

Implementing Model Portfolios – Solutions for SMSF Advisers

David Heather
Chief Executive Officer



Disclaimer

This information is unsolicited general information only for licensed dealers and advisers. None of the information contained herein is to be taken as personal financial product advice. In preparing this information, Investment Administration Services Pty Ltd has not taken into account any individual investor's objectives, tax and financial situation or particular needs. Before making any decision based on the information herein, investors should consider the appropriateness of any investment vehicle relevant to their own personal objectives, financial situation and needs. Investors should seek professional advice and read all relevant Product Disclosure Statements and/or other relevant documents before investing.

Agenda

- Implementation options available to the SMSF adviser
- Can a Managed Discretionary Account (MDA) Service enhance your practice and enhance the client experience ?
- Key aspects of the MDA approach: legal and regulatory overview, roles and responsibilities, financial obligations
- Establishing a MDA Service as part of a service offering: portfolio management, documentation, advice and differentiating yourself
- From the coalface – practical tips for advisers considering using a MDA
- Real client case studies

About managedaccounts.com.au

- Sydney based company founded in 2005, previously known as Investment Administration Services or IAS
- Listed on the ASX in June 2014 with market cap ~\$30m (ASX: MGP), cash flow positive and profitable
- A specialist managed account provider enabling advisory firms to implement a MDA solution without the need for advisory firms to have a MDA Operator authorisation
- \$1.17bn in FUA as at September 2014
- Does not provide investment management or personal advice
- Providing solutions to 25 boutique advisory firms, all differentiated from each other through branding, portfolio design and fee approaches

Lets Not Let The Facts Get In The Way of a Good Story !

- “A professional direct model portfolio service can solve most of the direct investment barriers”
- A common statement across the industry but factually only correct when the adviser does not do the implementation
- Why ? Because compliance and adviser desire to sign off stock selections to share ownership in the decision mean that there is always distortion between model changes by the model provider and the client portfolios
- So an advised or “Do it with them” model using model portfolios cannot solve most of the direct investment barriers...in fact it solves none
- Lets drill into this further

Implementation Options Available

- Creative solutions across portfolio construction and administration, some more robust than others, all driven by a desire to lower raw cost of delivery by the adviser

Stock Selection and Portfolio Construction	Administration
Adviser Driven	Wrap
Practice or Dealer Model Portfolios	Inhouse Off Platform
Broker Model Portfolios	Broker Administration Service
Research House Model Portfolios	Outsourced Administration Provider
Professional Manager Model Portfolios	Broker Trading Records
Broker bespoke Portfolios	Managed Account

Managing Your Own Portfolios Without Discretion

Pros	Cons
Potential increase in revenue	Margin dilution potential through inefficiencies
Potential reduction in cost to client	Additional research, ongoing monitoring and governance requirements
Transparency for the client	Need for ongoing RoA's for portfolio changes and corporate actions
Client can better control tax position	Increased accountability of adviser
	Heightened advice risk
	Inability to actively manage portfolios across client base
	Increased trade execution requirements and corporate action response requirements
	Ongoing business growth cannot be sustained

Using Externally Managed Model Portfolios Without Discretion

Pros	Cons
Potential increase in revenue	Margin dilution potential through inefficiencies
Potential reduction in cost to client	Need for ongoing RoA's for portfolio changes and corporate actions
Transparency for the client	Heightened advice risk, adviser is still responsible for the advice
Client can better control tax position	Inability to keep clients in line with model portfolio leads to different outcomes for clients
Eliminates or reduces research inputs and some governance	Increased trade execution requirements and corporate action response requirements
Some model portfolios are "free"	Ongoing business growth cannot be sustained

Using Broker Bespoke Portfolios

Pros	Cons
Potential reduction in cost to client	Broker and planner convergence, every broker will be a planner !
Eliminates or reduces research inputs and some governance	Broker needs to deliver personal advice to the client, so what is the adviser role ? Or some brokers may pass trades back to adviser to provide advice under your AFSL so you take responsibility for the advice
Use of specialist resource but who owns the client	Corporate actions not advised on, potential risk to adviser
Typically no ongoing management fee but a brokerage cost	No active management, adviser push approach to any portfolio reviews
Trade execution handled by the broker	Poor business model will be exposed by better clients or clients will be poached by the broker

