

MANAGED ACCOUNT

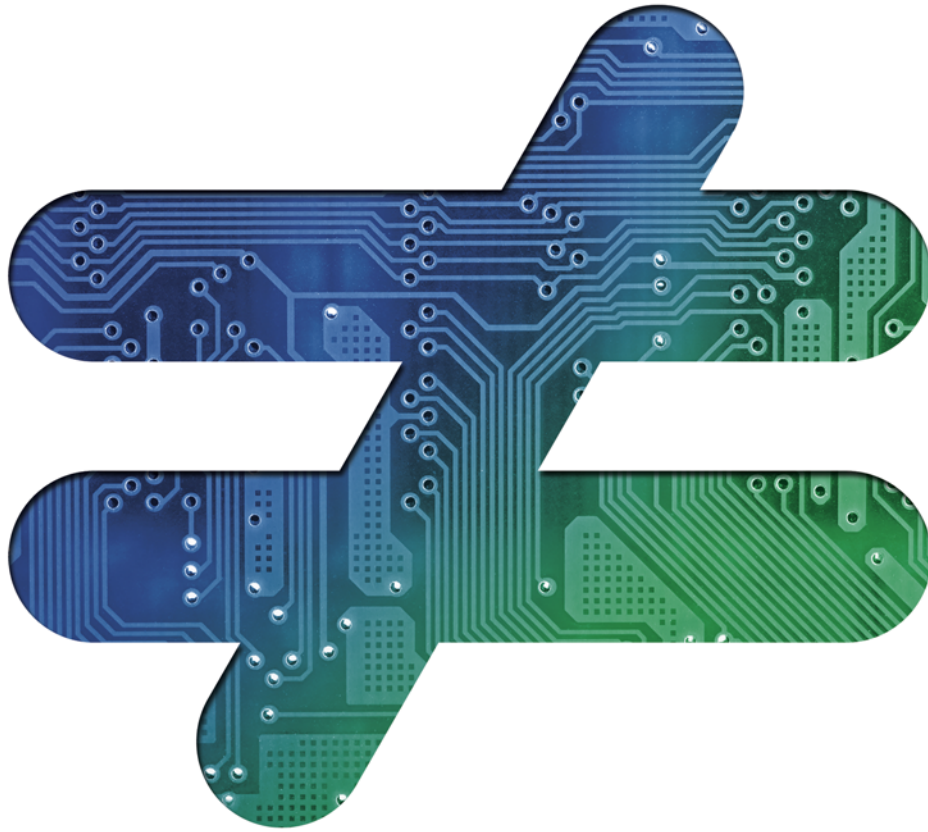
PERSPECTIVES

5 DRIVERS OF PROFITABILITY TERRY BELL AND TIPS FOR BUSINESS SUCCESS

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VOLUME 2 ISSUE 1 MARCH 2018



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PERSPECTIVES

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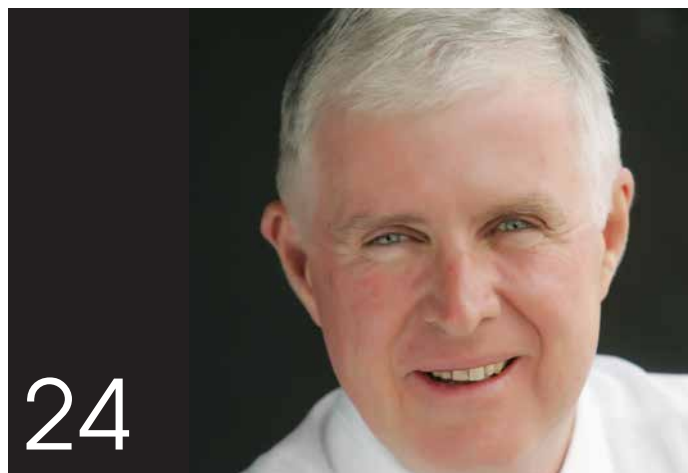
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Managed Account Perspectives is the official publication of the Institute of Managed Account Professionals Ltd (ABN 57 125 794 274). IMAP was formed to act as the nexus in this increasingly important part of the advice profession. Our aim is to bring together advisers, managers, platforms and other managed account service providers to help build a better industry.

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HOW ARE MANAGED ACCOUNTS CHANGING THE ECONOMICS OF ADVICE?

One of the negative responses that the use of managed accounts elicits is that their adoption is simply a revenue grab by advice businesses.

I've heard this complaint about revenue from a variety of sources – regulators, researchers and fund managers, and even some planners themselves.

Since FoFA and the banning of commissions and product incentives, the advice industry has been forced into an existential examination of the services it delivers and the way it charges for those services. And this, despite the fact that for almost all advice clients, the cost of the service is clearly disclosed to them before commencement and then crystal clear every month in their cash account statements.

Assessing whether the value received is worth the cost, is something that clients can, and presumably do, undertake for themselves each time they look at their portfolio statement.

Implementing a managed accounts program is an opportunity for licensees to examine the structure of their business in a root to branch way. This includes:

- What do we believe about investments?
- What resources can we bring to bear on making investment decisions? And who is best equipped to make those decisions?
- What value are we trying to provide

directly or through management of the decision-making process?

- What is the role of advisers and how far is that from the role they currently fulfil?
- What type of managed account service best suits our business and our client base?
- What partners or service providers do we use currently, and can they continue to support our evolving business?
- How do we manage the communication process surrounding the implementation of the managed account service, so that advisers and clients are as engaged as each feels necessary?
- How do we ensure that our best interest obligations to the client are actively met?

What I've seen occurring as a result, is a dramatic improvement in the professionalism of the delivery of advice and the management of portfolios. This has had two countervailing economic consequences. Operating and administrative costs have fallen as a result of:

- More efficient portfolio implementation; and
- Use of lower cost investment alternatives – broader industry economic drivers are at play here.

Portfolio management costs have risen as a result of the greater level of commitment of resources

to this area. In particular, the use of external specialists as portfolio managers, investment managers and independent members of the investment committee, have all added to a rise in the cost of investment management.

In addition, managed accounts, of course, have a legal structure of either being a registered managed investment scheme – as are most SMAs – or managed discretionary account. This brings with it compliance costs and the cost of assuming risk.

As a result, the increased costs arising from greater investment in the portfolio management process and regulatory overheads have generally been passed on to clients. This has been offset by the reduction in the cost of administration and underlying investment products.

In aggregate therefore, compared to adviser directed and implemented portfolios, although the standard of service and its robustness have risen substantially, there is generally no increase in cost to the client.

On the other hand, for advice businesses, because they are now being paid in an appropriate way for the services they are responsible for providing, the value of their business is rising, compared to the previous business models based on rebates and product payments.

Toby Potter, Chair



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IMAP ANNOUNCES INAUGURAL AWARDS

IMAP has announced it will be organising the inaugural IMAP Managed Accounts Awards in August 2018, to coincide with the 2018 IMAP Portfolio Management Conference on 2 August 2018 in Sydney.

The awards will cover both single sector asset classes and multi-asset class programs, which generally have a range of risk profiles or other goal-based objectives.

In addition, there will be Dealer Group Awards specifically for managed account programs offered by advisory firms that are integrated into the advice process.

The categories that recognise individual AFSL or practice managed account programs will cover both those that are fully managed internally, as well as those where portfolio management or investment management is outsourced.

Both SMA and MDA programs, along with the other legal structures used by managed account providers, will be included in the awards.

"Managed accounts are becoming a significant part of the advice profession, with many managers now offering portfolios. The managed account programs that are offered by advice firms are also an important development that we want to recognise," said IMAP chair, Toby Potter.

"We want the IMAP Managed Account Awards to be a recognition of excellent practice among advice firms. The managed account programs they offer are operated largely out of sight and the best are well resourced, carefully thought through, have a clear investment philosophy with decent track records, and deserve to be recognised."

To adjudicate the awards, IMAP has convened a panel of independent researchers, each of whom consults to advice firm investment committees. Financial Express will provide the data analysis capability that will underpin the quantitative aspect of the awards.



The Dealer Group Awards are the most important as they represent best practice in advice businesses.



"Managed account programs can be more complex to evaluate than funds," Potter said. "This is partly because of the variety of legal structures that are used but also because they are intrinsically linked to the advice process."

"That's why it's important to recognise advice firms that are doing a good job. At IMAP, we believe we can help broaden the understanding of what industry best practice looks like."



Wade Matterson

MILLMAN JOINS IMAP FOR CENSUS

Global actuarial firm, Milliman, has announced its partnership with IMAP in delivering the next update of the Managed Account FUM Census.

The Managed Account FUM Census is a bi-annual study of the FUM invested through the main forms of managed accounts, including SMA, MDA and IDPS-like services. The last June 2017 survey showed over \$47 billion was invested through these vehicles.

In making the announcement, Milliman (Australia) practice leader, Wade Matterson said: "Managed accounts are one of the key areas of product development for advisory firms, so by partnering with IMAP, it seemed natural for us to bring our deep market insights and rigorous methodology to the Managed Account FUM Census," Matterson said.

IMAP chair, Toby Potter welcomed the announcement, saying he was delighted to have Milliman assist IMAP in developing the FUM Census.

As part of its involvement with the census, Milliman will assist IMAP develop deeper analysis of the underlying investment types, such as ASX-listed securities, ETFs and managed funds, while also identifying the product development opportunities that managed account providers and advisory firms are taking.

According to IMAP data manager, Craig Dewhurst, a new section has been added to the questionnaire that looks at asset types, which will enable IMAP to get an overall market view of the assets being invested in via managed accounts.

"We also are asking participants two new opinion questions," he said. "These are: 'What will be the key developments in managed accounts in 2018?'; and 'What is the most useful new question(s) we should ask in future surveys to provide better market insights for all?'"

