns may be overblown and managed accounts could potentially be a hit among investors.

Inflows on the rise

For the first time since 2006, the proportion of new business that planners write into two types of managed accounts - separately managed accounts (SMA) and individually managed accounts (IMA) - rose to 5 per cent in 2010, according to Investment Trends.

"For many years the proportion of inflows, new business that planners write into SMAs, has been jammed at just below 3 per cent," the research firm's principal, Mark Johnston, says.

"This year, what we have seen for the first time is a bit of an uptick in the proportion of inflows going into SMAs, so there are some signs beginning to emerge that there

might be a little bit more traction in the market than there has been in the past."

The gain has been partly driven by a big boost in planners purchasing assets directly for clients.

"Planners have been flagging that they intended to increase their use of direct shares as well as other things like exchange-traded funds (ETF) and index funds and there has been a gradual increase in usage of direct shares," Johnston says.

"But all of a sudden in the middle part of this year we have really seen that accelerate a lot. So what has been a gradual drift towards direct shares at the expense of managed funds has really moved a lot more quickly.

"So we see a little bit of associated growth in the SMAs as well as part of that broader theme of more use of direct equities."

Growth in MLC & National Australia Bank (NAB) Wealth's Navigator, one of the mainstream platforms to make its foray into managed accounts, is also clear evidence of the industry's progress.

"We are approaching the $100 million mark for inflows since the launch of our integrated SMA in September 2009," MLC & NAB Wealth manager of wrap investments Chris Weldon says.

"This growth follows a series of adviser education sessions which have helped demonstrate how easy our SMA is to use.

"We are also the only SMA with a retail-superannuation offer and we have seen around 75 per cent of flows come into our retail superannuation and pension wrap platform."

NAB gained Navigator through its purchase of Aviva Australia Holdings' wealth management business last year.

There are 180 advisers using Navigator's integrated SMA on behalf of around 2000 clients, Weldon says.

The model portfolios available on Navigator include Blue Chip Top 20, Aviva Investors Dividend Builder, Perennial Value Shares for Income, Aviva Investors Core Opportunities, Ausbil Australian Concentrated Equity, Goldman Sachs JBWere Core Australian Equities, Perennial Growth Shares and UBS High Alpha Long Term Opportunity.

Weldon says advisers continue to give outstanding feedback on Navigator's SMA, particularly around its flexibility and the fact they do not have to change any of their processes.

"Many advisers are using SMAs to complement other managed funds across a variety of asset classes. We have seen approximately 25 per cent of inflows to our Australian equities diversified asset class on the platform directed into the SMA," he says.

Industry abuzz with activity

Institute of Managed Account Providers (IMAP) chairman and managed account consultant Toby Potter agrees the industry is in growth mode and a lot more is in store.

"There seems a lot of new activity, for example, OneVue has certainly appeared to have achieved a number of new signings," Potter says.

"I notice AMP have also recently moved their managed account - Personalised Portfolio - administration in-house.

"And that represents quite an interesting new development in the provision of services and the adoption by a major advisory group of managed account functionality is significant.

"The other thing which I think is particularly significant is the apparent development plans for the major platforms such as BT, Asgard and Colonial First State, who have all announced a managed capability of one sort or another.

"I think all this represents significant development of managed accounts generally."

He also points to the importance of statistics in the Investment Trends report, which revolves around the proportion of new money being invested in equities, SMAs and planners' expectations of how that will develop in the next three years.

The data shows that in 2010, planners poured 44 per cent of new client money into managed accounts, shares, ETFs and listed investment companies, up from 26 per cent in 2009.

"More importantly, they are expecting that in three years that will have grown to 54 per cent of new money," Potter says.

"If you look at the data, the proportion of new money going to managed funds over the last three years had been stable at around 65 per cent, dropped to 50 per cent this year and planners expect it to drop to 40 per cent in three years.

"I think that is a very telling statistic of the take-up of direct securities and managed accounts."

Managed accounts don't have an exact technical definition.

Generally, they are an investment account owned by an individual investor, but all the investment decisions are made by a fund manager, dealer group or an adviser.

Instead of buying units, clients typically invest a dollar sum into managed accounts.

The main benefits of the structure include tax benefits and transparency, the industry claims.

There is no inherited capital gains tax within managed accounts and investors can view the shares they own and also receive franking credits.

The beneficial ownership of shares owned within a managed account remains with the client or the trustee if the account is held in superannuation.

However, managed accounts are not restricted to just Australian shares.