Using Wrap

Pros	Cons
Outsourced administration	Expensive for what you get in return but a compliant framework
Consolidated reporting including tax reporting	Old technology and managed funds orientation provides sub-optimal solution for listed products eg. Waiting on sale proceeds before purchasing
Integration of listed and unlisted investments for portfolio where both are used	No link between advice, investment management and administration – just a record keeping mechanism
Backed by large players	Wraps now actively marketing and communicating with clients

Inhouse Off Platform Administration

Pros	Cons
Potential increase in revenue to practice	Margin dilution potential through inefficiencies or poor delivery
Potential reduction in cost to client	Responsibility for technology, reporting, additional resources to manage administration functions and mail house administration
May use better technology than wrap	Increased risk to business
	No link between advice, investment management and administration – just a record keeping mechanism
	No regulatory regime overlaying the service; Administration Services do not require an AFSL where not offering custody

External Off Platform Administration

Pros	Cons
Often provided through improved technology over wrap and providers are experienced in direct investments	No regulatory regime overlaying the service; Administration Services do not require an AFSL where not offering custody
Integrated solution for execution and administration	Retail client adequate protection if something goes wrong ?
	Sustainability and quality of provider if not a core business
	If a broker, a future competitor may have your client details

Investment Trends and the Advised or “Do It With Me” Model

Investment Trends Research *	Fact	Solution
Compliance Risk	Significant compliance risk, RoA for each portfolio change and corporate event. The adviser is still providing the personal advice to the client	
Too much work monitoring individual stocks	Advisers have to monitor for portfolio changes and be across the stock changes to incorporate into the personal advice to the client	
Prefer to access professional fund managers	No professional fund managers makes their IP available in this way, outside of Lonsec of course !	
Not my area of specialty	Adviser may not be licensed or accredited or lack confidence to discuss direct investments with clients so unlikely to use a “DO IT WITH THEM” model	

Investment Trends and the Advised or “Do It With Me” Model

Investment Trends Research *	Fact	Solution
Lack of client demand	Who is the adviser here ? If a client seeks transparency, lower fees or an ability to manage their tax position better, they are demanding direct investments	
Not allowed by the dealer group	Adviser may not be accredited as the dealer may not have the AFSL authorisation	
Lack of investment expertise/ experience	Adviser may not be licensed or accredited or lack confidence to discuss direct investments with clients so unlikely to use an advised or “Do it with them” model	
Prefer to diversify into other assets	Unlikely to change this thinking even with a broad range of options	
Lack of tools for managing corporate actions	Some guidance may be provided but the implementation client rests with the adviser and these tools are lacking across the various administration solutions	

Conclusions on the Advised or “Do It With Me” Model

- Compliance Risk – adviser is providing the same personal advice as if they were selecting the stocks themselves, not to mention corporate events
- Practice Efficiency – additional RoA’s for portfolio changes and corporate actions across a growing client base can significantly impact on practice efficiency
- Portfolio Management – client portfolios cannot be managed in line with the model due to compliance requirements, adviser and client availability and implementation timeliness which leads to different performance and risk outcomes
- Reduction in cost to client – but that can be wiped out in one trade that is not implemented or is slowly implemented ?

Conclusions on the Advised or “Do It With Me” Model

- Practice profitability enhancement – often questionable and if so at what cost to the client ?
- Clients – is this type of model in the best interests of the clients when a better model is available ?
- Scalability – no matter which model portfolio source you use, few can implement a scalable advice model and no what off platform or wrap platform you use, without discretion, modelling tools and a custody capacity, you do not have scalability

Optimal Requirements

- Compliance Risk – reduction in personal advice but retain the direct investment outcome
- Practice Efficiency – eliminate ongoing RoA's
- Portfolio Management – enable client portfolios to be actively managed particularly to preserve capital
- Reduction in cost to client – deliver an integrated solution across administration, portfolio management and advice at a competitive cost
- Practice profitability – enhance profitability through greater revenue streams and more efficient processes
- Scalability – a scalable administration solution to handle growth
- Management – refocus on business growth, client strategies and relationships not supporting the current business

Optimal Requirements

The optimal solution is a Managed Account !