"Responses to the IMAP Managed Account FUM Census

are due back by late February. We will then begin our compilation and analysis of the results."

For more information or to participate in the next census, contact Craig Dewhurst on (02) 8003 5077 or at craig.dewhurst@imap.asn.au

WORKING GROUP KICKS OFF WITH DATA STANDARDS

The IMAP-led industry working group to develop data standards for the exchange of managed account model data has kicked off, with the inaugural meeting taking place on 11 November 2017, with a follow-up meeting on 15 February 2018. Over 20 companies were represented at the meetings.

The industry working group was set up by IMAP to develop a common standard for the definition or formats of model data being electronically distributed between participants in the managed accounts sector.

"With the rapid growth of managed accounts in the financial services industry, model data is being electronically distributed between all participants. However, no standard is in place for the definition or formats for this data," said Toby Potter, Chair of IMAP.

"This leads to bespoke development, greater risk of error and higher cost of integration. That's why this industry working group is so important in developing data standards for managed accounts."

According to IMAP co-ordinator of the Data Standard Project, Mark Perica, the two meetings of the industry working group resulted in robust discussion between platform providers and fund managers.

The key outcome of the meetings were to establish an agreed set of priorities. The first priority was to review the model changes data sharing. To that end, participants were asked to submit their examples of this file. IMAP has since compiled and compared these, and made notes on the files and their use. From this, IMAP developed a suggested standard for this file for review and discussion by the industry working group.

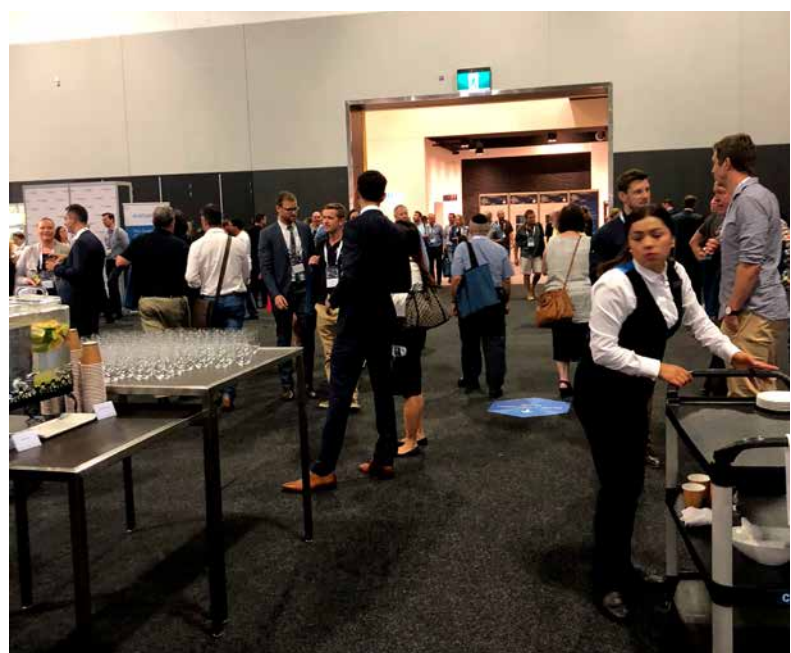
The following companies are members of the industry working group: AMP, APIR, Bennelong Funds, Blackrock, BT, Colonial First State, Copia/Ralton, Elston, Financial Express, Franklin Templeton, Hub 24, IOOF, IRESS, Lonsec, Macquarie, Morningstar, NAB, Netwealth, Powerwrap, Praemium and Schroders

For more information, contact Toby Potter at toby.potter@imap.asn.au or Mark Perica at mark.perica@imap.asn.au.



Managed Accounts Central at SMSFA

From 14-16 February, IMAP rolled out its Managed Accounts Central to industry professionals attending the annual Self Managed Super Fund Association (SMSFA) conference in Sydney. Delegates showed great interest in managed accounts and the key providers at Managed Accounts Central showcasing their capabilities.





PRAEMIUM ADDS INTERNATIONAL TO SMA

Managed accounts provider

Praemium has enhanced its SMA offering in Australia with the addition of international securities.

Michael Ohanessian According to Praemium chief executive officer, Michael Ohanessian, with increasing demand for globally diversified portfolios, the addition of international model portfolios to the Praemium SMA will provide greater choice for advisers and their clients, providing them direct access to quality global investment opportunities in a cost-effective manner.

Several model managers, including Arnhem, Joseph Palmer & Sons and Watershed have been approved to run international models in the SMA scheme. The new models provide access to 26 developed international markets on the MSCI World Index.

"We are very excited to have added an international capability to the Praemium SMA," Ohanessian says. "With established expertise in corporate actions and reporting for international securities, it's a natural evolution of our proposition and further strengthens our position as a leading managed accounts provider."

"The international portfolios offer access to high-calibre global investment managers, professionally managed portfolios with direct international share ownership, and the tax efficiencies and cost savings that managed accounts offer."

"This provides advisers with the ultimate choice in diversified portfolios backed by first-class reporting and performance analysis."



AUSSIES STILL CAUTIOUS ABOUT RETIREMENT

The sense of preparedness by Australians for their retirement has improved slightly over the last 12 months, increasing by 2 per cent to 46 per cent in 2017.

King Loong Choi "Fewer Australians are worried about external factors, such as market performance and regulatory changes eroding their super savings, compared to 2016, and this has led to more individuals feeling equipped to face retirement," said Investment Trends Senior Analyst, King Loong Choi.

Yet, despite this improving sentiment, retirement remains a concern for many Australians, with the Investment Trends

'Retirement Income Report' revealing that only one-in-four people believe they will be able to live comfortably in retirement.

"Many Australians are concerned they will not be able to reach their retirement goals, and only one-in-three believe they can do so without the help of professional assistance," said Choi. "This highlights the important role that advice providers play in helping Australians along their retirement journey, and in helping them achieve their retirement goals."

Key findings of the report showed that when seeking help with their retirement goals, Australians were most inclined to turn to a financial planner (33 per cent) or their super fund (25 per cent) for assistance.

According to Choi, individuals with a super balance less than \$100,000 were just as likely to seek help in achieving their retirement goals from planners, as they were to seek help from their super fund. However, he said it was a different story for people with a super balance greater than \$100,000, where financial planners were "significantly" preferred.

Further analysis of the 'Retirement Income Report' showed there were three distinct segments of retirees:

1. **Active** retirees, who are in good health;
2. **Semi-active** individuals, who enjoy decent health but may require a little assistance; and
3. **Dependent retirees**, defined as those individuals in poor health requiring assistance.

"The needs and wants of each segment are distinct. For instance, active retirees are most likely to be worried about the adequacy of their retirement savings, while the key need for dependent retirees is information about the financial considerations of aged care," said Choi.

"While age is an obvious driver of the lifestyles represented by these segments, it is not the only contributing factor. A key insight from this research is the need for advice providers and product manufacturers to be more bespoke in their service and product design to cater for the lifestyle characteristics of their retiree clients."

The eighth edition of the 'Retirement Income Report' provides an analysis of Australian adults and their attitudes towards retirement and post-retirement issues. This report is based on a large-scale survey of 7,305 Australians over the age of 40, and was conducted between September and October 2017.



David Court (left) and Frank Varga (right)

ATTENTION: MDA SERVICE PROVIDERS, DEADLINES APPROACHING

By David Court and Frank Varga
Holley Nethercote

There are still scores of advisers who operate their MDA service through a regulated platform and are not ready to comply with ASIC's amended policy in relation to Managed Discretionary Accounts (MDAs).

ASIC's 2016 amendments to its policy in relation to MDAs included the removal of its 'no-action' letter position for those advisers who provided an MDA on a regulated platform holding a limited power of attorney. This no-action letter was very popular and many advisers took advantage of it over the past 13 years, as they structured their business to meet the terms of the no-action letter.

To continue to provide MDA services, those advisers who relied on the no-action letter will need to apply for a variation of their AFSL to provide MDA services and be approved by 1 October 2018.

“ In addition to the requirement to be appropriately authorised, there are new disclosure and reporting obligations that will require changes to existing documentation. ”

The number of existing licensees transitioning to a licence enabling them to provide MDA services has been quite

low to date. As with previous licensing transition periods, it is likely there may be a rush of applications being submitted with ASIC in the first half of 2018.

However, unlike previous transition periods, such as margin lending, ASIC assessment periods are now quite lengthy, with most applications taking approximately six months to be finalised.

On 28 November last year, ASIC notified licensing experts that it is pushing out its decision timeframes for 70 per cent of applications from two months to five months, and for 90 per cent of applications from three months to eight months.

Therefore, licensees applying to add MDA services will need to ensure they treat the application process seriously by submitting quality applications; otherwise the applications may be rejected prior to assessment or they may have an extended assessment period.

Advisers should also consider new ASIC 'fee-for-service' regulations being proposed by Treasury from 1 July 2018. Current fees to vary an AFSL are approximately \$300. Fees proposed by Treasury may see the cost of a variation application increase to as high as \$11,305.

In addition to the requirement to be appropriately authorised, there are new disclosure and reporting obligations that will require changes to existing documentation.

However, it's not all bad news, as ASIC will allow transitioning licensees to count their experiences in operating under the no-action letter as relevant Responsible Manager experience for the licence variation.

In light of this extended assessment period and the new fees from 1 July 2018, there is a need for advisers to commence their preparation to comply with the new policy (including preparing the licence application).

