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WHY FINANCIAL PLANNERS HAVE DIVED INTO PLATFORMS

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As managed fund inflows struggle to return to pre-GFC levels, share trading and direct investments became increasingly popular with retail investors over the past couple of years. Financial planners seem to prefer platforms as a tool to manage direct investments and Benjamin Levy examines why this is the case.

No investment trend is permanent. Yet for now, there is no end in sight to the growing popularity of direct shares and exchange traded funds (ETFs).

Direct share trading has continued to increase in funds under management over the last year as investors seek out more control, more flexibility, and more value for money. Industry research house Investment Trends has predicted that 40 per cent of new client funds will be placed into direct shares within the next three years, up from 28 per cent in 2011.

Platforms, the primary source for most planners wanting access to direct share investments, are benefiting from this growth. BT Wrap saw their direct share investments on the platform jump from \$4.2 billion in June 2009 to \$7.1 billion in June 2011. While the amount of funds under management as a proportion of total platform assets only rose from 16.2 per cent to 17.5 per cent during the same period, it is still a significant amount.

But some advisers are concerned that platforms are not delivering enough with their direct share offering, an accusation hotly disputed by the platform providers.

While managed funds have continued to decline as direct equities gain in strength, ETFs are continuing to expand, combining benefits from both sectors and providing a source of competition to direct equities.

More control, more efficiency

"There's no question for me that people are taking increasing ownership of their retirement portfolio. They're more hands on and switched on with it, and that's not going to go away," says Andrew Bird, Australian executive director of online portfolio management company, Sharesight.

Self-managed super fund (SMSF) investors, who are more sophisticated and involved, are one of the main interest groups involved in direct share trading. With investments in any superannuation account being long-term accumulation assets, direct shares will play an important role within SMSF portfolios for many years.

The main driver of interest in direct shares among SMSF investors, and for financial planning clients, is more control and flexibility over investments, Bird says.

"People are going to be better educated and more hands on with their investments, I think, and that tends to support direct equities," Bird says.

A significant amount of the direct share trading growth on BT Financial Group's BT Wrap is driven by the SMSF sector.

"If someone has enough investment dollars to warrant a self managed super fund, typically they're going to be more sophisticated in terms of investment criteria, and therefore more interested in shares," says head

of BT Wrap, Chris Freeman.

The portion of direct shares on BT Wrap is growing both as a proportion of total assets and in terms of absolute numbers, Freeman adds.

Direct equities traditionally represent around a third of the assets on the Macquarie Wrap platform.

"The use of direct equities continues to increase and interest in them continues to increase," says Macquarie Adviser Services head of insurance and platforms, Justin Delaney.

According to Delaney, Macquarie has the highest proportion of equities on their platform compared to the rest of the Australian market, with investors able to access every stock listed on the Australian Securities Exchange.

"I expect that to increase, so certainly from the trend we see by talking to advisers, they talk about increased appetite from their clients to add equities to the platform," Delaney says.

Cheaper for planners

"Reporting and optimisation of the portfolio can be a lot easier with direct shares, and they can be cheaper to manage and administer depending on how you do it," according to Bird.

Using direct shares means that advisers often deal with 20 to 30 stocks in a client's portfolio instead of a handful of investment funds. Once you multiply that by your number of clients, a pile of paperwork becomes a mountain and a once-simple process can seem overwhelming. However, the extra work is often illusory.

"If you're organised, a lot of the work is fairly mechanical record keeping rather than complicated issues, which I think sometimes gets lost in the debate about wrap platforms and reporting and everything," Bird says.

Investment Trends identified a clear attraction towards cost saving measures in its 2011 Planner Direct Equities Report. In a multiple question survey in the report, 58 per cent of financial planners said they recommend direct shares to their clients because it was cost effective, according to senior investment analyst, Recep Peker.

The platforms are also aware of cost concerns among clients and are taking measures to lower transaction fees. BT implemented bulk trading capabilities last year to improve efficiency for advisers, allowing them to bulk buy shares for up to 25 client portfolios at once.

Freeman indicated at the time that planners were struggling to service large numbers of clients and simultaneously manage costs.

One of the barriers to building direct equity portfolios on the platform was a high administration burden involved in trading shares across a diverse client base, Freeman said last year.

Platform offerings prove popular

Platform providers are the principal benefactors of any growing interest in direct equities trading. Around 60 per cent of financial planners use an investment platform for the share exposure, with the other 30 per cent relying on an online broker, according to Investment Trends research.

Pooling all your direct investments in one place and letting the platform take care of the administration is no doubt what lures most planners to the platforms.

Macquarie's Delaney said the group realised that many advisers were toying with the idea of using equities on platforms, but they were unsure about the perceived high costs of doing so.

