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MANAGED PORTFOLIOS

A sound investment in your clients and your business

HUB24

CORE DATA research

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It is no secret that financial advisers are under increasing pressure to grow their business which means focusing on revenue growth and profitability as well as delivering quality financial product advice to their clients in the context of an increasing and ever changing regulatory and compliance environment. Most importantly advisers are looking for ways to add value to their clients. Following improvements in technology, managed portfolios have the potential to streamline administrative operations and deliver measurable gains to clients, and advisers, in terms of outcomes and costs.

Uptake of new technologies – especially those that challenge the status quo – can often be slow, and despite their many benefits, research by CoreData[1] suggests only one third of advisers in Australia are using managed portfolios within their practice. A lack of understanding about the potential benefits available and how platforms are delivering these solutions is often a key impediment to their take-up, yet the concept is remarkably straightforward.

In essence, a managed portfolio is a package of a diverse range of investments, which may encompass traditional managed funds, and listed securities including exchange traded funds and listed investment companies, as well as cash-based assets such as term deposits that is managed by a professional investment manager within the framework of an investor directed portfolio service (IDPS) or super wrap platform.

"In essence, a managed portfolio is a package of a diverse range of investments"

The client can provide a standing instruction in relation to the investments in the managed portfolio – so those investments remain investor directed. Those investments, however, typically reflect the investment strategy developed by a professional investment manager who is responsible for the development and ongoing monitoring of the investment strategy of the managed portfolio. This means investment rebalancing and reallocation of investments within the managed portfolio can occur seamlessly as and when required.

There can be important benefits to the client of holding such a portfolio: exposure to a broad selection of asset classes enabling risk management and the pursuit of growth objectives, access to professional investment managers and the potential for tax efficiencies that are not available through investing in traditional managed investment schemes.

For advisers, the ability to collaborate, outsource or partly outsource investment management in accordance with a client's standing instruction can provide new opportunities to reduce or remove some of the burden associated with records of advice (RoAs). The ability to construct managed portfolios that can speak to the needs of different types of clients, while reducing the administrative burden has the potential to enable a greater focus on the core function of providing holistic planning and strategic advice for their clients.

References

1. CoreData Managed Portfolios White Paper, 2015

THE GROWING TREND TO MANAGED PORTFOLIOS OVERSEAS

The use of managed portfolios in jurisdictions such as the United States and the United Kingdom is part of a wider outsourcing trend driven by a confluence of factors including the bid to reduce regulatory risk, lower investment management costs and meet rising client expectations.

Growing momentum in the UK

Momentum for investment management outsourcing has increased measurably in the UK following the introduction of the Retail Distribution Review (RDR) on 31 December 2012[2]. The RDR resulted in heightened scrutiny of adviser recommendations, and many advisers no longer consider investment selection their core strength.

Support for managed portfolios in the UK has been further bolstered by the incoming MiFID II (the Markets in Financial Instruments Directive) regulations, set to take effect in 2018.

Under the regulations, advisers will have to comply with additional transparency and reporting obligations.

The shift from managing investments to financial planning was underscored by CoreData's Adviser Fees and Business Models 2015 report[3], which found UK advisers only spend 15% of their time managing existing client portfolios.

The net result is that as many as 45% of UK advisers use managed portfolios[4], a figure that could potentially reach 60-70% over the next few years. In fact, research by Skandia in the UK found the majority of investment advisers now outsource portfolio management[5]. Findings from the research, which surveyed 252 UK investment advisers, reveal the proportion of advisers outsourcing portfolio management rose to above 50% for the first time in Q4 2016, while the proportion of advisers who choose not to outsource dropped to 48%. Under the regulations, advisers will have to comply with additional transparency and reporting obligations.

Risk mitigation drives US outsourcing

In the United States, the Natixis Portfolio Clarity U.S. Trends Report for the third quarter of 2016[6] reported that financial advisers are increasingly using diversified managed portfolios as a means of risk mitigation in expectation of volatile market conditions.

The same report found advisers are managing two-thirds (67%) of their clients' discretionary assets themselves though 33% of client assets are either in their firm's managed portfolios or managed by external consultants[7]. One in 10 (9%) advisers say they plan to outsource investment decisions[8].

