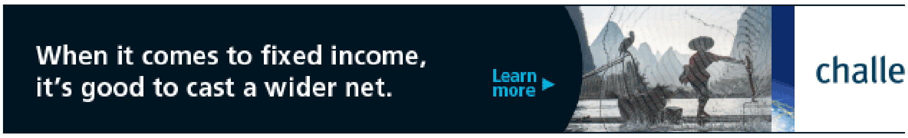

The curious rise of managed accounts

6 October 2017 by Malavika Santhebennur | 0 Comments

Managed accounts have been around for over 20 years but their use has risen suddenly in the last three to four years, particularly in the IFA market. Malavika Santhebennur writes that the reasons varied, from enhanced technology, and FOFA to increased availability on platforms.

There has been a surge in the use and popularity of managed accounts and the independent financial adviser (IFA) market has led this charge.

The rise in popularity among financial planners and IFAs, and the shift away from direct shares is despite the industry having confused advisers about what managed accounts really are.

The myriad of acronyms was to blame, according to Mason Stevens' managing director, Thomas Bignill, who said introducing terms such as separately managed accounts (SMAs), individually managed accounts (IMAs), and managed discretionary accounts (MDAs) had contributed to the confusion.

"We as an industry did a very good job in confusing advisers early on. With all the acronyms, all of that rubbish marketing rubbish that's out there, I think we did a wonderful job of confusing advisers," Bignill said.

"There was no leadership there to really lay out that this is the common acronym. These are what they all mean. And I think a lot of participants in the industry are blamed for that, from the Australian Securities and Investments Commission (ASIC) to

Despite the confusion in messaging, the rapid increase in the use of managed accounts, to the detriment of the use of direct shares, cannot be ignored.

Industry experts attribute this to a variety of reasons, including the availability of information at the fingertips of end investors due to technology, the increasing availability of managed accounts due to the growth of MDAs and independent operators.

LET THE NUMBERS TALK

Recent research released jointly by the National Australia Bank (NAB) and Investment Trends showed the IFA market was leading the trend in the use of managed accounts, with 53 per cent of IFAs using managed accounts, compared to 47 per cent of aligned firms.

Furthermore, the report not only illustrated the increasing take-up of managed accounts by financial planners, it also showed the proportion of planners who recommended direct shares was simultaneously falling.

The 'NAB/Investment Trends 2017 Planner Managed Accounts and Direct Equities Summary Report', released in July, showed that the proportion of planners who currently advised on client investments in direct shares fell to 50 per cent in 2017, down from 57 per cent in 2014, 56 per cent in 2015, and 55 per cent in 2016.

Conversely, planners' use of managed accounts increased for the fifth consecutive year, with the largest year-on-year growth coming in the last 12 months.

In 2017, 26 per cent of the financial planners surveyed have used managed accounts and intend on continuing to use them, up from 18 per cent in 2014, 20 per cent in 2015, and 22 per cent in 2016.

The appeal of managed accounts may lie in the fact that while, like a managed fund, it allows investors access to a diversified investment portfolio monitored by a professional investment manager, the investments are not pooled with money from other investors.

Managed accounts are personalised investment portfolios designed for the specific needs of the investor, and the investor can see what shares and securities they are holding, monitor performance daily, and can exit their positions at any time.

Furthermore, where capital gains tax liabilities would be shared by all unitholders in a pooled managed fund, this would not be the case with SMAs. Investors can change portfolios without paying tax penalties.

WHY ARE IFAS LEADING?

Perhaps the most significant finding of the NAB/Investment Trends report was the fact that IFAs were leading the trend by a six-per centage point differential.

Investment Trends chief executive, Michael Blomfield, said at a media event during the release of the report in July that while this may not seem significant, accounting for the process IFAs must endure to secure inculsion of managed accounts on approved product lists (APLs) would illustrate the considerable differential.

"It's a huge differential in just the number of organisations that have to approve so for them to be able to go through all the approval processes right across the IFA community and be six points up on the bank-owned distribution is actually a really big differential," he said.

WLM Financial Planning director and Certified Financial Planner, Matthew Walker, said the firm transitioned from the more traditional platform and wrap accounts to managed accounts approximately four or five years ago.

He attributed the rise of managed accounts usage among IFAs to the fact that they have been able to adopt them more rapidly because they could make faster choices on how they managed their clients' funds.

"The APL for an IFA is able to be managed more dynamically whereas for large institutions and aligned advisers, that APL is far less likely to be as flexible and therefore be able to capture these sorts of evolutions in the market," Walker said.

"The aligned adviser, bank distribution network will be looking more at their own APLs and their own products and their own distribution approaches and can take time to adapt."

Blomfield said aligned institutions and banks were conservative and hence the take-up has been slower.

"In the network of planning around the banks, equally, this is a more complex product and whilst it's quite clear that it's being used with clients of lower values, I think the movement down the value curve has been and will be slower through the bank-owned distribution channels than it will be through the IFAs," he said.

"If we look at IFAs versus bank-owned distribution, we do tend to find this higher net worth in the IFA space and that's to be expected, right?

"There is a process to get these things on the APL list, there's a process of client suitability that tends to expand over time in the banks."

Investment Trends' research director, Recep Peker, observed that there had been a confluence of factors that had contributed to the greater adoption of managed accounts.