The company ran research indicating that advisers would be able to service 40 per cent more clients on average with direct equity trading on a platform than if they left the direct equities off the platform.

"The efficiency of having equity managed through the platform for an adviser was significant," Delaney says.

However, there have been accusations that some platforms are failing to deliver on their direct share offerings.

Only 16 per cent of financial planners who use platforms said the direct equities offering was 'very good', according to Investments Trends' report.

Furthermore, the number of planners using platforms appears to have plateaued. No extra planners are using platforms for direct investments than what has already been recorded in previous years.

Platforms have improved their offering by fixing shortcomings, but new problems with share market research, timelines of data and pricing are emerging, Peker says.

However, providers are vigorously defending their role against questions of discontent.

"We spent a lot of money over the last three years improving our equities functionality because we saw that as a growing trend," Freeman says.

"The big thing for us – and this is from adviser feedback – is that advisers using our models are saving up to 2.5 hours on portfolio rebalancing compared to doing things manually," he says.

BT has improved its access to information, with tailor-made watchlists and same-day trading also being available to advisers.

OnePath's wholesale administration wrap platform, Oasis Asset Management, launched a new online direct share trading facility last year to combat concerns that advisers didn't have enough control and had to deal with perplexing systems.

The feature allows advisers to hold a separate Holder Identification Number for each client and maintain control of their share holdings, according to OnePath head of superannuation and investment platforms, Mike Pankhurst.

Macquarie also worked on removing the cost concerns that worried advisers and clients.

However, Delaney acknowledged that they could do more to evolve research and trading services for advisers.

Despite most signs pointing to platforms as the optimum direct investment management tool, Morningstar co-head of fund research, Tim Murphy, said advisers tended to complain about platforms because they don't have the right structure.

"Platforms in general were designed with managed funds in mind, they weren't really designed for trading securities on live exchanges," he says.

"Some platforms have addressed that situation better than others, but it varies across the board," Murphy says.

With ETFs and direct shares becoming more popular, platforms have been ploughing money into their structure, but they are at different stages of success.

But Investment Trends' claims of gaps in market share research among platforms ring hollow. Share research is widely available, with online broking companies such as Bell Direct offering research and trading abilities for just \$15, while Westpac broking and Commonwealth Online securities also offer these services to advisers at a slightly higher price of \$20.

Freeman denies that there is a problem with platforms' provision of share research.

"Research is like a commodity, you can get it anywhere," he says.

"Most advisers are part of dealer groups, and they have their own research areas that have different arrangements with different brokers, who also provide their own research. So I don't think research is much of an issue," Freeman says.

Whatever the criticisms, platforms can take comfort in the fact that they are the favourable investment management tool in the sector.

"If you tell advisers that there was only one place for direct share trading and what should it be, then investment platforms do come out on top slightly," Peker says.

Direct shares vs managed investments

Investors have a nasty habit of abandoning one investment solution in favour of another when things don't go their way in the short term. The disillusion with fund manager performance during and immediately after the global financial crisis (GFC) has continued to force a shift away from managed funds towards more transparent solutions like index funds and ETF's, and direct equities are riding that wave all the way to the top.

In a multiple choice question from the Investment Trends direct equities report, 58 per cent of financial planners said they used direct equities because they're transparent.

"If I'm just holding managed funds, my clients don't see what's in them, but by holding direct shares they understand what they're holding, and there's no fund manager to pay, its only whatever fee I'm charging," Peker says.

Managed fund investments also have a lag time between the end of the financial year and when they distribute their final distributions, which can be frustrating for advisers unable to tell their clients how much money they are receiving.

"That's a significant issue, certainly for a lot of advisers, because they can't close off the investments

often until September or October [after the financial year]," Bird says.

Managed funds typically contain multiple layers of fees that take away from the final return for the investor. Management expense ratios (MER), buy/sell spreads, internal portfolio transaction costs, performance fees, arranger fees and platform shelf fees all add up, and make managed funds increasingly opaque and expensive.

A natural benefit of transparency is that bad shares can be easily identified and sold off, according to Godfrey Pembroke principal consultant, David Benney.

A more active managed fund with 100 per cent total fund turnover each year will also incur more capital gains tax (CGT). While a less active fund can lower its CGT, knowing whether it is a more active fund or not won't be possible until after the end of the financial year, Benney wrote.

Direct shares, on the other hand, can have their CGT and franking credits controlled.

"Managed funds typically invest in direct shares anyway to generate returns, so the end investment is often the same stock," Benney added.

However, only a minority of investors believe they can get a better deal through direct shares than through managed funds, according to Freeman.

There has been a bit of disillusion with active fund managers who have had performance issues since the GFC, he says.