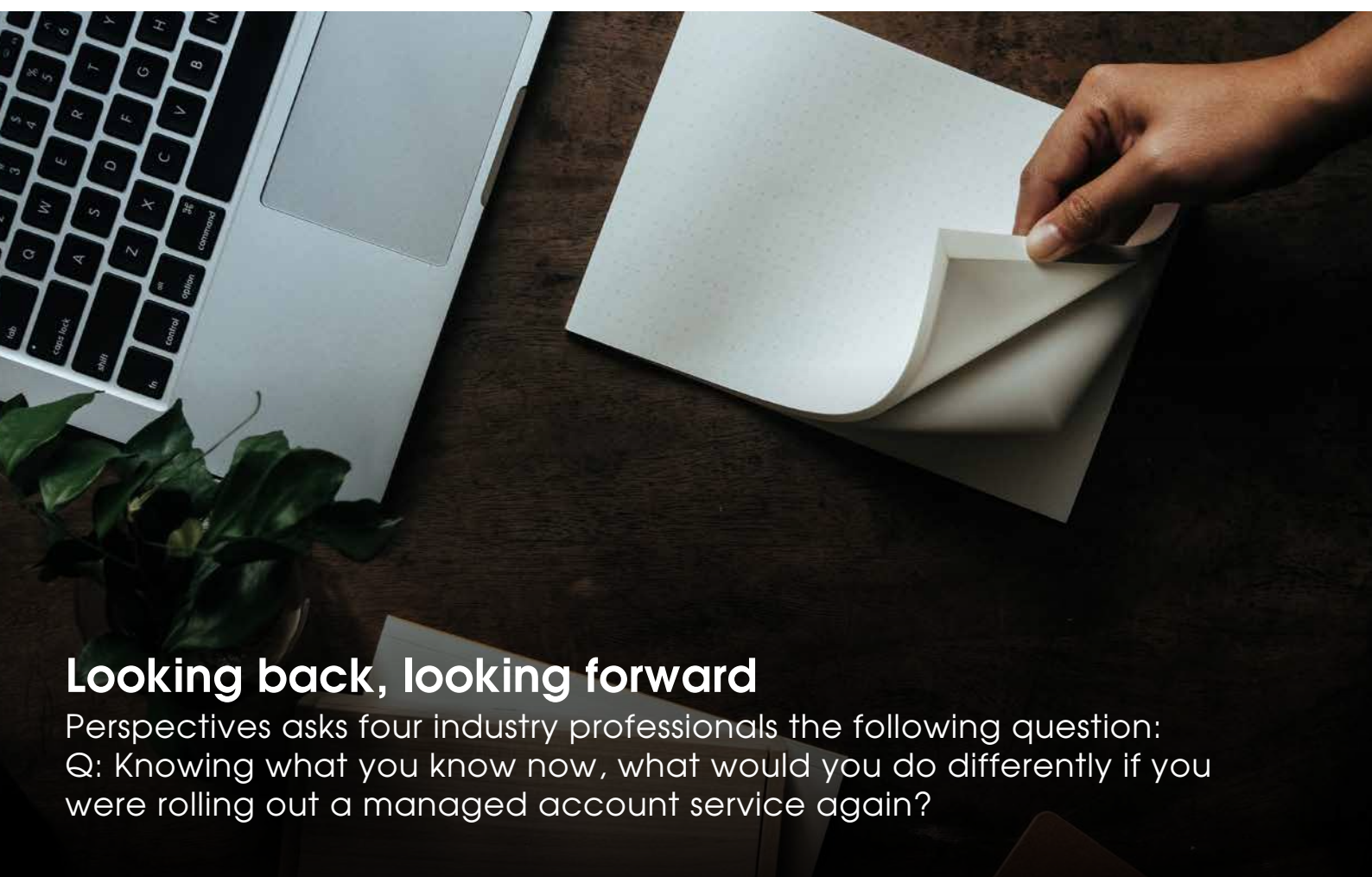
We have been helping industry participants' transition into an MDA-licensed regime, and would welcome current licensees who offer MDA services to contact us at Holley Nethercote to discuss their needs in relation to licensing and documentation updates. Just go to the AFSL Applications and Variations page on the Holley Nethercote website at www.hnlaw.com.au.

David Court is a Partner and Frank Varga is a Licensing Specialist at Holley Nethercote Commercial and Financial Services Lawyers and Compact Compliance and Training.

Thrive and survive at InvestTech

IMAP's inaugural InvestTech 2017 conference showcased some of the industry's leading technology experts, with delegates taking away valuable insights that will help improve client engagement and business efficiency. Over 200 delegates attended the 5 December event.





Looking back, looking forward

Perspectives asks four industry professionals the following question:

Q: Knowing what you know now, what would you do differently if you were rolling out a managed account service again?



JULIA SCHORTINGHUIS
CFP®

Director, Lighthouse Capital



Reaching out to peers can help to build an 'objective, realistic and practical' viewpoint.



For anyone who is looking to gain practice efficiencies by implementing an MDA service, I would emphasise the need for robust back-office processes and systems.

Operating an MDA service enables you to reduce the production of ROAs and other advice documents, whilst simultaneously opening a window for more tailored and relevant client communications.

It is essential to have a clear understanding of what you are wanting to achieve and how you will deliver it. Enhancing the client service experience has underpinned our decision to operate under an MDA model.

Take the time to understand pending changes under ASIC's Regulatory Guide RG179 reissued in September 2016, which sets out an overview of the MDA policy, how it defines

MDA services and the main policy in regulating MDA services.

I have noticed there is generally a tendency to promote the positive aspects of operational solutions and undersell the negatives. One way to get a clearer picture is to have a team member spend a day in the office of another practice that is successfully operating an MDA service.

Reaching out to peers can help to build an 'objective, realistic and practical' viewpoint. This will enable you to gain an understanding of the day-to-day realities, take a deeper dive into the back-office systems and see examples of how others reinvest the time savings.

I have found this approach to be really helpful and for the most part, have found that other businesses are open to sharing.



PETER MCVEIGH

Executive Chairman, Elston

We have always offered managed account services, so for us, it's been a process of continual improvement.

Offering a managed account solution is not only about gaining practice efficiencies but about providing an exceptional experience and superior investment outcomes for your client.

Another driver for Elston has been our clients desire to have greater transparency and control over their direct investments, which also enables after-tax investment management.

The transparency is a huge plus, but from a practice management perspective, it can create issues if it's not addressed correctly. This is particularly the case if you are investing in direct assets and not ETFs, or wholesale managed funds.

For example, with a service focused on direct assets, I'd recommend practices consider how they are going to communicate changes within portfolios. Communication needs to be proactive rather than reactive. Efficiency gains can soon be lost if advisers start fielding calls from clients asking why 'investment A' was sold and

'investment B' was bought.

To assist with this, it is vital to have a defined investment philosophy and process that can be easily articulated to clients. Without this, investment decisions will appear to be made in a vacuum. If an investment philosophy has been communicated, and agreed to, it can be referenced when having client conversations about portfolio movements, which in turn will re-enforce the investment philosophy.

Don't underestimate the time and effort it takes to manage the investments. If you don't have a dedicated asset management team, outsource to an external. Ideally, advisers are 100 per cent dedicated to managing client relationships or gathering new clients – not managing investments part-time.



PATRICIA CHAN CFP® CA

Managing Principal,
DFS Advisory Services

With the benefit of hindsight and experience, improvements can always be made. For DFS, it was the realisation that our clients were more ready to embrace technology than what we gave them credit for. Knowing that, our transition plan could have been 'bolder'.

To put this into perspective, our clients were already in our model portfolios,

albeit on wrap platforms. The move to a managed account structure delivered greater efficiencies and improved portfolio management timeliness; however, this only becomes optimal under a fully implemented portfolio service.

But in 2008, managed accounts were not widely used and we weren't entirely sure whether our clients would be open to having their portfolios managed under a full discretionary service.

We erred on the side of caution and took great care and time to ensure that clients were comprehensively engaged along the entire way. We staggered the transfer process into phases and invested in internal resources to manage the project. We successfully completed the managed account platform changeover for all our clients over four months. We subsequently transitioned a large proportion of

this client-base to our flagship Risk Profile Models (our fully implemented portfolio service) a few years later.

In hindsight, our roll-out plan was largely unnecessary for every client; we could have 'cut to the chase' and still achieved the same outcome for many. Some common feedback from clients was:

- i. there is trust in what we do, given we already manage their investments; and
- ii. moving to a technologically advanced platform is viewed as being very positive.

So, our concern around client reservation was ultimately not there.

Regardless, significant goodwill was generated from the exercise. Clients saw that the transition effort was genuinely about alleviating each potential concern. Goodwill, how ever gained, is always a good thing.



JOHN MCILROY

Director, Crystal Wealth Partners

“

We believe that our MDA service has provided a high degree of flexibility for different client scenarios and is a very efficient way of running a modern practice.

”

Our MDA services provide two main options for clients. The first option is for clients to have their portfolios managed under a custodial structure using model portfolios. Portfolios are managed strictly in line with the models. The second option is for client portfolios to be managed with MDA assets registered in the client's name.

There are four things I would do differently if I was rolling out our service again. I would:

1. Have developed software internally to manage the portfolio rebalancing of client portfolios, which were not under custody. There wasn't software available at the time we started the service that would do this well and there is still very limited functionality available in the market. This would have made portfolio rebalancing for these clients more efficient.
2. Promoted the use of the model portfolio/custodially held assets approach more, rather than being more neutral with clients. It is a more efficient structure and generally leads

to better investment performance outcomes for clients.

3. Have had better processes for managing individual client preferences, mainly in regard to ethical overlays. Clients with ethical and other specific overlay requirements do not use our model portfolio/custody option. However, managing these requirements can be problematic without the right software.

4. Have promoted our direct global equity model portfolio more. It has performed very well and apart from providing clients with direct exposure to some of the world's best companies, it is highly transparent and cost comparative with an Australian equities model portfolio.

We believe that our MDA service has provided a high degree of flexibility for different client scenarios and is a very efficient way of running a modern practice. Most of the above items would have extended that efficiency to a higher level.