"For example, something that's been challenging in the past was the limited range of platforms on which managed accounts were available. But now, 30 per cent of financial planners have access to managed accounts on their preferred platforms," he said.

"As recently as 2012, only seven per cent had access to it on their preferred platform. So the proportion of planners who have access to it on their preferred platform in four years between 2012 and 2016 increased fourfold."

Institute of Managed Accounts Professionals (IMAP) chief executive, Toby Potter, recently told Money Management's Fintech Platforms and Wraps Conference that the Future of Financial Advice (FOFA) reforms and rules around things like volume rebates destroying licensee revenue streams had driven the rise in the use of managed accounts by advice firms.

However, Walker said FOFA had not had any direct impact other than the fact that with compliance requirements being fairly high, and the cost of advice being fairly high, financial advisers were looking to run a business as efficiently as possible to price advice at a point that was acceptable to clients while generating profit. This could be through gaining economies of scale or reducing costs in administration services.

"That's where managed accounts, because of the way they can be managed in an aggregate and particularly if you go to certain levels or styles of using a managed account such as an MDA, you can manage all of your clients' investments in aggregate, and therefore greatly reduce the back office overheads and the transaction costs," Walker said.

OLD BUT NEW

Macquarie Wealth Management's head of wealth product, Cameron Garrett, said managed accounts have been in existence for a long time, with the firm launching its first managed account solution, an IMA, in 2000, while it launched its first SMA in 2007, and built in its SMA onto its platform solution in 2014.

He attributes the sudden increase in usage to the fact that:

1) It has become part of a platform solution, two, the solutions have been simplified and were better understood;
2) The solutions had been simplified and they were better understood by advisers; and
3) The platform functionality in managed accounts provided the flexibility to meet advisers; needs.

Garrett also said there was flexibility in the way advisers charged the SMA and they may charge differently on the SMA compared to how they would on the rest of the client portfolio.

"Advisers are increasingly having the negotiating power with fund managers to be able to have preferred pricing and this is something we'll be able to have shortly within our SMAs," he said.

"Shortly we will be launching the capability for the adviser or the client to remove specific investments within the SMA in the same way that institutional investors have been able to do in the past.

"There's also the opportunity where we're about to release the capability to provide rebates within SMAs for specific fund managers."

MULTIPLE MANAGERS

Netwealth head of managed accounts, Steve Thomas, said that when advice groups first began using managed accounts, they were using a range of risk profiles or diversified portfolios for clients. A dealer group might have structured five risk profile managed accounts that were conservative, moderate, balance growth, and high growth as an example, and they would all be managed by the one manager.

"What we've actually seen and particularly over the last six months, a lot of groups now are looking to providing more sophisticated portfolio management solutions. So where previously they might have used one manager, they're now looking at effectively outsourcing part of the portfolio to specialist managers," Thomas said.

"For example, in a balanced portfolio, they might say to a group such as DNR or a group such as Ralton, can you handle and manage the direct Australian equity portion of my balanced portfolio?

"In effect, you're really creating these models of models where the expanded number of managed account providers and asset classes available within managed accounts are enabling groups to almost pick a best-of-breed for the different asset classes."

Netwealth, which recently expanded its retail managed account menu with the appointment of two new managers, has seen a 385 per cent rise over the 2016/2017 period of managed accounts assets held within its platform, with $800 million in assets sitting in the space.

TRANSITION IS TOUGH

However, a surprising finding for Thomas was that the use of managed funds was higher than what he anticipated. The reason was that they were still easy to use: they might have somewhere between eight and 15 managed funds that they have used for all their clients.

"Now, to transition a client from those eight to 15 managed funds directly into eight or 15 managed accounts or even three or four managed accounts, the number of assets because effectively you've got full transparency to the underlying asset, the portfolio might go from eight or 10 underlying assets to potentially 70 or 80 or even more," Thomas said.

"That's a really big jump for clients so we're finding a lot of groups in that situation are transitioning over to a managed accounts structure, getting the immediate benefits of not having to do the ROA [records of advice] paperwork, but then looking over time to transition from a managed fund to a direct holding where a managed account is available."

Bignill, whose firm, Mason Stevens, began in 2010, and acquired its first managed account client six months into conception, said 'transition' was the key word for advisers who were beginning to use managed accounts: transition meant change, which meant advisers required education to learn about the new service, so they could then educate their clients.

"I think the fact that you had to change your business, you have to go back to every client, in most cases you're changing platforms, or moving to a managed account operator, which means you're coming off a platform and onto a managed accounts operator," he said.

"So you have to go to every client, every client has to get an SOA, so there's a real process in doing that and I think that's been one of the major barriers of and why it's taken a long time because people are slow to change."

However, Walker said technology had reduced barriers for the take-up of managed accounts as firms did not need to spend the amounts of money that they used to in order to implement new services.

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"With technology, and open-sourced architecture across a lot of different platforms these days, you can build solutions at far less capital-intensive levels and therefore provide access in a fairly cost-effective way and roll that out fairly easily across a range of different platforms or pieces of software or through adviser groups," Walker said.

"The software that we use for financial planning didn't have to change, the reporting didn't have to change, nothing fundamentally changed. The managed accounts are simply an administration service for us in exactly the same way as a wrap would be or a superannuation fund is or anything of that sort of nature."

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