What is a Managed Account ?

A portfolio of assets that are owned by an investor, managed by an investment manager in accordance with an agreed investment strategy or mandate, and administered by a professional administrator who undertakes the portfolio administration functions and provides reporting to the investor and their adviser

Comparing Managed Accounts

FEATURE	MANAGED ACCOUNT	MANAGED FUND	DIRECT EQUITY
Transparency	√		√
Professional management	√	√	
Beneficial ownership	√		√
Client owns tax position	√		√
Tax reporting	√	√	
Avoid embedded CGT	√		√
Corporate actions	√	√	
Portability	√		√
Legal structure	√	√	

Managed Account Value Proposition

- Compliance – no need for advice on individual securities with personal advice at the strategy level rather than security level
- Advice – no RoA's necessary for ongoing portfolio changes and corporate actions
- Portfolio Management – client portfolios are actively managed and implementation is centralised using sophisticated modelling capability through wholesale broking arrangements
- Reduction in cost to client – integrated solution across administration, portfolio management and advice with administration from 25bp and brokerage from as low as 3bp
- Practice profitability – offers practice profitability enhancement over other vehicles. Fully implemented solutions for as low as 55bp allowing for practice margin into investment piece with reduced cost to deliver advice and administration
- Scalability – across advice and administration

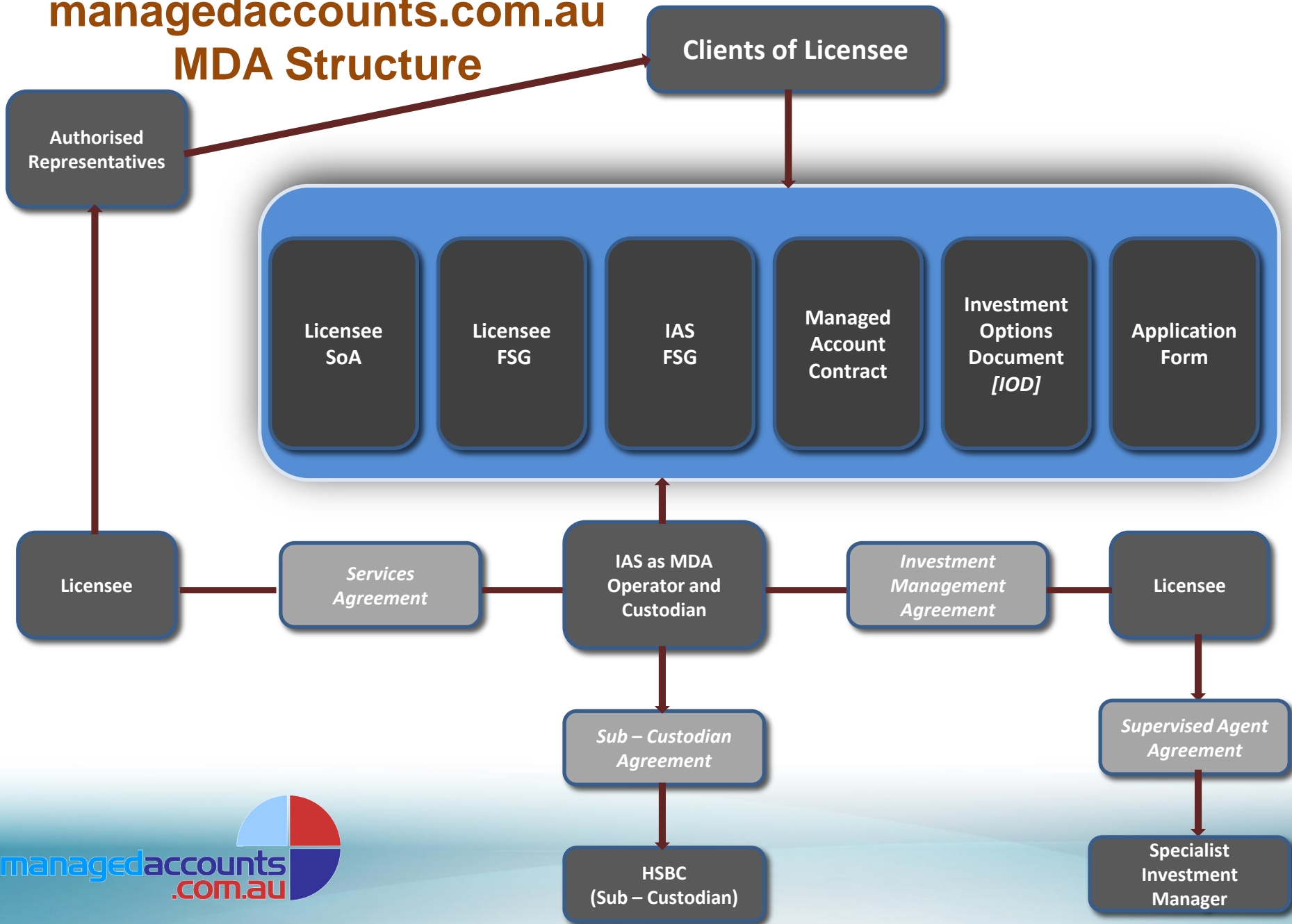
Managed Account Legal and Regulatory Overview