MANAGED ACCOUNTS ADVISER ROADSHOW 2018

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ASIC and MDAs

Jane Eccleston outlines the various issues ASIC is dealing with in the MDA sector, and explains how the regulator continues to work with IMAP on a small number of transitional and implementation issues.

JANE ECCLESTON

Senior Executive Leader, Investment Managers and Superannuation, ASIC

Once viewed as a boutique offering, the managed discretionary account (MDA) industry has experienced significant growth in recent years. The growing significance of the MDA industry means that ASIC's interaction with the industry is expanding.

In September 2016, ASIC introduced the *Corporations (Managed Discretionary Account Services) Instrument 2016/968* and revised *RG 179 Managed Discretionary Accounts*.

We thought it timely to raise a few issues that have emerged as a result of ASIC's work on MDAs.



Care needs to be taken not to create unrealistic expectations. While important, it is not sufficient to only draw attention to the fact that past performance is not indicative of future performance.



Emerging issues

There are some regulatory issues that are unique to MDA products and the MDA industry.

ASIC recently intervened to improve disclosure on a number of web sites about the past performance of certain MDA services. The sites promoted MDAs offering trading in foreign currency, futures and/or commodities. Each site contained the usual disclaimer that 'past performance is no assurance of future performance' and the risks of investing.

Some of the claims included: "over 630 per cent growth since inception"; "30 per cent return per annum"; and "the system has achieved good average returns ranging from 5-20 per cent per month".

On one web site, a "Case Study: 20 per cent return in one week" recounted how an investor who had a negative experience with another firm, invested \$300,000 and made sufficient profit in a week to obliterate their trading loss.

Enquiries made by ASIC about the basis for these claims led to a range of responses.

One explanation was that the trader's actual returns were approximately 180 per cent over a

three year period, however, the firm did not want to overemphasise the benefits and used a 30 per cent figure instead.

In another instance, the claimed returns were said to be based on a single audited brokerage account with a trading history prior to the introduction of the relevant trading strategies of the MDA.

ASIC did not accept the explanations provided and this advertising ceased following ASIC's intervention. Part of ASIC's role is ensuring that investors are provided with disclosure that complies with the law and assist them in making informed investment decisions.

From an industry perspective, a key component of a firm having a sustainable business is its ability to match investor expectations with the benefits that a financial product or service can actually deliver. Poor disclosure practices – particularly around disclosure of past performance – is detrimental to the investor and can ultimately prove detrimental to the firm, too.

These matters focused ASIC's attention on the issue of what is the approach of the MDA industry to disclosure of past performance, particularly given the unique features of MDAs.

In many instances, MDA providers and advisers are offering a bespoke service. Even where a model portfolio is used, there may be scope for the portfolio to be further tailored to the client's needs.

Then there is the variety of underlying financial products that can be provided through MDA services. Some MDA services are offering a vehicle to invest in securities or managed investment schemes, while other services are essentially offering the trading skills of their foreign currency or futures traders.

ASIC's good practice guidance on advertising (see *Regulatory Guide 234: Advertising financial products and services*) stresses that advertisements need to give a balanced message about returns, benefits and risks.

Care needs to be taken not to create unrealistic expectations. While important, it is not sufficient to only draw attention to the fact that past performance is not indicative of future performance. The nature of MDAs mean there will be real challenges, in particular, in giving the right balanced messages about past performance in product advertising.

Going forward, ASIC will be engaging further with the MDA industry on this and other issues unique to the industry.

Current issues

ASIC has been working with IMAP in relation to a number of transitional and implementation issues arising from some of the policy or procedural refinements introduced by the *Corporations (Managed Discretionary Account Services) Instrument 2016/968* in September 2016.

This engagement is important, as it enables us to provide further feedback in relation to a number of policy changes and refinements.

Prohibition on investing in unregistered managed investment schemes

The regulatory framework for MDAs now prohibits the inclusion of unregistered managed investment schemes in investment portfolios offered to a retail client through an MDA. This requirement took effect on 1 October 2017.

We recently confirmed that there is no grandfathering to allow retail clients to retain existing investments in unregistered managed investment schemes as an asset in their client portfolio under the MDA service after 1 October 2017.

However, ASIC may consider relief applications from an MDA provider where there is a compelling reason to depart from this requirement in circumstances where ASIC's policy objectives are met. For example, ASIC recently granted individual relief to allow an MDA provider to continue to include certain offshore Exchange Traded Funds in its portfolio.

Obligation for MDA providers to review SOAs of external advisers

One issue raised with us is in relation to the obligations for MDA providers who are using an external MDA adviser to prepare an investment program for retail clients.

The requirement is for the MDA provider to review the Statement of Advice (SOA) in relation to that investment program before entering into the MDA contract, and not enter into the contract if they have reason to believe that the MDA is not appropriate to the client's relevant circumstances.

MDA providers are not expected to 'second guess' the appropriateness of the advice provided in the SOA by the external adviser. MDA providers are, however, expected to draw on their own knowledge and experience both about the service they are offering and their clients/client profiles when reviewing the SOA.

The MDA provider is not to enter into the contract if they have reason to believe that the MDA is not appropriate to the client's relevant circumstances.

MDA Contracts and the handling of assets on termination

One of the requirements is that an MDA contract is to make provision for how and when a client's portfolio assets will be disposed of, or transferred to the client, if those assets are not held directly by the client. This requirement is imposed by the *Corporations (Managed Discretionary Account Services) Instrument 2016/968*.

ASIC acknowledges that at the time an MDA contract is entered into, it is not always possible for an MDA provider to know what assets will be in a client portfolio at the time the contract is eventually terminated.

ASIC accepts that it is sufficient for most MDA contracts to specify that, on termination of the portfolio services, the assets are to be transferred to the client, or their nominee, as soon as it is reasonable, having regard to the liquidity of assets.

Ongoing issues

There are still a small number of transitional and implementation issues that ASIC will continue to discuss with IMAP. These issues concern various disclosures:

* Whether it is possible to streamline the disclosure of

information about the investment program offered, given there may be duplication of information in the investment program, MDA contract and statement of advice;

* The inclusion of external MDA adviser details in an MDA provider's Financial Services Guide (FSG), which may pose difficulties if the FSG is not an individually-tailored document; and

* Whether further clarity can be introduced around the meaning of 'total management costs'.

The regulatory regime in the *Corporations Act* has required adaption for the MDA industry.

Part of ASIC's role is business facilitation. In exercising its powers, ASIC takes appropriate account of investors to promote investor trust and confidence.

The release of the instrument and the revised Regulatory Guide provide a policy framework as the MDA industry grows, and also provides an opportunity for businesses to examine their operations and adapt to the future.

Jane Eccleston, Senior Executive Leader, Investment Managers and Superannuation, ASIC.





Fintech tomorrow and the future of advice

As Gihan Perera writes, fintech should be seen as an opportunity for planners to improve their service offering to clients.

As Henry walks from the train station to his office in George Street, his eye is caught by the black cashmere trench coat on display in the Burberry store. It's exactly what he needs for his trip to Prague next month! The store isn't open, but Henry holds up his phone camera to the shop window, and starts a virtual reality app that shows him wearing the jacket, 'trying it on' with other items from his wardrobe.

The app also shows him the price – just over \$4,000 – which is more than what he would usually spend on a jacket, but is not beyond his reach.

As he closes the app, another app automatically starts, beeping and flashing in red, 'Warning – Exceeds budget!' This financial planning app, connected to his bank accounts, credit cards and financial plan, has noticed his activity and determined that he can't afford to buy the jacket this month – at least, if he wants to stay on track with his plan.

Henry is startled, but not annoyed, because he installed the app himself.

Henry is a high earner – not rich yet, but working towards it. He knows he can afford to buy the jacket, but he's also aware of his other responsibilities. He's a single father with two teenage daughters, he has a mortgage on his own home and an investment property, he's engaged to be married again, and he wants to continue thriving for many decades. So, he has engaged a highly proactive financial adviser, Fatima, who offers financial advice with technological integration of money and other assets.

Henry really wants the jacket, so he clicks the 'Advice' button on the app to ask Fatima for help. Within two minutes, she responds with a text message (At least, he thinks it's Fatima, but he wonders whether it's one of her team or even an AI chatbot).

"Henry, you can't afford it this month," she says.

"But it's only the 5th, and I have hardly spent anything," he points out. But Fatima knows better, and replies with a list of other expenses due later in the month, leaving him well short of funds for discretionary spending.



Fintech companies truly give their customers power over their money – how they access it, use it and control it.



“But I’ll make it up next month,” he writes back.

“We both know you won’t,” she shoots back immediately.

Henry knows she’s right. His financial DNA profile indicates a preference for short-term rewards over long-term investment. Besides, his past spending patterns are available to him and Fatima, and – combined with big data analysis of clients with a similar financial profile – they both know that Henry is unlikely to stick to his resolution.

“Other options?” he asks, still determined to own that jacket.

This time the response takes longer – about 30 seconds – but Fatima has a suggestion.

He can buy the same jacket online using points from his bank’s loyalty rewards program. He doesn’t have quite enough points, but can transfer some of his airline frequent flyer points to top up the balance, and then pay \$450 (which is within this month’s discretionary spending budget) to make up the difference. There’s a small tax implication because he’s using business funds for a personal purchase, but Fatima ensures this is recorded accurately, so it will be reflected in his tax return.

Henry clicks ‘Confirm’ to proceed with the string of transactions, and continues his walk to work.

In Fatima’s office, the AI chatbot – for it was indeed a chatbot, not Fatima herself – makes a file note in Henry’s blockchain record, and moves on to the next client ...



The future of fintech

Virtual reality ... augmented reality ... AI ... DNA profiling ... big data ... instant advice ... blockchain ...

These might be far removed from the current day-to-day operations of your work, but they are the future – and in some cases, the present – of fintech. And that means they need to be on your radar as well.

