

Planners going for brokers

Lisa Pennell delves into the world of direct equity investing and reports on the latest trends and developments in products and services

The global financial crisis (GFC) wrecked more than just portfolio values - it shook consumer trust in the financial services industry overall. When the dust finally settled, many managed fund investors were left scratching their heads, asking why they had trusted and paid for expert advice from fund managers to end up losing out anyway.

As part of the ensuing fallout, there's been a surge in the use of retail online brokers. The number of Australians trading online rose by 50,000 over the past year to a new high of 650,000 in May 2010, according to the Investment Trends *First Half 2010 Online Broking Report*. And that's just the beginning - the growth in underlying trader numbers should see future high-volume months set new records for the online brokers.

Demand from their clients is thought to be driving a similar behavioural change in financial planners, who are increasingly turning towards direct equity investments for new client funds. Since 2008, advisers have been gradually moving towards direct shares and other listed investments, including hybrids, exchange-traded funds

(ETFs), real estate investment trusts (REITs), listed invested companies (LICs) and separately managed accounts (SMAs), but this year in particular, there's been a dramatically larger shift.

Managed funds have clearly been the biggest losers - the *June 2010 Planner Direct Equities (& SMA) Report* shows that just half of recent inflows were directed to unlisted managed funds, down from 62 per cent the year before. And the trend looks set to continue. Investment Trends say two-thirds of all planners now advise on direct shares and this group expects their allocation to direct equities to rise from the current level of 23 per cent of funds under management, to 34 per cent within the next three years.

The move away from managed funds and towards direct listed investments is prompting another shift in the financial services industry - leading planners to look for alternative platforms. The Investment Trends report shows many planners are currently using multiple channels for direct equity transactions, with each planner using on average 1.5 different channels. Of those, 64 per cent currently use an investment platform, 42 per



Arnie Selvarajah

The Core Trading platform.

Pete Steel



cent use a full-service stockbroker and 32 per cent use an online broker that's not on a platform.

Interestingly, how trades will be facilitated in the future is still not clear, although it does seem likely that most planners intend to trade electronically. When the planners were asked which channel they would prefer to be using for direct equity transactions in three years' time, 45 per cent said an investment platform, 20 per cent said an online broker (not on a platform), 16 per cent said a full-service broker, 7 per cent said planning software and 6 per cent said they would prefer to use a white label platform.

Among the investment platforms, BT Wrap, Macquarie Wrap and Asgard eWrap are the most widely used for share trading, and these are also perceived to have the best direct equities offering. On the other hand, there are no statistics currently available on the wholesale

market share of the online brokers.

According to Investment Trends, just over half of online Australian retail investors use CommSec as their main broker. E*TRADE, owned by ANZ, has 17 per cent market share, Westpac Online Investing holds 10 per cent and NAB OnLine Trading is at 6 per cent. In what may yet shape up to be the David and Goliath battle of online broking, the biggest mover over the past year was Bell Direct, whose primary share doubled from 2 per cent to 4 per cent, driven by a combination of low price and high client satisfaction.

Despite the lack of accurate market share data, anecdotal evidence suggests CommSec's retail dominance is reflected in the wholesale arena. The acquisition of IWL three years ago gave CommSec significant market share in wholesale broking, leading to the launch of Core Equity Services in

March 2009.

After six years' experience with the Commonwealth Bank, most recently as CommSec's CIO, Pete Steel was appointed general manager of Core Equity Services in November 2009. He says that at the time, he saw an opportunity to transform the wholesale online broking services on offer. He also believed no one was providing a good end-to-end solution for advisers whose value proposition had been challenged by the GFC.

"We set out to provide a good, viable alternative to existing channels. The difference in the Core Equity Services offering is that it's built for service, including the capability for data feeds, invoicing and a whole range of tools," Steel says.

"Most importantly, we have great people, a dedicated adviser desk and a world-class website with robust technology. We are able to provide guidance to planners on

'The real question is, is the platform the hub or is the planning software the hub?'

exactly what to buy and sell via our para-planner portfolio construction service, which helps them look good to their clients.

"We have the best research in the market and are focused on creating models that are more acceptable to advisers. The next step will be integrating those models to make them even easier to use as well as bringing out new services to improve the integration of information."

Steel says while we've already seen a big flow out of managed funds, he will not be surprised if between 60 and 65 per cent of client inflows are directed to direct listed investments within the next 18 months.

"ETFs are going to become even more important for planners as a cost-effective and easy way to diversify their client portfolios," he says.

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“The challenge as the financial planning industry moves towards a fee-for-service model is for planners to figure out how to provide a good value proposition and attach the right fee structure.”

Online broker Bell Direct was first launched in November 2007 and in May 2008, Arnie Selvarajah was appointed CEO. Sporting a resumé that includes executive manager at CommSec and a role at Bankers Trust, where he was directly involved with the development and launch of BT Wrap, he says the aim was to create a new paradigm in online broking with a strong client focus.

Selvarajah says the Bell Direct website is easy to use and informative with several unique features, including multi-client trading, which allows a planner to place buy or sell orders for multiple clients at the same time.

“Although the orders are placed separately with the ASX, they are placed almost instantaneously. The feature enables a planner to get a number of clients in or out of a particular stock with the press of one button, relieving the pressure of execution,” he says.

“The functionality of the site makes it easy to find a client’s portfolio and instantly see any relevant news and announcements relating to that stock, giving the client the confidence [that] their adviser is on top of things.