They can also hold managed fund units, hybrid securities, ETFs, cash and sometimes direct international shares.

There are two well-known types of managed accounts: SMAs and IMAs.

SMAs are generally a model portfolio operated by a fund manager, dealer group or adviser.

When an investor puts money into an SMA model they own all the stocks the manager likes and the portfolio is run the way the manager wants, just like a fund.

However, there is a degree of flexibility in certain circumstances where the client can ask the manager to include or exclude certain stocks in the SMA.

The investment minimum for an SMA model can be as low as $10,000, depending on the provider.

IMAs are generally the same but designed for high net worth individuals with over $500,000 to invest.

In an IMA, the client can agree on a specific investment mandate with a manager.

Cleaner investment experience

All in all, managed accounts provide a much better investment experience, according to OneVue head of sales Brett Marsh.

"If your money goes down in value you can crystallise a capital loss, which may be a benefit to offset future gains," Marsh says.

"That's what happens when you invest in a managed account because you're effectively on a beneficial basis investing directly.

"When you invest in managed funds you can't use that logic. Your money might go down and you may still have to pay tax."

Business has travelled "exceptionally well" for OneVue, he says.

The firm's FUA has grown to $1.1 billion since its inception in 2006.

"There has been the normal money flows but what the GFC (global financial crisis) has done is turn people to reassess needs which previously they had taken for granted," Marsh says.

"We've heard stories of clients coming back to advisers saying 'look, I understand my money has gone backwards as the markets have fallen through the global financial crisis, but what am I paying tax on my managed fund for?'

"And it wasn't an easy thing to answer because most people don't understand managed funds' tax implications.

"Many of these planners and dealer groups who faced this situation wanted to learn more and when they learned more many of them have been looking and made the

decision to move into the SMA space because it's a cleaner investor experience."

OneVue recently partnered with self-managed superannuation fund (SMSF) provider BGL for a project with dealer group Australian Financial Services.

The project aims to provide a holistic SMSF service that incorporates SMAs, managed funds and direct equities and also uses OneVue's broader unified managed accounts service, which allows for one single portfolio view of all investments.

Yellow Brick Road, co-founded by Mark Bouris, also chose OneVue as its business partner and is particularly interested in efficient direct investing.

"We expect many of their clients would be transferred to OneVue's SMA over time," Marsh says.

OneVue currently has 10 managers that offer 29 mandates via an SMA and is keen to expand that list.

"We certainly look to ensure that we have a diverse range of managers on the service and there are a couple of quite significant names we are expecting to launch in the next few weeks," Marsh says.

Its most recently added managers are Platypus Asset Management and Proactive Portfolios, he says.

He says he believes the addition of Proactive Portfolios is a step forward for the market.

"Interestingly, Proactive Portfolios, which is run by James Purvis, the founder of Purvis van Eyk, launched in May and he has got what we think is the first multi-asset class SMA in Australia," he says.

"So he'll be putting in cash, fixed interest, international equities via ETFs and multi-manager Australian shares within the one portfolio with proactive asset allocation.

"The initial take-up of that has been quite strong, so a number of advisers have immediately picked that up and we have a fair bit of interest from others who are interested in getting a product disclosure statement and indicated that they would be advising clients into this in the near future."

Fund managers paranoid

More managers are exactly what the industry needs in order to gain more traction, according to Hub24 managing director Darren Pettiona.

"For SMAs to really get the traction that they require you have to have as many non-unitised model portfolios on offer as there are traditional managed funds," Pettiona says.

"Once this occurs, it will make no sense for anyone to place money in a unitised trust structure.

"We're pushing pretty hard for that to happen; we have a lot of managers coming

on."

However, due to the transparency demands that come with SMAs, there has been paranoia from fund managers about intellectual property.

"A lot of the good brand managers are having trouble participating in SMAs, and if you don't get them to participate, it defeats everything we are trying to achieve," Pettiona says.

"Historically, fund managers did put a time lag on reporting or implementation, both of which are inefficient and has contributed to the poor growth of SMAs to date.

"At Hub24 we make managers manage their model portfolio in the same manner in which they would trade their managed fund, or alternatively build a distinct separate SMA strategy."

Hub24 allows managers to limit the amount of stocks they show on the valuation report, he says.

"When a client has a multi-manager portfolio the unrealised gains/loss report shows all underlying tax parcels as managers hold many like stocks. This ensures reporting and implementation is in real time while protecting the manager's intellectual property," he says.

Hub24 will have over 36 options in the SMA structure and Pettiona expects it to grow beyond 50 in the coming months.

