Head over heels for SMAs

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BY DAVID CHAPLIN

After a couple of false starts there's a growing sense in Australia that, this time around, the separately managed account revolution is real. As David Chaplin discovers, it's independently-minded advisory groups leading the charge.

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David Lamb began with a blank piece of paper and the brief to build a system that could turn the traditional financial planning model on its head. Just over a year later, Lamb's piece of paper, now chock-full of designs, has been signed off by the board of Fortnum Financial Advisers - the new venture launched last year by industry pioneer Ray Miles.

Lamb says Fortnum will roll out part one of its new advice platform this September, with the remaining eight or so components to be put in place over the next three years.

Lamb, who joined Fortnum full time this July after a year in a consultative role, has essentially been creating the technological platform capable of delivering the dealer's promise to put the client first.

While Fortnum isn't the first dealer group to chant the client-first mantra, Lamb says in the past, advisory firms have been restricted from meeting that promise by the technological chains of traditional platforms.

He says if advisory groups want to transform into the fee-for-service, conflict-free businesses that regulators and consumers are demanding, they're going to have to strip away all that constraining technology.

Lamb quotes recent comments from a high-profile doctor who compared the medical industry with an old house that has been fixed up one too many times.

"I see the financial planning industry like that," he says. "It's been renovated and repaired so many times over the years but it now needs to be knocked down and built again from scratch."

That means dismantling many of the structures that have evolved in the financial services industry, such as wrap accounts with opaque pricing points and hidden volume rebates that act as cross-subsidies, Lamb says.

A central part of Fortnum's solution will be its Advice Wrap. The group's website claims it has "eliminated rebates, which we believe compromise the advice process".

"It's our policy to ensure complete transparency so our clients know exactly what they are paying for and who they are paying it to," the website sas.

And clients also want to pay less.

Lamb says with margin compression now apparent at all levels of the financial services value chain, fund managers, platforms and advisers must all lift efficiency levels in order to survive.

One important element of the efficiency drive for Fortnum, as well as a growing number of advisory firms, is the adoption of managed account processes at the core of the investment offering.

The managed account industry has spawned its own range of sometimes confusing terminology including, but not limited to: separately managed account (SMA), individually managed account (IMA), universal managed account (UMA), investment advisory program (IAP), managed discretionary portfolio service and discretionary portfolio account (DPA).

In 2003, the Australian Securities and Investments Commission (ASIC) attempted to corral all these acronyms under the managed discretionary account (MDA) banner, which it defined as a service that involved:

A client giving their money or other assets to the MDA service operator, or access to their money or assets (the client's contributions).

The operator having the discretion to buy and sell financial products using the Âclient's contributions.

The operator agreeing to manage the financial products acquired or derived from using the client's contributions as a discrete portfolio belonging to the client.

Despite the regulator's best attempts, though, it was the IMA and SMA labels that gained the greater

currency in Australia's financial advisory community.
The difference between the two, which providers still dither about today, comes down to the ability of clients to deviate their holdings from a set portfolio, which ranges from high, in the case of IMAs, to low, or non-existent, for SMAs.
Earlier this century the SMA model was hyped up as the perfect foil to the increasingly clumsy unit trust structure typical of managed funds. According to the blurb, SMAs offered clients the power of professional portfolio management combined with the advantages of direct ownership of shares - that is, tax benefits, flexibility, low cost and certain psychological benefits of having your name attached to assets.
It was a good story with many truthful elements, but advisers initially found it difficult to comprehend. To be fair, too, there were plenty of holes in the original SMA plot: the technology was clunky, the costs were high and the products limited.
Asgard, for example, flopped with its SMA launched in 2002, claimed then as a market first but which barely raised a dollar.
But by the time BlackRock came to the market a few years later, the conditions were much more amenable for the SMA concept. By offering improved technology, lower costs and a wider portfolio choice, BlackRock has ground out an impressive SMA business in the intervening period.
This April, BlackRock accrued $500 million in the 4500-plus individual SMA accounts it administers in association with technology partner Praemium - an event it celebrated by press release.
In the release, BlackRock head of retail Scott Phillips said the growth of the firm's SMA, called the Customised Portfolio Service, "has primarily been driven by adviser and investor demand for a low-cost portfolio solution that is simple, transparent and flexible".
That demand is also driving a considerable expansion in the SMA market generally as fund managers, platforms, dealer groups, software firms and research houses are beginning to tap into the niche pioneered by BlackRock.
According to Toby Potter, who describes himself as the "only consultant specialising in the managed account space", the confluence of regulation, consumer awareness and technological advances has created the ideal conditions for SMAs to flourish.
Potter, who was also recently appointed head of nascent industry body the Institute of Managed Account Providers (IMAP), says the growth in the number of SMA software and platform offerings in the last couple of years alone has been staggering.
"When I first started consulting [in the managed accounts area], if you wanted SMA software then IAS [Investment Administration Services] was the only choice," he says.
"Now there are tonnes of technology providers and each one implies a different business model."
Potter reels off some names of the niche SMA platform/software names contending for adviser support: OneVue, Hub24, Linear, Praemium and netwealth.
The list is by no means complete.
It also excludes the traditional, institutionally-owned wrap providers who, Potter says, are working furiously in the background to engineer their systems for managed account business. "[Institutions] are making considerable expenditure on building portfolio management capabilities into their platforms," he says.
The NAB-owned Navigator platform has already scored a notable success in the space, attracting about $100 million into its SMA-friendly superannuation product since launching a year ago.
Navigator has proven the institutionally-owned platforms won't easily give up their market dominance to the SMA-inspired upstarts.
However, those upstarts are beginning to forge close relationships with many financial planning groups, which is clearly posing a threat to the status quo.
Chris Hipkin, head of the Melbourne-based Linear Financial, says close to 1200 advisers are already using his firm's system, either directly or via badged versions.
Hipkin says Linear provides "an investment platform that puts SMAs at its centre". As well as offering a range of SMA portfolios, some of which Linear manages itself, he says the platform can deliver the traditional services of a regular wrap - reporting on managed funds and the like at a much discounted cost.
For example, Linear provides platform administration for as little as 44 basis points and investment management fees starting from 25 basis points.
According to Hipkin, in the past 12 months or so, interest from dealer groups has picked up considerably as they recognise how new-generation platforms like Linear's can help re-engineer advice businesses.
"Adviser business models are being challenged," he says.
"And for many managed accounts are the way to go ahead."
But Hipkin also tempers the optimism with a note of realism. He says SMAs will probably never entirely replace the traditional unit trust managed fund structure.
"Unit trusts are made for the masses," he says. "I think we need to recalibrate our expectations for SMAs."
But there's no doubt that the range of SMA portfolios available, and their accessibility, has improved markedly over the last couple of years.