“In terms of research and modelling, after my previous experience

‘Trading outside a wrap allows the planner to make a variable margin on each trade’

in development of a wrap, I didn’t want to create a closed model. Rather than dictating what the planner can do or where they can access research and portfolio modelling, we are focused on building links and integration with other sources of information.”

Bell Direct also has the facility for client trading, either alongside the planner in one account or in separate accounts, which can still be consolidated for reporting purposes.

“We’ve had a great response to this feature. It’s a great way for planners to demonstrate value and allows for increased transparency,” Selvarajah says.

Steel says that Core Equity Services expects to add a similar functionality by the end of the year, but points out that not all planners

will want their clients to be able to view or access their portfolios directly.

“Today, the whole model is in question and it’s important for planners to get a clean business model to begin with,” he says. “Some of the new features available via online brokers could in fact create challenges for planners if they’re not prepared for them.”

Selvarajah describes the move towards direct equity investment as a “quantum shift” and says that on top of a general dissatisfaction with managed fund performance post-GFC, investors are tired of seeing any positive returns whittled away by fees.

He says planners are transitioning from a commercial model based on fees and trail commissions to a fee-for-service model, and direct equities trading outside a wrap allows the planner to make a variable margin on each trade.

“There’s new consumer resentment towards high fees buried in managed funds, and in fact any lack of transparency on commissions or payments,” Selvarajah says. “With a flat fee of \$20 per trade on our service, the planner can decide a specific mark-up for each client, or even each trade if they want to.

“The reality is there’s an arms race going on at the moment in online broking. It’s all about technology; who will get it out first, who will offer it cheaper.”

Steel says Core Equity Services has a highly competitive rate card,

which calculates a fee based on the bundle of services a planner is using, rather than a flat fee-per-trade pricing structure. He adds that in the current environment, as well as wanting to manage costs, advisers want good integration of information to facilitate performance and tax reporting, leaving them less dependent on wraps.

Selvarajah agrees, and says Bell Direct is also working on data feeds for all major planning software options to reduce the workload for planners in consolidating information.

Within the world of investment platforms, listed investments are also attracting attention. Macquarie’s head of insurance and platform, Justin Delaney, says he’s seeing increasing demand and increased awareness from planners for direct equities via the Macquarie Wrap. Around 40 per cent of Macquarie Wrap’s holdings are direct equities - around double that of its competitors - with the platform currently settling around 35,000 trades a month.

Delaney points out that the liquidity of listed investments is also driving their increased popularity after many managed funds were frozen post-GFC.

“Investors want to know they can easily access their money, if they want to, when they want to,” he says.

Although Macquarie does operate a wholesale online broker arm offering, Delaney says it would be

...to meet your clients’ increasing demands.

“premature” to talk about specifically targeting the online segment at this point. He believes a wrap platform is not in competition with an online broker in any case, as he says the value proposition is completely different.

“The wrap offers a full custodial service and so it’s a strong efficiency choice. The benefit of the wrap comes with settlement and planner access to overall information. We contain all the cost-based, income and trading information in one place, reconcile it and audit it,” Delaney says.

“Even though interfacing can work, with any sort of feed of information there’s always the chance of missing pieces and at the end of the day, someone still has to perform the reconciliation.

“Our research shows a planner can manage 120 clients within the wrap compared to 70 without it, which is a 70 per cent increase in efficiency via the wrap. The wrap enables the planner the time to provide advice to their clients.

“It’s a case of horses for courses. If a planner is able to get a client a good deal with another option, go for it. But it doesn’t take long for the value of the wrap to become clear, particularly with any sort of volume or complexity - the administration has got to be done somewhere.”

But Steve James, head of adviser trading solutions at Core Equity Services, says although the wrap is “a bigger universe”, many clients simply don’t want their shares held

in the name of the custodian.

“In today’s environment, a lot of investors want to see their shares held in their own name. And with more and more clients pushing for transparency, the wrap holding fee can be a barrier too,” James says.



Justin Delaney

He says that with Core Equity Services’ data feed capability with the major planning software, including Visy Plan and XPlan, the issue of consolidated reporting within a wrap is less relevant.

“The real question is, is the platform the hub [of an adviser’s business model] or is the planning software the hub?” he says.

“Whatever the research says,

our sales reports show the hard truth. The trend towards online broking is definitely growing.”

The online brokers say one of the big draw cards for planners using their service is the lower cost, but Delaney says the argument that

wraps are more expensive is simply not true.

“Planners can choose from 40 different brokers within the wrap to facilitate a trade, so the cost of the trade will be according to whichever broker they choose, and it’s clear and transparent. The other discrete fees involved in the wrap are based on each component in the chain,” he says.

Delaney says as the Macquarie Wrap model is relatively advanced, the only significant new feature planned is the inclusion of model portfolios, which he expects to be available by the end of the year.

“Every adviser has their own way to manage client portfolios. We want to offer options for the adviser while still allowing them to tailor the macro to the individual client,” he says.

Selvarajah suggests that rather than planners making a channel choice for direct equity investments based on their own priorities, the key challenge today is to understand what clients are looking for.

“It’s a new world and planners need to deliver what their clients want,” he says. “To do that, they need to ask their clients what they want; do they want to be advised? Do they want to place trades themselves? Do they want to review their own portfolio? Will they be using an accountant anyway, meaning reporting might be less important?”

“In the past three years there’s been more written about financial services than ever before, including the way advisers are remunerated and how fees can be hidden.

“The client has changed in what they want and what they know - the average consumer is much better equipped and hungry for value. As an industry, we’re now dealing with a knowledgeable and discerning consumer.

“I’d dare anyone at this point to ignore the client.” ■

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