Most banks and other financial institutions are struggling to come to terms with the fintech revolution, and are caught unawares when smart, savvy, agile fintech companies start intruding on their turf – sometimes seemingly with not much more than a smartphone app and smart back-end software.

But fintech – an obvious combination of the words ‘finance’ and ‘technology’ – isn’t just about technology. And it’s not really about money, either.

For financial institutions, fintech is about three fundamental shifts in the way they do business:

1. From Finance to Money: Ordinary people don’t care about ‘finance’, but they do care about money. Fintech companies help them with their money – budgeting, saving and spending it. Yes, and even investing it, but in smaller portions (such as the Acorns app for investing rounded-up credit card amounts) or for shorter terms (such as social enterprises like Kiva, for lending money to people in developing countries).

2. From Controlling to Empowered: Traditional financial institutions might claim to be tailoring banking to your needs, but they just play around the edges of customisation, stopping when they think they have enough of an edge over their other traditional competitors. Fintech companies truly give their customers power over their money – how they access it, use it and control it.

3. From Private to Connected: Traditional financial institutions have kept everything private, tightly controlled, and hidden behind multiple layers of security. Fintech still provides privacy and security, but also gives customers the ability to selectively connect other people to their money.

In summary, traditional financial institutions are about privately controlling your finances, and they are being

disrupted by fintech companies empowering and connecting clients with their money. This is a profound change in the world of personal finance ... err, money.

As just one example, today’s customers don’t care that their bank sponsors the Australian cricket team, but they want a banking app that lets them make micro-payments to selected Facebook friends who want funding for their own junior cricket teams.

What fintech means for financial advice

The financial planning industry is one step removed from financial institutions, so it hasn’t been as disrupted by fintech ... yet. But it is only one step removed, so the disruption isn’t far away.

In fact, the three features of ‘old’ financial institutions are common to traditional financial planning practices as well: finance, control and private. In other words, you create a private Statement of Advice for a client’s finances, and keep the assets under your control.

But clients will want the same three features that fintech companies offer:

1. Tell them how to do more with their money (rather than just advising them about ‘finance’).
2. Give them a suite of tools that empowers them to manage their money every day (not just a static SOA they only review once a year).
3. Help them connect all their financial instruments – not just super and long-term investments, but bank accounts, credit cards, loyalty points, store discount cards and the like.

Here’s the test: If Henry was your client and wanted that jacket, could you have provided the same level of financial advice as Fatima? If not, what would you need to change to get there?

Gihan Perera is a futurist, conference speaker, author and consultant who gives business leaders a glimpse into what’s ahead – and how they can become fit for the future.

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Fintech still provides privacy and security, but also gives customers the ability to selectively connect other people to their money.

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Developing the resources to implement a managed account program

When implementing a managed account program, it's critical that advisers and licensees develop and use the right resources to ensure the success of their new service, writes Toby Potter.

In deciding to implement a managed account program, advisers and licensees should not underestimate the resources that they need to have, in order to make a success of their new service.

Let's focus on the issues relating to implementing a managed account program on platforms. There are other models, such as individual client HINS or wholesale custody arrangements, but they raise the complexity further and are outside the scope of this article.

The nature and extent of resources required will depend on the type of program that advisers or licensees are planning to implement. The main choices that are likely to be considered are:

- Recommend a portfolio comprised of SMAs offered by the preferred platform;
- Licensee specific SMAs issued in conjunction with the platform;
- Become an MDA provider; or
- Act as a portfolio manager in partnership with an MDA provider.

Whichever of the choices are considered, resources are going to be required in several key areas:

- Management attention;
- Investment approach; and
- Compliance.

And in addition, depending on the platform capability, there may also be a requirement to take on some of the operations of the service.

Management attention

I've placed this first because before all else, the decisions that management make determine the structure of the program, and the decisions made early on will determine the characteristics and structure of the program. This will include decisions about:

- Investment approach;
- Target clients;
- Operating model and costs of the program;
- Pricing; and

- Partners or service providers.

A clear set of objectives for the managed account program and the metrics for success need to be determined before any other operational decisions can be made.

Of course, the consequence of this is that once these measures are agreed, they should be reported on and measured on a regular basis to determine whether the service is achieving the objectives which were set for it.

Investment approach

This is often thought of as the most significant area in which resources will need to be increased.

Apart from the first managed account type listed above – simply adding a number of the platform’s SMAs to the Approved Product List (APL) – the other three are going to require a significant focus on the investment area, as the licensee and its advisers move from a model portfolio – generally paper-based – to a process that takes responsibility for developing investment models through which actual client portfolios will be managed.

While this is sometimes viewed as simply ‘beefing up’ the investment committee, in reality it is a more significant task. Key questions here will be:

- Do we have the expertise to take responsibility for portfolio management within our current structure and resourcing?
- Do we have partners in research houses who we can rely on for portfolio construction?
- Who will be responsible for the daily monitoring of the portfolios and recommendation of any adjustment?
- What will be the costs of portfolio management and who will bear this?
- What continuity will there be between our current approach and the managed account portfolios?

These questions invite a full review of the investment process within the business. This will include:

- review of the documentation of the firm’s investment philosophy;
- development of the investment charter for the investment committee and determination of its membership;
- Specific allocation of key responsibilities for individual tasks – for example, asset allocation, manager selection and

review, and security selection if this is undertaken in-house;

- Selection of partners to provide inputs, such as asset allocation, for each portfolio; and
- Documentation of policies, such as conflicts of interest and performance measurement methodology.

Clearly, the scope of these tasks will require significant input if they are to be properly carried out. The Responsible Entity (RE) of the platform’s SMA program, or an external MDA provider, is going to require that all these capabilities, and the resources to deliver them on an ongoing basis, are in place.

Compliance

Finally, once the managed account program is in place, the resources in the licensee’s compliance team need to be reviewed to ensure that they, and the procedures they follow, are adequate to monitor the implementation of the service.

This is in two main areas:

1. Is there an independent process that confirms the portfolios are being managed in accordance with the SMA product disclosure statement of the MDA investment program?
2. Is the advice process consistent with the regulatory requirements?

Maintaining an independent process to confirm that the portfolios are compliant with their mandate is a responsibility that the SMA responsible entity, or MDA provider, is primarily responsible for. They are likely to insist that the portfolio manager has appropriate internal resources to carry this out.

In the case of advice, particularly for MDA services, the licensee will need to implement a specific process for checking that the correct document set has been provided to the client and that the annual review process is undertaken.

Summary

Unlike simply approving a new product on an APL, the decision to implement a managed account program where the licensee or adviser is involved in portfolio management, is going to require significant resourcing.

This may already exist in the firm, but will need checking against the requirements of the SMA responsible entity or MDA provider.

Toby Potter is Chair of IMAP.

Adviser Roadshow 2018: Building better business

The annual IMAP Adviser Roadshow will be rolled out across Melbourne, Brisbane and Sydney in March. The roadshow will focus on the practical implementation of managed account programs in established advisory businesses, demonstrating how to make managed accounts truly effective for advisers and clients.

Highlights of the Adviser Roadshow 2018 include:

- Building a private label platform.
- Using managed accounts to meet the retirement income challenge.
- What determines practice profitability? Are managed accounts a path to improved profits?
- Best interest: What role can managed accounts play?
- Managed accounts for direct securities oriented advisers.
- Using your program to improve client engagement.

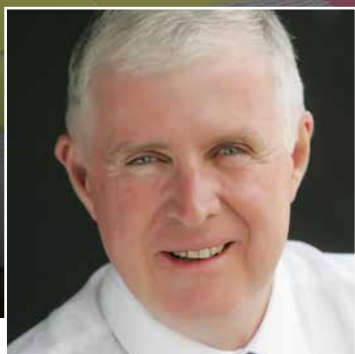
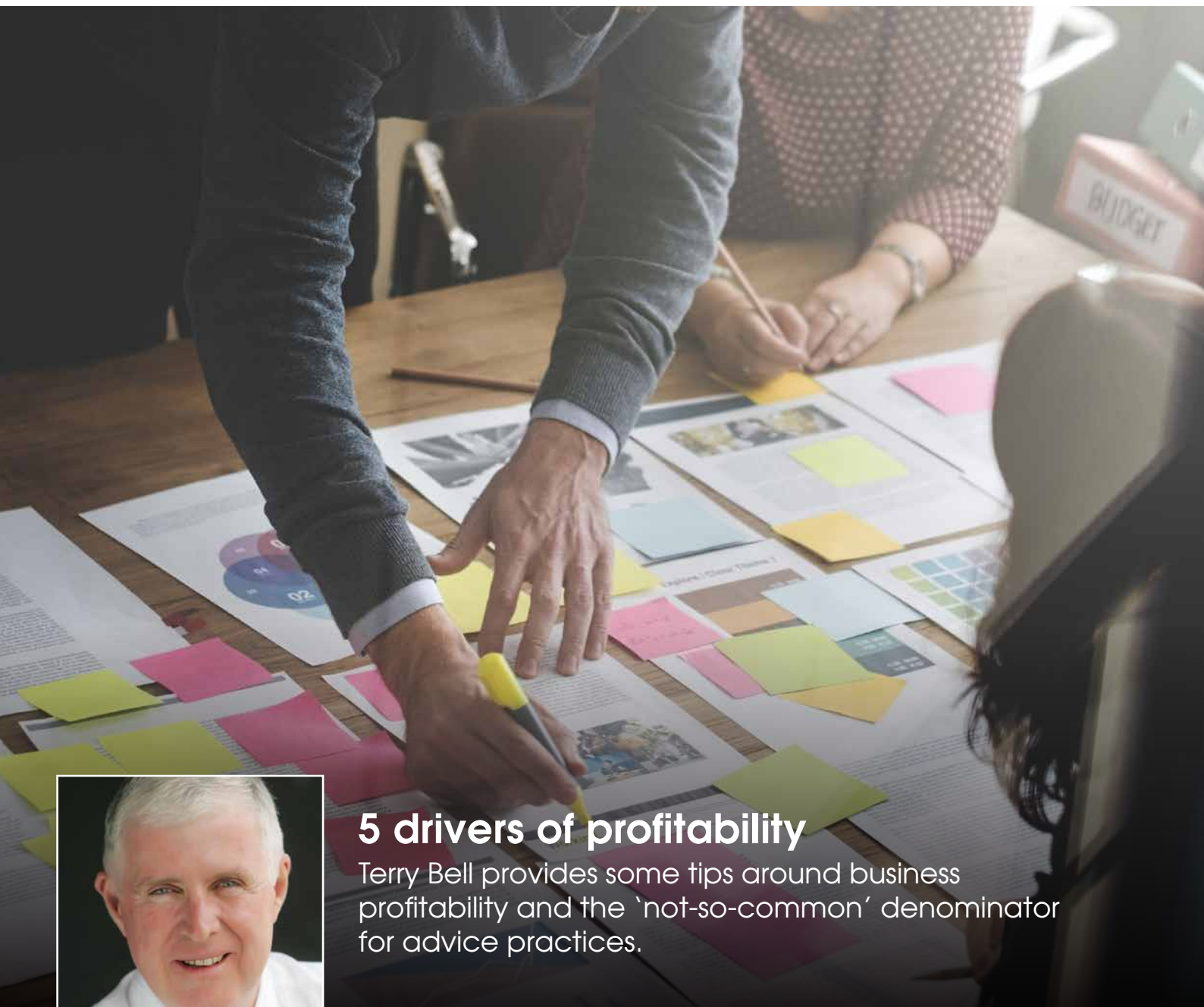
For more on the IMAP Adviser Roadshow 2018, Perspectives magazine has published a collection of white papers and analysis that will be discussed at the conference. Read on.