New technology underpins growth in use of managed portfolios in Australia

Managed portfolios have been available in Australia in various forms for many years. However, in practice many of the processes associated with them were manual or unscaleable, which led to higher costs where only high net worth investors could benefit. In recent years, the development of more efficient technology has meant that managed portfolios can be operated in a way that is cheaper and faster, and therefore more accessible to a broader range of investors.

In September 2016, the Institute of Managed Account Professionals released its 2016 Managed Accounts FUM Survey, estimating the investment pool of outsourced assets is currently more than $30 billion[9].

References

2. Schroders Adviser Survey Q4, 2016
3. CoreData Research Adviser Fees and Business Models, 2015
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5. Schroders Adviser Survey Q4, 2016
6. Natixis Portfolio Clarity U.S. Trends Report, Q3 2016
7. Natixis Portfolio Clarity U.S. Trends Report Q3 2016
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THE TRIFECTA OF BENEFITS OFFERED BY MANAGED PORTFOLIOS

To understand some of the advantages of managed portfolios it is worth breaking down the advantages across three key groups: clients, advisers and practice staff.

Wins for the client

For an adviser, any product or service must fulfil one overarching brief – better serving clients' needs.

Control and Transparency

One of the headline advantages of managed portfolios is the potential they offer to build a highly diverse portfolio.

Rather than being limited to traditional listed investments such as equities, managed portfolios can encompass other listed securities including hybrids, bonds, exchange traded bonds, units and exchange traded funds as well as unlisted managed funds.

In specie transfers can typically be made into the managed portfolio, and, subject to the terms on which the managed portfolios is made available, specific stock holding can be removed or swapped to reflect the preferences, current holdings or ethical considerations of each client.
Without an interposing trust, clients can see exactly which assets comprise the managed portfolio, with complete visibility of underlying investments. This transparency also allows advisers to monitor client portfolios on a daily (rather than monthly or quarterly) basis, which in turn can enhance a deepening of the client/adviser relationship.

Tax efficiency

Australian investors are increasingly becoming aware of the need to measure portfolio success by after-tax returns. Yet, in a traditional managed fund, investments are unitised, hence individuals have no control over the timing of transactions with regards to personal tax planning. Indeed, the fund manager's decision to sell underlying assets may be driven by the redemption requests of other unitholders, rather than reflecting market timing benefit that an adviser or their client is seeking to achieve.

Within a managed portfolio, tax benefits that can be associated with dividends and franking credits flow directly to the client (which in turn can offer predictable cash flows to them), something that may not always be the case with a managed fund.

Furthermore, by using the platform technology through which managed portfolios are made available, advisers can time the transacting of specific parcels of securities to optimise tax outcomes for the individual client (with a view to maximising or minimising gains).

"Australian investors are increasingly becoming aware of the need to measure portfolio success by after-tax returns"

Wins for advisers

Benefits delivered to clients can organically flow through to advisers not just in terms of an improved service but also through business growth via increased client referrals.

Enhanced efficiency deepens the client relationship

Research by the Association of Financial Advisers[10], indicates that 82% of adviser clients place greatest importance on their adviser's ability to build rapport, show their concern for the client and understand the client's needs.

Strong technical skills on the other hand, are assumed to be a given, with just 4% of respondents citing this as the "most important" quality of a financial adviser.

How does this relate to managed portfolios?

Improved management of tax outcomes (often a key client objective) allows advisers to demonstrate on a practical level, genuine concern for their clients' tax positions.

The transparency of managed portfolios allows advisers to keep each client better informed, often with near-real time data. The portfolio manager typically provides regular commentary, firstly on their view of the global outlook, and then, on how they are tailoring the position in the portfolios in response to market developments. This can resonate with clients, who can track what is happening in the world in the news, and then see how their portfolio manager is responding to these events. This can then provide a topic of conversation between clients and their social network, acting as a driver of referrals.

The outsourcing of asset management and portfolio construction also provides efficiencies in the implementation and management of client portfolios. This can result in cost savings to the adviser, which can be passed on to clients.

By integrating managed portfolios as part of a broader proposition, rather than as a standalone managed portfolio offer, advisers can access the services provided by the platform provider – including superannuation and investments, consolidated reporting and tax optimisation.

The use of managed portfolios can be a radical step for advice practices, and it may involve a rethink of an adviser's value proposition. Ultimately though it also allows advisers to focus on what they do best – engaging with clients to provide holistic and strategic, tailored advice – the very activity that clients value most. From a business continuity perspective, outsourcing the investment function also eliminates many of the concerns over succession planning.