In the past, SMAs were really limited to Australian equity portfolios alone.
But the increasing popularity of exchange-traded funds (ETFs), for instance, has enabled the model to extend into other asset classes, such as international equities and commodities - albeit in a passive management mode.
Likewise, providers have been able to bolt on other features to SMA products, such as capital protection. Hipkin says Linear's capital-protected SMA has drawn in over $50 million over the past 12 months.
IMAP's Potter says another trend is becoming apparent as some advisory firms have begun to assert control of the asset management process, rather than simply purchasing SMA portfolios from firms such as BlackRock.
Potter says he would be surprised if at least half of the top 100 dealer groups were not investigating how to use SMAs.
"Perhaps a better way to see [the growth of SMAs] is that they are an evolution of model portfolios," Potter says. As a consequence, he says many dealer groups are currently beefing up their investment committees to direct how SMA portfolios are constructed.
Listed financial services firm Snowball Group, for example, is making a concerted push to rejig the investment menu for its affiliated advisers, who operate under the dual Western Pacific and Outlook brands.
Eammon Roles, who recently joined Snowball to help modernise its product range, says SMAs would form a core part of the group's investment solutions for advisers.
Roles says Snowball advisers already use BlackRock's SMA service but the firm intends to take a more active interest in how its model portfolios are structured and administered.
Earlier this year, Snowball appointed a central investment committee that will oversee the approved product list for both its dealer groups, which will include a strong focus on developing an SMA strategy.
"From the research we've done and observed, there is a significant move towards greater use and appetite for SMAs among advisers and clients," Roles says.
While he says the group has "just started on our SMA journey", it's committed to going down that path.
The Melbourne-based boutique dealer group, Paradigm Wealth Management, is already a year ahead of Snowball down the SMA road.
Patrick Nalty, Paradigm managing director, has not regretted the change of direction.
Nalty says Paradigm, which appointed an independent investment committee to help guide its SMA choices, has lowered its costs to clients while improving the level of service they get.
At the same time, Paradigm has increased its own margins as it earns 60 basis points for investment management services - a fee that typically gets dissipated between platforms and fund managers in a wrap world.
In effect, Paradigm now acts like a "mini industry super fund", Nalty says, awarding mandates to its SMA managers. The group has transitioned about $100 million to its SMA models so far and also white-labels the service for a couple of other dealer groups.
According to Nalty, fund managers also like the new way of doing business, despite having to give up some margin and their portfolio information.
"I think [SMAs] are the way of the future, especially for independent advisory groups," Nalty says. "Managers tell me they like it too because they don't have to pay for all those shelf-space fees and other things."
Damian Holland, head of distribution for Ralton Asset Management, agrees that fund managers are losing their SMA fears. Holland says Ralton, which only distributes its value-based portfolios via SMAs, has noted an almost daily increase in managers joining the market.
He says the SMA business is finally beginning to fulfill its potential - Ralton Asset Management alone has pulled in $30 million over the past 12 months.
The recent Planner direct equities and SMA Report from research house Investment Trends also confirms the shift in sentiment. Mark Johnston, head of Investment Trends, says the report recorded an almost doubling of the number of advisers using SMAs - from 5 per cent up to 9 per cent.
That increase has mainly been fuelled by advisers who don't usually deal in direct equities, a group that also appears to be keen to increase their SMA exposure, Johnston says.
Both Nalty and Holland admit the new SMA world does hold risks for advisers and fund managers alike. Without the sticky legal structures of unit trusts, master trusts or wrap accounts, clients are much freer to exit the grip of funds and/or advisers.
"If clients don't like us they can transfer," Nalty says. "We, and fund managers, will live or die by how good we are. We will all constantly have to prove our value.
"Everyone is on notice. It keeps everyone on their toes."

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