Adviser Roadshow 2018

Melbourne - Commonwealth Bank of Australia /
Level 19, Tower 1 Collins Square / 727 Collins Street / Melbourne /
19 March 2018

Brisbane - At Royal on the Park / 152 Alice Street / Brisbane /
22 March 2018

Sydney - Whiteley Ballroom / Amora Hotel Jamison /
11 Jamison Street / Sydney / 27 March 2018



5 drivers of profitability

Terry Bell provides some tips around business profitability and the 'not-so-common' denominator for advice practices.

At the IMAP Adviser Roadshow, Business Health will be presenting its latest findings on the topic of business profitability, with specific reference to the emergence of managed accounts over recent times.

Over the course of the last two years, almost 300 Australian practices* have utilised Business Health's unique practice assessment tool, the HealthCheck**, to reality

check the 'health' of their business, benchmarking it against peers and colleagues. And, from our consolidated analysis of their results, we can state with some confidence that the biggest drivers of profitability within advice practices are the ones outlined in Table 1.

Out of the 20 business areas we assess, these are the top drivers of profitability in advisory practices today.

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Invest in your people – not just with a competitive remuneration package but also by recognising their career plans, professional development goals and perhaps even their equity aspirations.

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Table 1: Profit drivers

Profit Driver	% of Australian practices	Profit Impact
Business Plan (12 month operational)		
No	24%	-
Yes, fully documented	38%	+121%
Effective (<i>Documented, reviewed at least six monthly, track progress monthly</i>)	5%	+209%
Client review process		
No documented regular review process	15%	-
Clearly documented review process	85%	192%
Personalised client communications		
Use personalised mail merges/broadcast functionality		
No	33%	-
Yes	51%	+166%
People management		
Last staff performance reviews		
more than 12 months ago	20%	-
within last 12 months	80%	+154%
Staff with documented job descriptions		
None	22%	-
More than 75%	67%	+130%
Client segmentation		
No	23%	-
Yes, effective (<i>Differentiated services, reviewed regularly, involve staff, 'A' clients widely known</i>)	33%	+148%

Unfortunately, as Table 1 also clearly shows, a significant number of Australian practices have yet to take full advantage of these profit drivers.

As to the reasons behind why some businesses do take full advantage of these profit drivers (the most profitable) and some businesses don't, well, in our experience, there is one not-so-common denominator for those practices that do, and that is... **strong and committed leadership** from a principal who invariably has:

- Developed a clear view of what he/she wants their business to look like in, say, 3-5 years.
- Clearly and consistently communicates this view to staff, clients and business partners alike.
- Takes positive actions to implement the vision – 'doing the do' as our US clients say.
- Are prepared to spend time, money and resources – investing especially in their people and their technology base.

- Embraces change whenever it occurs and 'got on with it' – it will be particularly interesting to see how this plays out with the emergence of 'managed account' solutions.

If the above profit stats have encouraged you to think again about these areas (for example, how do you compare?), here are five tips to help you:

1. Business planning

- Open a good bottle of red and consider: What do you want your business to look like in, say, 3-5 years? What will be your role in this business? And on the personnel front?
- Objectively assess where your business stands today. Benchmark it against similarly positioned practices, and seek feedback from staff and clients (warts and all!).
- Invest time in putting together a plan for your business on two levels:

- For the longer term (3-5 years) – to flesh out your view (vision).
- For this year. Include your clearly defined goals, strategies, accountability and timeframes.
- Make sure both plans complement each other, are documented and shared with your key people.
- Work with someone you respect over the course of the year to measure progress against your plan and to hold you accountable.

2. Client review process

- Recognise that this is the perfect opportunity for you to demonstrate the value you're delivering to your clients (for the fees they're paying you).
- Schedule meetings in advance and don't let them be postponed.
- Prepare beforehand and seek the client's input into the meeting agenda.
- Wherever possible, conduct these meetings in your office and look to involve other personnel in the 'experience' – for example, client service manager and junior adviser.

3. Personalised client communications

- This is an absolute must for client-centric businesses – no one likes to be addressed as 'Dear valued client' (if I was so 'valued', surely you'd know my name!).
- And, of course, ensure all names are spelled correctly.
- Finally, all communication must be relevant to the client. For example, wealth accumulators don't really want to know about retirement income streams just yet. And the only way to guarantee this is through a CRM that holds the key relationship building data needed to build out and maintain the relationship.

4. People management

- Appreciate your staff for who they are – one of your most valuable assets.
- Respect staff by ensuring they have up-to-date job descriptions, co-written by the person currently doing the role. After all, they are the person best placed to draft and review.
- Ensure they have at least one formal review of their performance each year – surely, that's not a big ask!

- Invest in your people – not just with a competitive remuneration package but also by recognising their career plans, professional development goals and perhaps even their equity aspirations.

5. Client segmentation

- While every client deserves to be treated fairly and with respect, not every client is equal. Evaluate your clients based on the contribution (how ever you define it) they make to your business.
- Differentiate your service offering to each segment.
- Segmentation is not a 'set and forget' exercise – review client allocation, the services offered, as well as the cost of service delivery, at least once a year.
- Seek feedback from your clients as to their level of satisfaction on a regular basis (say every 18–24 months).

As we enter the end of the first quarter of 2018, I hope you'll find the time to reflect on the above and commit to at least one specific profit driver for the next quarter. We're sure that your efforts will be rewarded.

Terry Bell is a Partner of Business Health. For more information, go to businesshealth.com.au

**A mix of aligned and non-aligned, city and regional, small and large practices, as well as a portion of 'better' practices that have been participants in various licensee premier practitioner programs or were entrants in several Best Practice competition initiatives.*

***The HealthCheck is a web-based business assessment and benchmarking tool specifically designed for advisory businesses. Its comprehensive report provides the perfect platform for business planning.*



Objectively assess where your business stands today. Benchmark it against similarly positioned practices, and seek feedback from staff and clients (warts and all!).





Fee budgeting in managed accounts

Lukasz de Pourbaix examines the natural tension between fees, investor outcomes and investment philosophy.

A key thematic impacting most parts of the wealth management industry in recent years has been the increased focus on fee disclosure and the ongoing downward pressure on fees across investment management fees, advice fees or platform fees.

Within the investment world, we have seen the regulator seek to provide clients with greater transparency around investment related fees in Product Disclosure Statements via RG 97, which has caused much debate in the industry.

The ongoing focus on fees in the industry is likely to continue from a regulatory perspective, which has led to the ongoing evolution of low cost product options entering the market. The managed account sector is no different, with various layers of fees involved depending on the managed account structure adopted.

Amidst this backdrop, there is a natural tension between fees, investor outcomes and investment philosophy, which warrant further exploration.

Fees

If we take the fees in a separately managed account structure (SMA) outside of platform and brokerage fees,

the key fees relating to the investment structure include:

- the model management fee, which is the fee paid to the appointed entity managing the SMA portfolio;
- the underlying investment fees, which relate to the indirect cost ratios (ICR) for the underlying investment options used within the portfolios, such as managed funds and ETFs; and
- the responsible entity (RE) fee, where the RE plays the dual role of trustee and manager of the investment scheme.

Where a 'private label' solution has been developed (a tailored SMA solution specific to a financial planning dealer group), the model management fee may be split between the model manager and the respective financial planning dealer group offering the SMA. Under this fee construct, the fees will vary materially between SMA portfolios. The key variable being the fees associated with the underlying investment vehicles used.

In developing an SMA portfolio, it is common practice for a fee budget constraint to be in place limiting the aggregate underlying product investment management

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Historically, the ability to negotiate fees with investment managers has been the domain of institutional clients, however, with the growth in managed accounts, we've seen an 'institutionalisation' of the wholesale space.

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fees. This is particularly common for private label portfolios, where the dealer group is looking to manage the 'all-in' cost associated with investing in their SMA offering.