"82% of clients place greatest importance on their adviser's ability to build rapport"

Wins for administrative staff

As managed portfolios remove a large part of the burden associated with building and managing a client's investment portfolio, administrative staff are relieved of a wide array of every-day, high-cost tasks.

As all or part of the investment management is provided by a professional investment manager, administrative operations are significantly streamlined. The process of buying/selling investments in-house can be virtually eliminated, offering considerable administrative time savings.

The result is that administrative staff can be freed up to focus on higher value activities. Indeed, a practice may find it needs fewer administrative personnel because of the efficiencies available through managed portfolios or they can be better utilised supporting client management and strategic advice functions.

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10. The Trusted Adviser - Honouring the client at every turn, AFA White Paper, May 2013 https://3-afa.cdn.aspedia.net/sites/default/files/uploaded-content/field_f_content_file/afa_-_the_trusted_adviser_white_paper_lr.pdf

MAKING THE RETURN TO ADVICE RATHER THAN PORTFOLIO MANAGEMENT

A CASE STUDY

By choosing the right IDPS and super wrap and embracing managed portfolios, a Hobart based financial advice practice has been able to return to its core role of providing quality, strategic advice, with improved outcomes for clients and the business.

In the aftermath of the global financial crisis, the principals of this practice realised a "set and hold" approach was no longer appropriate. They began to adopt a more active approach to portfolio management with a new goal of buying undervalued shares with strong income potential.

While clients liked, and understood this approach, portfolios soon began to diverge. Behind the scenes the practice was experiencing tremendous inefficiencies and congested administrative operations saw the number of back-office staff numbers balloon rapidly. As increasing amounts of time were taken up with investment implementation, the principals began to question whether they were advisers or portfolio managers.

Returning to dynamic asset allocation

Understandably, the principals were eager to relinquish some of the portfolio management work and return to dynamic asset allocation (DAA). However, sector funds offered limited flexibility and directly held securities were inefficient to implement.

In 2014, a chance meeting saw the principals introduced to the concept of managed portfolios made available through an IDPS or super wrap. They recognised the potential of managed portfolios to provide DAA-driven portfolios managed by well-resourced professionals. It meant the application of institutional-level knowledge to individual clients, and diversified investments that would be managed by a skilled asset consultant or investment manager in tandem with the firm's advisers. In short, managed portfolios offered the potential to let the principals return their focus to delivering quality advice.

At this stage, however, platform support was limited, and the concept was outpacing the capacity to deliver.

A new platform overcomes hurdles

The breakthrough came later in 2014 when the principals were introduced to HUB24's platform. The principals saw the combination of HUB24's platform and the managed portfolios made available through that platform as providing:

1. An investment menu with greater flexibility to blend traditional and contemporary investment models,

2. Sophisticated portfolio modelling tools enabling tax optimisation, and

3. Flexible, transparent reporting to clients.

The firm's principals embraced HUB24's platform, with support of dealer group Paragem Pty Ltd (a wholly owned subsidiary of HUB24 Ltd), developing seven risk-based managed portfolios representing various life stages. A three-part bucket approach was applied based on cash to provide liquidity; a 'core' of managed funds; and an adviser tilt including selected direct securities and/or sector specific managed funds with the potential to address clients' long term goals (subject to their objectives, financial situation and needs).

The core managed portfolios provided consistency while continually tapping into the investment insights of professional managers, and the combination of standing instructions from the client and rebalancing of the managed portfolio components improved responsiveness without the need for additional paperwork. This was combined with transparency, competitive pricing, flexibility and overall tax efficiency to deliver an all-round solution.

The end result? A win-win.

Today, the practice principals are confident their clients' portfolios have access to professional management, and for the practice the use of managed portfolios has contributed to reducing the adviser-administrative staff ratio from 1:3 to 1:1.17 – an efficiency gain of 44% .

Overall this has allowed a greater focus on strategic advice and greater engagement with clients. Not only has this created a sharper focus on the practice's core value proposition, it has also facilitated greater delivery of a value-add, cost efficient service. It is a point of difference the practice has found clients appreciate. Additionally, implementing managed portfolios as part of a client's investment strategy, the resulting efficiency gains and ability for improved customer service has been seen as contributing to practice revenue growing from $800k to $1.2m for the 12 month period from February 2015 to February 2016. Today the principals can celebrate a successful, sustainable practice.

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