- Available through different legal structures – essentially via a PDS based arrangement or via a Managed Discretionary Account (MDA)
- PDS based approaches generally use a one size fits all approach to model portfolios with new and existing money being constantly rebalanced against client portfolios
- MDAs are a contractual based arrangement where the client contracts with a MDA Operator. MDA Operator is responsible for all aspects of the MDA Service though some functions can be outsourced
- MDAs are regulated through Regulatory Guide 179 and Class Order CO 04/194
- Over 190 MDA Operators in Australia, many are advisory firms
- Many other advisory firms use a Limited MDA arrangement

MDA Operator Roles and Responsibilities



managedaccounts.com.au MDA Structure



MDA Proposed Regulatory Changes

- ASIC have flagged a number of changes to the MDA compliance regime
- Increased NTA requirements – from \$50,000 to 0.5% of FUA eg. \$200m in FUA would equate to \$1m NTA
- Removal of Limited MDA (effectively a MDA run by an AFSL without an MDA Operator authorisation in its AFSL)
- Operational and documentation compliance based changes
- Significant impact on existing MDA Operators in Australia and barrier to entry for any firm looking to obtain an MDA
- Likely in 2015

Options Available For A Managed Account

- Use a product off the shelf – a number of wrap providers now have model portfolio capability and a number of other independent providers have model portfolio and wrap capability
- There is convergence between wraps and the new providers with both offering a menu of managers and models for advisers to use
- Set up a Limited MDA – not recommended given that ASIC has flagged that these will require MDA Operator arrangements to be put in place
- Obtain a MDA Operator authorisation – unlikely to obtain without the relevant experience and consider the NTA imposition likely in 2015
- Work with a specialist provider to establish a MDA Service for you, customised to your needs, with the MDA Operator authorisation and NTA provided by the specialist provider

Understanding Your Requirements

- Clients and Advice – take the time to understand what your clients require. A managed account design is matched back to client needs to get best outcomes
- Portfolio design – take the time to understand how a managed account can provide a range of investment options to suit a range of needs
- Portfolio management – consider how portfolios should be managed and whether portfolio management is part of your value proposition or whether all or part of this should be outsourced
- Fees – better providers have a flexible approach to fees to create different options
- Branding – understand the depth and breadth of branding capability of providers and match to your needs. Don't just use an off the shelf product when you can have your own custom built Service

Advice Considerations

- Regulatory Guide and Class Order are very prescriptive for advice on MDAs
- SoA upfront recommending the suitability of the MDA and an Investment Program for the client with prescribed wording to be included
- No ongoing RoA's unless the client is switched from one Investment Option to another
- Annual review requirement to confirm the MDA and Investment Program are still suitable
- Establishes a value proposition for your business

Portfolio Design Is Not Just About Equities

- Discretion across a broad range of assets –

Cash	Australian Shares
Term Deposits	Registered Managed Investment Schemes
Government and Semi Government Bonds	Unregistered Managed Investment Schemes
Corporate Bonds	Listed Investment Companies (LICs)
Bank Bills	Exchange Traded Funds (ETFs)
Listed Income Securities	A REITS