In my experience, the common rule of thumb investment fee figure used by financial planning dealer groups as a reference point as an 'all-in' investment cost is 1 per cent per annum. This fee comprises of the model manager fee, underlying investment fees and RE fee.

Fees vary across the industry depending on scale, portfolio structures and platform providers, but a sensible proxy for the fee breakdown is an RE fee of approximately 0.10 per cent per annum, a model management fee of circa 0.10 per cent per annum to 0.30 per cent per annum, leaving approximately 0.60 per cent to 0.80 per cent per annum to construct a diversified portfolio.

This does not include any margin the dealer group may look to generate under a private label structure, which would generally be incorporated within the model management fee.

Fee budget

In setting a fee budget, there are several things to consider.

A key consideration is whether the fee budget constraint allows the model manager enough scope to execute on the investment philosophy the manager has adopted and ultimately, whether the model manager will be able to achieve the portfolio objectives within the stated fee budget.

For example, if the investment philosophy states that the model manager believes in active management, then creating a portfolio largely consisting of passive strategies in order to reduce cost is not consistent with that investment philosophy.

Ultimately, the objective of setting the fee budget is to keep the model manager focused on executing

the investment philosophy and investment objectives at a reasonable fee point, rather than constraining the portfolio to such a degree that the portfolio does not reflect the investment philosophy and investment objectives are not met.

In managing to a fee budget, there are two main levers model managers have at their disposal.

The first is to prioritise the areas where they are prepared to pay more and where they are comfortable to seek lower cost options.

Typically, this will be determined by identifying which sectors and investment strategies are deemed to be 'high alpha' segments or investments that offer a unique exposure to diversifying assets not accessible in lower cost structures. Examples may include long short equities, alternative strategies, active small caps and absolute return strategies.

Conversely, the model manager may seek lower cost options to access market beta, be it in the form of a passive market cap weighted index exposure or 'smart beta' approaches that seek to exploit a particular market factor, such as 'quality', 'value' or an equal weight approach to investment.

Interestingly, we have also seen some traditional active strategies reassess their fee model, recognising the downward pressure on fees in some asset classes by lowering their investment management fees.

The other increasingly common approach to managing investment fees is to negotiate fee rebates with fund managers.

Historically, the ability to negotiate fees with investment managers has been the domain of institutional clients, however, with the growth in managed accounts, we've seen an 'institutionalisation' of the wholesale space.

There are various approaches fund managers take towards fee rebates, ranging from managers not offering fee rebates, a tiered fee model based on scale, through

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The other increasingly common approach to managing investment fees is to negotiate fee rebates with fund managers.

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to access to the institutional class of a fund.

The drivers for managers negotiating fees will vary significantly. Considerations such as fund capacity, scale, client servicing requirements, and where a product is in its product lifecycle, will all have an impact in manager fee negotiations.

From an investment perspective, the fundamental consideration in building a portfolio should be the quality of the underlying managers and the net of fee outcome for clients. Any fee rebate discussion should fall out of the process, rather than being a primary driver of manager selection decisions. The main situation to avoid is compromising quality for fee rebates, as over the long-term, it will ultimately compromise the overall portfolio outcomes for the client.

Ongoing focus

The ongoing focus on fees within our industry is unlikely to subside any time soon.

The main focus in constructing a managed account portfolio should be the consistent execution of the stated investment philosophy and achieving the investment objectives over the relevant investment time horizon.

The underlying investment management fees should be

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The main focus in constructing a managed account portfolio should be the consistent execution of the stated investment philosophy and achieving the investment objectives over the relevant investment time horizon.

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considered from the context of whether the relevant investment strategy is achieving the desired risk and return profile on a net of fee basis.

However, there are an increasing number of investment options that are available to portfolio constructors to assist in the management of fee budgets, and the growth in managed accounts has certainly seen the institutionalisation of the wholesale market with respect to the ability of negotiating fees with fund managers.

Lukasz de Pourbaix is Chief Investment Officer at Lonsec Investment Solutions.





The retirement riddle: Solving it with data and algorithms

Australia's retirement industry is the envy of the world, yet few Australians know if they're on track for a comfortable retirement. Wade Matterson says data and algorithms are a key part of the solution.

Australians hold an incredible \$2.3 trillion in retirement savings – more than the country's annual GDP – and yet few people know if they'll have enough to live the life they want in retirement.

It's no surprise given the confusing and contradictory advice directed at couples saving for retirement. Media publications regularly quote retirement nest egg targets ranging anywhere from \$640,000 to \$2 million.

A key problem is the input data – it's based on qualitative surveys of retirees that have only a tenuous relationship with their actual needs, wants and desires. We know this because big data has shone a light on investors' actual lives and shown just how inaccurate even their own estimates are when compared to their real-world choices.

Knowing who people really are is just the first step – it's equally important to know how to help them achieve their goals. Understanding people takes time, but when big data is combined with powerful algorithms, it can fast-track the process by creating direct and clear investment strategies linking investors and their goals.

Just as we use Google Maps to help us identify the best

way of getting from point A to point B, big data combined with powerful algorithms can identify where retirees are now, where they want to go and the best way of making sure they get there.

It's time for data, analytics and finally, appropriate products, to form the basis for good financial advice, leading the way towards personalised retirement goals.

Clients: Know thyself with big data

Financial planning questionnaires tend to ask clients how they believe they will react in different circumstances ('stated' preferences) but good advisers know this rarely gives the full picture.

'Revealed' preferences – either real-world data or simulated events that trigger real-world responses – are far more accurate.

Without a deeper understanding of decision theory and behavioural economics, advice that appears sound can easily misdirect investors towards the wrong goals.

For example, more than two-thirds (69 per cent) of seniors in a recent ASIC survey (*Building Seniors' Financial*

Capability) said 'having enough money to enjoy life and do what they want to do' was a financial priority. Yet more than half of retirees spend less than the Age Pension, according to the *Milliman Retirement Expectations and Spending Profiles (Retirement ESP)* analysis of more than 300,000 retirees' actual spending patterns.

This contradiction may be explained by a fear of outliving their retirement savings (not helped by out-of-reach retirement savings targets) or a desire to leave something for the next generation.

Similarly, many retirees state their strong desire for consistent income but few will buy annuity-type products: a latent desire to have more flexibility with their savings (and other drivers) often takes precedence.

A good adviser can better understand these discrepancies by using big data, which helps reveal not only what retirees are doing now, but what they are likely to do in the future.

While super savings targets vary widely, we know that retirees aged 65 to 69 actually spend a median of just \$31,068 from all income sources each year. A savings target of around \$640,000 equates to the top quartile of investors (although many of these will be the ones who seek personal financial advice).

More importantly, big data allows advice to be tailored across wealth bands, age, location and other filters.

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...we know that retirees aged 65 to 69 actually spend a median of just \$31,068 from all income sources each year.

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For example, a client may plan for their retirement expenditure to remain constant or even rise over retirement, whereas the *Milliman Retirement ESP* shows that, in practice, it tends to drop.

This type of real-world data can help recalibrate retirement expectations and behaviour, so that it better matches personal goals.

Algorithms power personal advice rather than replace it

Big data means little if it doesn't carve a clear path that brings investors closer to their goals.

Financial planning is a complex business. At its heart is managing clients' assets and income needs to meet their changing expenses over time. It's an asset-liability problem, and one that has been successfully managed by large businesses and institutional investors for decades.

Algorithms can bridge this divide and, thanks to powerful cloud-based technology, households can now use the





It's time for data, analytics and finally, appropriate products, to form the basis for good financial advice, leading the way towards personalised retirement goals.



same institutional grade analytics as global firms. Risk tolerance, which was once the centrepiece of simple, product-based advice, is just one component of this holistic, goals-based approach.

This approach is inherently more complex, but a goals-modelling engine should be able to run what if, trade-off, tracking and optimisation analyses that incorporate client preferences and risk profiles. It should also allow for feedback loops and intelligent learning, ultimately offering real-time household asset-liability analysis across multiple advice channels.

Advice algorithms must be accurate, complete, consistent, fast (real-time), supported and backed by a strong company.

This confidence then allows advisers to focus on differentiation, their business strategy and the user experience. The result is more customised goals, which can radically change investment advice and recommended products.

Products: Beyond investment returns and closer to personal goals

The *Milliman Retirement ESP* has revealed many surprising aspects about retirees, including that more than half spend less than the Age Pension. While we don't yet know the full qualitative reasons behind this behaviour, we know that risk is a key concern.

Longevity risk is a reasonable fear for many people, given that a 60-year-old man is now expected to live for a further 26.4 years and a 60-year-old woman for 29.1 years, according to the Government's 2015 Intergenerational Report.

Many investors would prefer to have more savings before they retire, given these growing lifespans. It requires saving more, spending less or boosting returns.

Unfortunately, cash and other safe-haven investment returns, like interest rates, have been slashed in many parts of the world. Asset returns are expected to be more

subdued, as central banks begin reining in the loose monetary policy that has powered markets in recent years.

Many investors also need to balance the desire for higher returns with a deep sense of loss aversion, given they no longer have time to recover from extended market downturns.

Sequencing risk describes the heightened risk that an investor with a large balance approaching retirement, or in retirement and drawing down a pension, faces. Younger investors, by way of contrast, are often making contributions (rather than withdrawals) and can benefit from an eventual market rebound.

An advice journey that begins with big data and continues with algorithms aims to achieve a defined personal goal and strategy for the investor, rather than a reactive strategy based on selling relatively short-term one-year investment performance.

When investors can clearly see their five to 15 year personal goals, explicit risk management strategies make sense.

Avoiding large and sustained market downswings means investors are more likely to meet their actual goals. Firstly, it minimises sequencing risk and, secondly, it makes investors less susceptible to making poor decisions under stress.