The platform recently added Ankura Capital, ATI and Renaissance to its list of non-unitised model portfolios.

Hub24 is currently transitioning over $100 million in funds and working with groups such as Sentry on their future platform and transition strategies.

"Our goal is to reach $500 million in 12 months and $1.5 billion in two years," Pettiona says.

"With the dealer group relationships we have, we are on track for that. We have [spent] a long time putting this technology together so we are in this space for the long haul. Asset transitioning takes time."

Industry to replicate platform boom

Praemium chief executive Arthur Naoumidis says that while managed accounts have taken a while to gain traction, recent data suggests the sector is now on the rise.

The firm is the underlying technology provider for BlackRock's SMA platform, Customised Portfolio Service (CPS).

"I think what the main issue is we started getting traction with BlackRock just before the GFC started," Naoumidis says.

"It grew to something like just under $100 million to just under $400 million in four to five months and then the GFC started and like everything else, it tanked. No inflows

for a little while, so for 18 months it stayed flat.

"And then at about this time last year as Australia was coming out of the financial crisis it started growing again and we are well over $500 million now."

He argues that managed accounts will boom similarly to how platforms did.

"People have been critical about it, saying it's not going to work in Australia, see how long it's taken?" he says.

"There are a couple of observations I'll make. We have gone through the worst financial environment probably in 70 years so it's not unreasonable that any new service like the SMA is going to feel it, which it did but it's starting to grow again.

"And when you look back in the 1990s when the wraps were growing, they said the same thing about wraps because the first few years wraps grew very slowly, it wasn't till the late 1990s it started getting real traction.

"Now when you look in the market everyone is working on an SMA and I think I can tell you Blind Freddy can see that an SMA is better than a managed fund on a wrap."

He says the current crop of SMAs is set to grow and there will also be a new generation of accounts that BlackRock CPS plans to launch later in the year, called full strategy SMAs.

"So the full asset allocation of an investor [is] in one SMA," he says.

"Instead of the financial planner putting their clients into 10 products they will put them in one strategy . which could include a mixture of equity products, ETF products and fund products and that way you get your geographic and asset allocation distribution."

The trend towards managed accounts will be driven by adviser demand rather than a surge in model portfolios offered by fund managers, he says.

"The fund managers will do whatever the advisers want," he says.

"If you get a large dealer group saying 'I want an SMA' and they manage $4 billion, do you reckon they're going to have trouble getting fund managers putting their models on it?

"It's rubbish that you need the model managers. What you actually need is the dealer groups and they are starting."

Legislation to underpin growth

Potter and other industry experts also believe legislation will help underpin a sustained boom for the sector.

"I think what we will see is through the government's Future of Financial Advice reforms is fertile ground for the managed accounts industry," he says.

"We see dealer groups rethinking their business model and increasingly we will see

them adopting a managed account relationship with their client as a way of completely stepping out of the rebate/commissions problem and yet maintaining margins equivalent to their current margins.

"But at the same time managed account technology offers the potential for a significant reduction in the cost of investing for clients."

Pettiona points to fiduciary duty responsibility as a particularly big driver.

"This could be one that will have the big impact on the whole market," he says.

"If I put my clients in a unitised strategy when a non-unitised one is available at less cost and with all the tax benefits, would I be breaching my fiduciary responsibility to that client? And we won't know, but someone will test it.

"You can't any longer say it's not on the approved product list, that's no longer an excuse. It's planners' responsibility to look after the best interest of the client and if you fail to do that you can't say 'oh my dealer group doesn't have that on the approved list', you have to look outside of your approved list."

Marsh says the industry can reach critical mass by delivering on promises including product innovation, more investment choice and delivering on basics such as better after-tax outcomes and transparency.

"I read a statistic which showed that 78 per cent of managers in the US offered their portfolios via a managed fund and in an SMA structure," he says.

"I would expect that trend to eventually be shown here as well; I couldn't tell you what the time frame will be."

While it seems the industry has all the necessary ingredients to grow, it faces enormous challenges in convincing planners to switch over from the ingrained managed funds model to managed accounts.

It will also likely be a long hard slog to get all the mainstream platforms and fund managers to offer SMAs and IMAs.

But as Naoumidis says, dealer groups are asking for it.

"If the dealer groups have asked for it they will get it and if they don't get it from one platform, they are going to move," he says.

"At the end of the day it won't matter what the fund managers think because if they don't join the party they will lose the money.

"So it's going to be a really interesting five years."

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