Advisory Firm Control Over Portfolio Design

Your Managed Portfolios or Outsource to
your Choice of Manager



Cash
Portfolio



Asset
Class
Portfolios
eg. Fixed
Interest
(Bonds,
TDs,
Cash)



Risk
Profile
Portfolios
eg.
Balanced

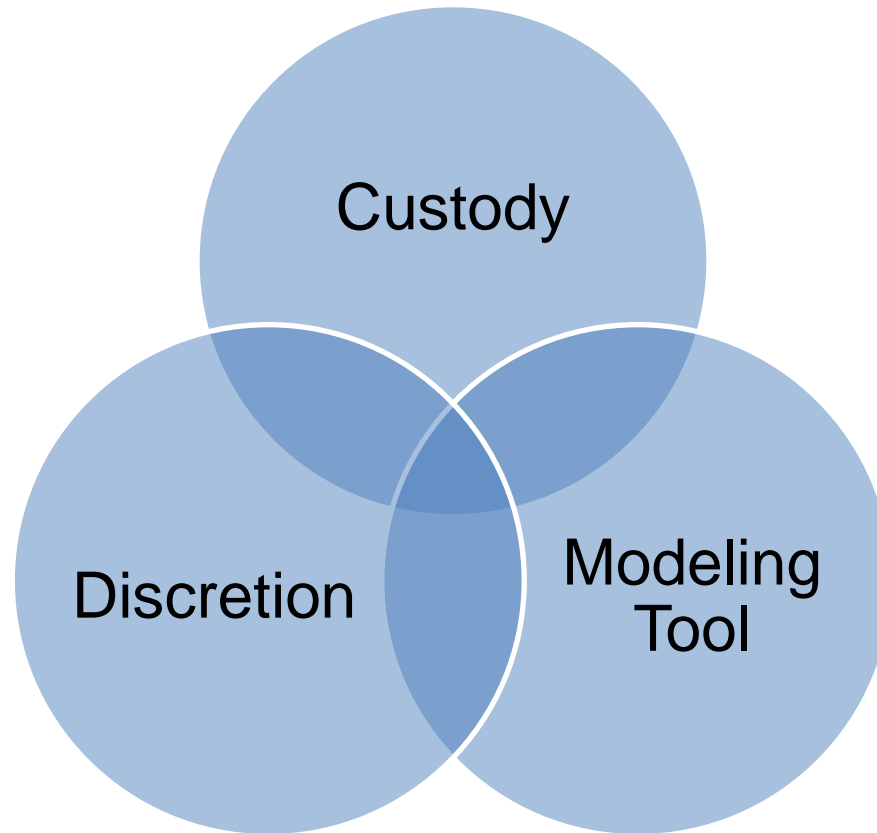


Mandated
Portfolios
eg.
Outsourced
Australian
Share
Portfolio

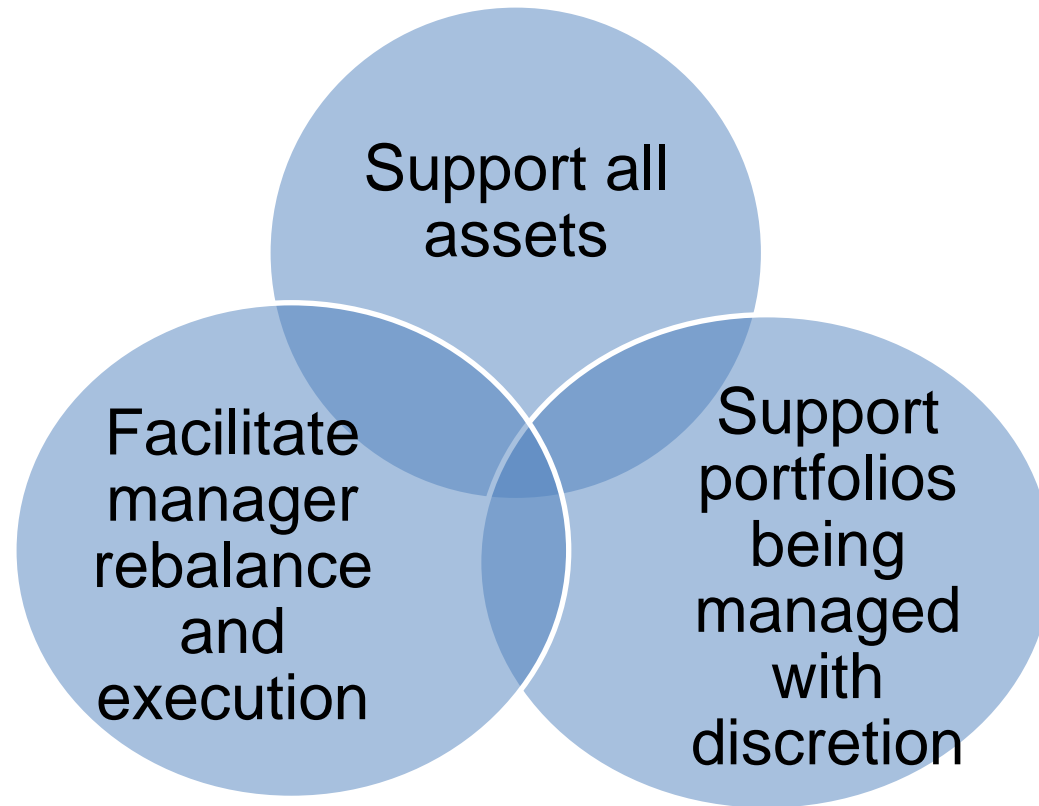


Tailored
Portfolio
eg. IMA
strategy
or parcel
locking

Three Pillars of Scalable Portfolio Management



Importance of Portfolio Modelling Technology



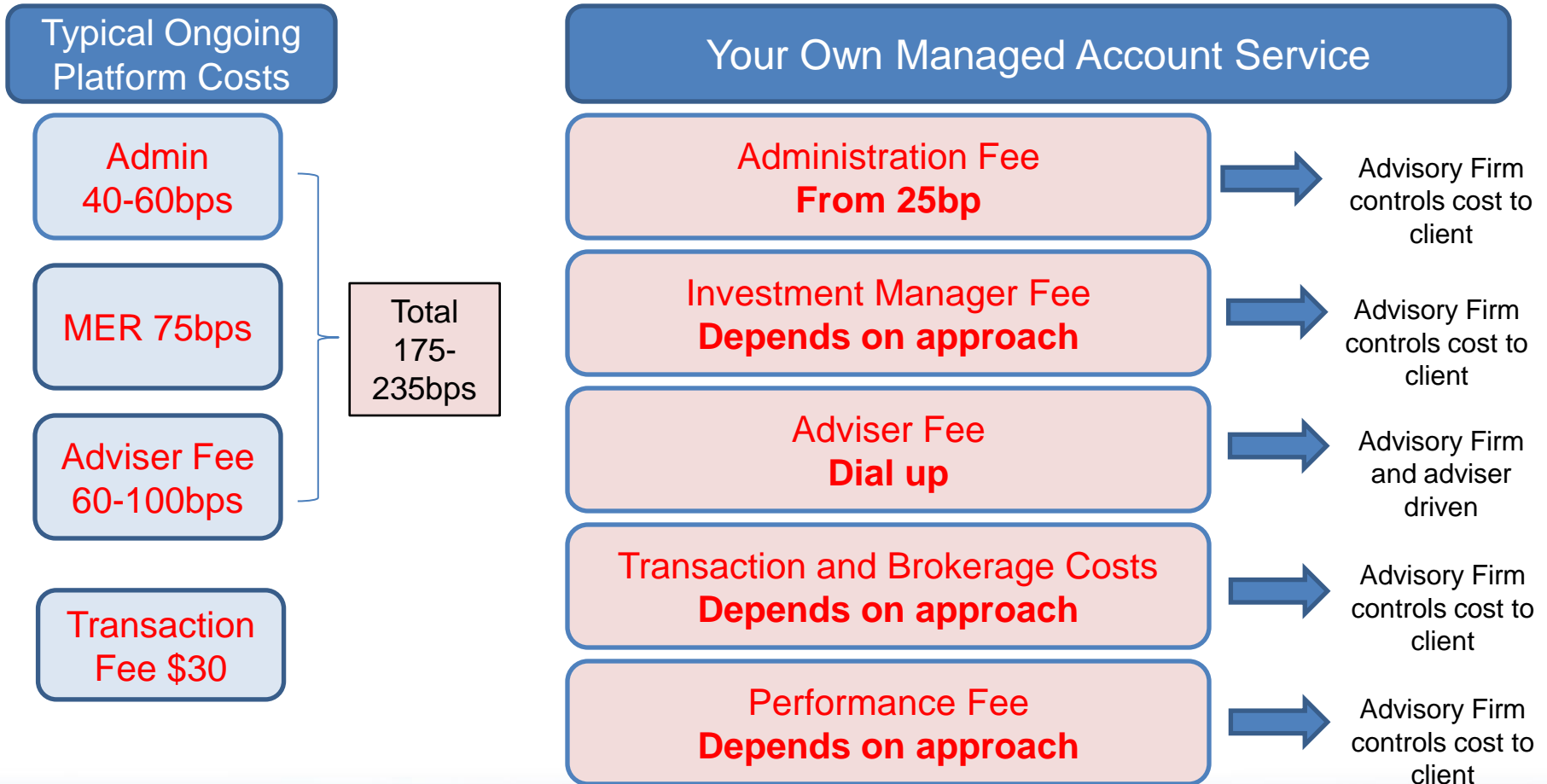
Portfolio Management Considerations

- Model approach – a number of providers work on a money invested today is fully invested tomorrow approach, and that new and existing money is rebalanced against one model, other providers have a discretionary approach able to be adopted by the portfolio manager – this can have a major effect of portfolio performance for new clients
- Model based vs client tilts – modelling tools are very sophisticated to achieve infinite outcomes but there is a trade off between maximum efficiency and client outcomes
- Asset coverage – the modeling tool and provider you select must be able to support all of the assets you intend to run through client portfolios with discretion for you to gain maximum efficiency
- Execution – don't have the provider do this, this is a manager function so work with a provider that allows this to occur