Good fund managers that are delivering above benchmark returns are still taking significant amounts of money, Freeman adds. The bulk of BT Wrap's investments are managed funds, as well as a significant amount in cash and term deposits.

The best way to increase an investor's investment potential is by increasing your tax benefits, and the tax optimisation structure within direct equities that the platforms offer is pulling advisers into the sector.

BT Wrap has just released a new tax optimisation functionality, in which advisers can set a default method of calculating tax on each transaction to minimum gain. Advisers are also warned about incurring capital gains tax on any transaction less than 12 months old.

"I wouldn't underestimate the impact of tax, because in a flat market, after tax investment returns means better value for clients," Freeman says.

"Tax management can give you significant benefits in terms of direct shares as opposed to other investments," he adds.

ETFs

Direct equities don't have a monopoly on transparency and simple products. ETFs have seen growth of 70 per cent every year over the last three years since the end of the financial crisis, according to an ETF report released by Tria Investment Partners.

The value of the ETF sector is meant to jump by nearly \$2 billion by the end of the year, according to a Russell Investments analysis of ETF market trends.

For advisers who don't want to move too far away from managed funds but still want to have the benefits of direct equities, ETFs can provide a unique blend of characteristics found in both sectors.

"ETF's are interesting because they're a sort of a hybrid between managed investments and direct equities. I think the plain vanilla type ETFs give you the benefits of both worlds, because they give you the ease of holding and record keeping everything in stocks but let you achieve the diversification and easy asset allocation that you can get with a fund," Bird says.

ETF provider Australian Index Investments (AII), which was launched in May 2010, owns six sector specific ETFs in financials, financial ex-REITS, industrial, development mining, resources and energy, corresponding to sectors established by Standard and Poor's.

Much like macro investing, AII's multi-sector approach to ETF investment means clients can split their funds up and overweight to certain sectors based on their performance.

"If you buy the broad benchmark, it's very difficult to overweight and underweight, you've just got to take the whole lot," says AII chief executive Annmaree Varelas.

Not only has the financial crisis caused a significant shift in investor's appetite for liquidity and transparency, but the incoming Future of Financial Advice regulations will also spur continued investment in ETFs, according to Varelas.

"The current moves by many of the financial planning groups at the moment to a non-commission payment future means you see them looking for cheaper products and a product that is easily accessible - and that's where ETFs come into their own, because they are a lot cheaper than traditional managed funds,"

Varelas says.

Splitting their ETF products among sectors like industrial, resources, energy and mining also ensures that the shares are even more liquid and high volume than investors have come to expect.

Statistics provided by AII found that ETF trade volumes were up 3.6 per cent over the last 12 months to June, while the market cap for the ETF sector increased by 33.7 per cent over that period to \$4.6 billion.

The 12 month average value of ETF trading also increased by 14.7 per cent.

However, ETFs may not be as popular as they are made out to be. While the sector has grown by \$ 4 billion up until this year, managed funds grew by more than \$1 trillion at the same time. It is a miniscule amount comparatively.

"There's a lot of talk about this product at the moment, and a lot of education going on, but the actual amount of money going into ETFs from Australian advisers still isn't big. If you define popularity by chatter, they're pretty popular, if you define it by actual money trading hands, it's not so popular yet," Murphy says.

This product has also come under increasing criticism from researchers and regulators in the industry.

The Australian Securities and Investments Commission (ASIC) recently raised concerns that retail client orders for ETFs were not being appropriately priced.

A number of times orders for index ETFs were placed well away from the value implied by the underlying index, resulting in an increase in pre-emptive actions against the practice, ASIC said.

Tria Investment has also been warning investors to research their ETFs before choosing them.

The emergence of increasingly complex and risky structures means that investors and advisers should do their homework first, the company warned.

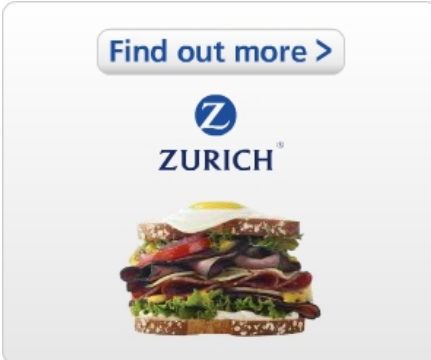
However, Murphy defended the product against ASIC's claims, saying that most of the regulator's issues came about as a result of inexperienced share traders and were a concern when investors traded any direct stock.

"I think all those specific cases that ASIC raised were self directed investors who weren't trading ETFs in the way that they should be traded," Murphy says.

"It just comes down to understanding if you're going to trade ETFs with the best trading or implementation method. In the scheme of things, it is a fairly miniscule proportion of what goes on."

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