For example, a post-GFC study by the Centre for Retirement Incomes and Financial Education Research found a surge of industry fund super switching beginning in October 2008 and ending in March 2009, just as the market reached its low point. The market then surged more than 44 per cent, but the report's authors found investors still remained in their low-risk investment options by September 2009.

Milliman's 'Even Keel' model portfolio strategy is one new offering that allows dealer groups and platforms to apply an institutional-grade, rules-based market risk management overlay to any model portfolio's underlying equity investments. It allows investors to retain a strong exposure to growth assets, while the downside risk is managed across their own unique portfolio.

Innovative products, built on big data and algorithms, mark the final step in the holistic advice journey. It is only by bringing together these disparate elements to underpin quality personal advice that investors can achieve their desired retirement goals.

Wade Matterson is Practice Leader, Australia at Milliman.



Do you know what your clients really want?

SHERISE MERCER

Head of Macquarie Virtual Adviser Network
Macquarie Group

With a wider choice of providers than ever before, today's financial advice and accounting clients are informed, selective and increasingly demanding. What does it take to nurture closer client relationships and convert goodwill into long-term business success?

Each year, Macquarie conducts in-depth analysis of around 1,500 clients from specialist and multi-disciplinary firms across Australia – to reveal the key drivers behind client engagement. The robust survey digs behind the customer satisfaction headline to look at what drives propensity to recommend, stay and increase share of wallet.

The findings of the most recent *Propensity Project Report* give advisers and accountants plenty of food for thought in terms of what customer-facing actions will move the dial to improve business outcomes.

Importantly, the survey focuses on 'actual' rather than 'stated' drivers. For example, if you ask clients directly about fees, people will tell you that's important. However, if you look at client behaviour, in comparison to other attributes or drivers, fees have a very low propensity to drive satisfaction.

Top 5 drivers of satisfaction

The survey found the top factors that actually drive satisfaction, across all ages, are:

1. My adviser manages my portfolio for best risk and return outcomes

This is not surprising, as it talks to the heart of why people go to a financial adviser in the first place.

This is a table stake for advisers, demonstrating how important it is to link what you do, back to a client's goals and strategy. It's not so much about absolute returns, but about getting the balance right. Clients want you to understand them as a person – what's important, what they're trying to achieve out of life, their appetite for risk and how to manage their fears.

This finding tells us that an adviser's primary role is to truly understand what will drive confidence and comfort in their clients.

2. I receive the right level of information about my progress

Over the last six years, this has become increasingly important. Communication usually falls in the top 5-7 drivers. But now getting the frequency, quality and clarity of that information right has become an even greater priority. The baseline is making sure your clients aren't waking up in the middle of the night because they don't know what's going on.

This driver becomes even more important as people approach the end of their earning capacity years.

People want to know: 'Will I have enough to live on? Will I run out of money?' The key is to make sure people have enough information to be confident about how they're tracking towards their goals.

3. My adviser identifies my needs and connects me to other experts as required

This is another driver that's been coming up the list over the last few years.

As people become increasingly time poor, clients expect to have a single relationship with one adviser who takes a macro view of what needs to happen to protect their financial wellbeing.

Clients typically don't understand the regulatory framework, so they don't really distinguish between tax advice and wealth management. They want advisers to take a holistic view of their needs and either provide everything or recommend someone in their network to fill any gaps.

There's a real risk of dissatisfaction if an adviser or accountant just does their bit, without taking into consideration the client's broader goals and financial situation.

4. My adviser proactively manages my affairs

Clients want to be more than a number. They expect advisers and accountants to look out for them, understand their changing needs, think about what's coming up and get ahead of it.

Client relationship management has moved from pulling out the file once a year, to proactively checking in based on life events (buying a house, saving for a big trip, planning a wedding) or even just regular 'health check' contact to ask: 'Is there anything I need to know?' It's a simple thing to schedule, but it will make the world of difference to how valued the client feels.

5. My adviser helps improve my financial knowledge

This driver is particularly relevant for younger clients

(under 46) in the accumulation phase. These clients don't necessarily want a detailed explanation of how the share market works, but they do want to get a handle on how best to structure their financial life.

There's a real appetite in younger generations to take personal responsibility for achieving their goals. They want to understand their options and participate by actively considering different strategies with their advisers.

It's a distinct generational change from many retirees, who often put an expert on a pillar and take their advice without more robust scrutiny.

What does it mean for my practice?

The report explores four key dimensions of customer satisfaction: people, process, personalisation and perception of value – and the big shift is in the importance of personalisation.

This year, for the first time, four out of the top five drivers are around 'personalisation': an adviser's ability to customise the entire client relationship.

So, this is where you're going to get a real uplift in engagement.

It's all about giving clients a truly personalised experience based on their needs and goals, and being proactive around communication and regular check-ins to build a trusted relationship.

There's a real opportunity for firms to refocus on the client experience to deliver what clients really want. See Chart 1.

How do we achieve this?

Well, managed accounts is a good start.

Chart 1: Top satisfaction drivers by age

<45	46-60	>60
1. My adviser helps improve my financial knowledge	1. I receive the right level of information about my progress	1. My adviser manages my portfolio for best risk and return outcomes
2. My adviser identifies my needs and connects me to other experts as needed	2. My adviser manages my portfolio for best risk and return outcomes	2. Professionalism
3. I receive the right level of information about my progress	3. Communication style	3. My adviser values my business and relationship with the firm
4. Attention to detail (from support staff)	4. My adviser completely understands my personal financial needs	4. My adviser proactively manages my affairs
5. My adviser gives me confidence	5. My adviser values my business and relationship with the firm	5. Integrity



By using managed accounts to systematise administration and compliance tasks, advisers can free up time, which can be better spent on delivering a thorough and personalised experience to their clients.

It's time to move the conversation from administration. Without managed accounts, the process to make changes to a client's portfolio can be slow, cumbersome and require hours of back-office administration.

The process not only involves excessive paperwork, it can also mean that the vast majority of your client interactions are based around tedious paperwork concerns. The focus on stock selection and trade execution decisions can keep the client conversation at a more reactive level. The focus is usually on: 'How are your investments performing?', rather than the more strategic, and ultimately more helpful, 'How are we tracking against your goals?'.

Managed accounts allow a more strategic focus. With managed account solutions, depending on whether

you buy, partner or build, the investment process is either performed in-house or outsourced to fund managers or research houses, and the rebalancing is performed by the platform.

Regardless, you no longer have to spend time on stock selection or trade execution, enabling you to be more proactive and have more compelling conversations with your clients.

Managed accounts provide advisers with a different discussion and a different relationship with their clients.

Managed accounts can position you, the adviser, as a specialist, with time to provide holistic investment advice and have more strategic conversations. You'll be able to help your clients make well-informed financial decisions aligned to their goals, creating a path to reach financial success and security in the future.

Sherries Mercer is Head of Macquarie Virtual Adviser Network at Macquarie Group.

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Upcoming Events

MARCH 2018**IMAP ADVISER ROADSHOW -
BRISBANE, MELBOURNE, SYDNEY****MELBOURNE**

When: 19 March, 2018

Where: Commonwealth Bank of Australia, Level 19,
Tower 1 Collins Square, 727 Collins Street, Melbourne

BRISBANE

When: 22 March, 2018

Where: At Royal on the Park, 152 Alice Street, Brisbane

SYDNEY

When: 27 March, 2018

Where: Whiteley Ballroom, Amora Hotel Jamison,
11 Jamison Street, Sydney

This year's highly anticipated IMAP Adviser Roadshow will be rolled out across three city locations in March – Brisbane, Melbourne and Sydney.

The annual IMAP Adviser Roadshow is a specialist event for dealer principals, adviser group management teams and advisers. It focuses on the practical implementation of managed account programs in established advisory businesses and how to make this truly effective for advisers and clients.

Topics being discussed by leading experts at the IMAP Adviser Roadshow include:

- **Building a private label platform.**

Hear from Lonsec and Netwealth about the requirements to build a managed account program for your business.

- **Using managed accounts to meet the retirement income challenge.**

Hear how managed accounts are enabling advisers to address the most important task of all – meeting investors' retirement income goals. Milliman – one of Australia's leading retirement income experts – sets the scene for

specialised managed account portfolios.

- **What determines practice profitability? Are managed accounts a path to improved profits?**

IMAP and Colonial First State commissioned Business Health to develop a specific Managed Account HealthCheck. Learn how advice practices that use managed accounts achieve higher practice profitability.

- **What resources will you need to be the portfolio manager?**

What capabilities will you need to take the step up to portfolio management? Hear what platforms, external REs and MDA advisers need to successfully fill this role.

- **Best interest: What role can managed accounts play?**

This Macquarie hosted session will help you understand how to meet the best interest obligations through a managed accounts program.

- **Managed accounts for direct securities oriented advisers**

Hear adviser case studies on developing managed account programs using ASX-listed investments in direct investing oriented practices.

- **High-net-worth clients: How different is it to serve this group?**

In this session, you'll hear how advice businesses serve this market with discretionary portfolio management.

In addition, Sam Henderson – author, media commentator, and CEO and senior financial adviser at Henderson Maxwell – will share his business secrets in a presentation titled, 'Building a Practice of Value'.

Sam's insights will help guide you in transforming your own business. However, this session will **only** be available at the Sydney roadshow.

For more information on this event or to register your attendance, go to imap.asn.au/events

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IMAP hosts leading managed account educational events, including webinars for dealer principals and advisers, advice roadshows, practitioner forums and the Responsible Manager Masterclass. For more information, go to imap.asn.au

For delegates attending the IMAP Adviser Roadshow, there will also be plenty of peer networking opportunities to discuss managed accounts in what is the fastest growing sector of financial services.

MANAGED ACCOUNTS ADVISER ROADSHOW 2018

MELBOURNE 19 MARCH | BRISBANE 22 MARCH | SYDNEY 27 MARCH



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