Portfolio Management Considerations

- Corporate actions – some provider make all corporate actions available including Share Purchase Plans, others not
- Corporate actions – some providers allow decisions to be made across all investors or can you take into account individual client circumstances
- Voting – is this important to you now and in the future ? If so, choose a provider who enables this

Control of Cost to Client



Fee Models – no one size fits all

- Driven by the compliance regime behind the offer you are using
- Consistent approach across investors through a PDS, client contractual based approach through MDA providing for variable pricing
- PDS based approach typically has an administration fee, investment management fee, performance fee and adviser fee identification
- Rolled up fees common in MDA – not possible through a PDS

Fee Models – no one size fits all

To extract greatest margin...

- Select a provider that meets your requirements, enables you to control the Service definition and thus enable you to control the investment manager margin and total cost to client

Branding Approach

- Portfolios in your brand if you desire or perhaps establish a separate AFSL for your portfolio management activity
- Marketing and disclosure documentation in your brand including application form and all client correspondence
- Website and reporting in your brand fully integrated into your own website

Supporting a SMSF Solution

- Segregated accounts – ability to run multiple member strategies within a single account structure
- Flexible Portfolio design to support specific strategies for SMSF's particularly Pension clients
- Super administration integration – to achieve end to end integration to the Administrator and Accountant
- Audit simplification – GS007 audit certificates
- RITC – is it claimed and who gets the benefit ?

Not Just a SMSF and Investment Solution

- Super Managed Account capability in place
- Partnership approach with Administrator and Trustee
- PDS requirement but same investment approach as SMSF and Investment
- Delivery of SMSF like investment outcomes to members with larger balances

Summary

- Managed accounts are the optimal solution for a SMSF adviser focused on listed products
- Managed accounts are a total business solution not just another product
- You can differentiate your business from your competitors, even without your own MDA authorisation - understand your requirements and match these up to the options available to you
- Managed accounts are about portfolio management first - portfolio management should not be a one size fits all if you can avoid it
- Managed accounts to drive additional efficiency and functionality into the delivery of SMSF's