Evolution in practice

Evolving your business to offer Separately Managed Accounts (SMAs)
In the current environment, Separately Managed Accounts (SMAs) offer investors of all sizes confidence, agility and control – and financial advisers a new means of adding value and achieving even greater scale. This paper examines the benefits SMAs can offer your clients, looks at where and how SMA pioneers are gaining traction and discusses different approaches to introducing SMAs to clients.
Until recently, many Australian financial advisers were essentially running stock broking businesses. Then Wrap platforms changed the game, enabling financial advisers to scale their business by offering a low-touch means of giving smaller investors access to managed funds. Wrap platforms improved administration and efficiency, reduced the cost to serve and allowed financial advisers to grow their client base without eroding value.

Now SMAs, which have been sold as a premium service in the United States for 25 years, are allowing Australian financial advisers to take traditional Wraps to the next level. Positioned between an individually managed portfolio and a managed fund, these new financial products offer higher levels of transparency, agility and tax optimisation to investors of all sizes, while still enabling scale.

What are SMAs?

An SMA is a non-unitised managed investment solution that uses the intellectual property of professional fund managers to achieve a scalable, customisable investment solution for clients. For equity based strategies, the client has beneficial ownership of the underlying shares they are invested in, providing benefits and flexibility which can be lost in a managed fund. You and your client can see the breakdown of the shares within the portfolio and receive the tax benefits.

SMAs offer higher levels of transparency, agility and tax optimisation to investors of all sizes
SMAs have been available in Australia for years, but they are only now becoming readily available on Wrap platforms. Sedat Papagan, a Senior Financial Planner at GHR Financial Planning, has begun transitioning his existing managed funds clients to SMAs in the past year. He says that industry conditions in Australia make the market ripe for the product.

Sedat Papagan, Senior Financial Planner at GHR Financial Planning:

“The combination of increased market volatility and the compliance obligations placed on financial advisers definitely make SMAs more attractive. Clients have an expectation that, if the market falls, we can get them out of trouble. When the market takes a hit, people always say: ‘Why didn’t you do anything?’ In reality, our compliance obligations prevent us from being able to move quickly to get out of risky markets.

It could take two or three days to generate a record of advice to sell and move a single asset because the risk return trade-off has changed – and we have to do that across hundreds of clients and numerous assets. SMAs change the game. They give everyone access to institutional grade responsiveness.”
The regulatory environment is a big driving force. The nature of the compliance regime means you can’t be proactive with all clients. I think financial advisers are realising we can’t be all things to all people. We have to make sure clients get the best outcomes.

Jarad Stirling, the Principal of Stirling Financial Consulting, agrees:
Benefits of SMAs for your clients

SMAs have a number of potential benefits, depending on a client’s goals and circumstances. Some clients are drawn to the transparency and control; others choose an SMA for its cost advantages alone and leave the investment decisions to the professionals; or they like the tax benefits.

Cost efficient
Like managed funds, SMAs offer far lower management, custody and execution costs than retail broking fees. Total fees vary, but can often work out at the same level as those for managed funds. Transaction costs can effectively fall to zero within an SMA as a result of the SMA provider netting the buy and sell transactions across all portfolios before placing orders.

SMAs can work out to have lower fees than you’re paying for your managed fund.

Sedat Papagan, Senior Financial Planner, GHR Financial Planning

Tax efficient
An SMA has tangible tax benefits, offering the flexibility to use parcel selection to optimise CGT. For example, you can choose a lock option for clients who might be worse off from CGT costs if the fund manager decides to sell a particular stock. This is in contrast to managed funds that often have negative tax aspects.

An SMA gives clients direct ownership and the benefit of franking credits.

Jarad Stirling, Principal, Stirling Financial Consulting

Transparent
You and your client can view the underlying securities held. In times of strong or poor markets, you can track the performance of individual holdings.

When the markets are as volatile as they are at the moment, clients find the uncertainty of not knowing stressful. Rather than the ‘black box’ of a managed fund, with an SMA the client knows exactly what they’re invested in and who’s managing their money. The clarity around performance and visibility of the underlying stocks means the client can talk about their investments with confidence.

Nick Walter, Investment Adviser, Macquarie

Agile
SMAs offer the advantages of dynamic asset allocation, allowing managers to move quickly into defensive assets or to take advantage of emerging opportunities.

Flexible
You have the option of adjusting your client’s portfolio, for in specie transfers of existing shares, and in some platforms, adding new shares bought outside the SMA or blocking the SMA portfolio manager from selling certain parcels of shares. You can also delete or swap stocks to meet specific criteria, such as ethical considerations.
Benefits of using SMAs for your practice

Scale benefits

SMAs create another level of scale, allowing you to offer new, value-added services for <$2m investors, giving these clients direct equity exposure and access to new managers currently not available on Wrap.

It’s a fantastic way to deal with a client efficiently. Scalability is important because you want to be able to build your client base this way.

Nick Walter, Investment Adviser, Macquarie

If investment management isn’t your primary value proposition, or if you have at least some Wrap clients, then SMAs work at multiple levels for you and your clients.

Sedat Papagan, Senior Financial Planner, GHR Financial Planning

Sedat Papagan has a suggestion for financial advisers who are currently only offering bespoke investment advice:

“Where is the industry going?”

“Will your business model still be relevant in five years’ time?”

“SMAs don’t fit with your current offering, but I’d still sit down and work out the numbers.”

“Should you consider diversifying into other revenue streams?”

Change the conversation

Walter says SMAs also change the conversation from stock picking to being more strategic.

My clients love the professional management, but they are still in regular contact with me to discuss markets. Rather than focusing on the nitty gritty – BHP vs. Rio – we’re considering market trends. This is a conversation I can have with confidence and where I can really add value. I’m not really comfortable positioning myself as a stock picker.

Speed up and improve reporting

He also likes the reporting functionality.

The reporting tools make it easy to calculate the client’s performance. Clients get very frustrated if it’s hard to see relative performance. Now, I can quickly and easily pull up performance pre-tax, after tax, and relative to the market. These days I might only spend 30 minutes building a document that’s the basis for a client review because a lot of the calculations are automated.
What sort of clients are buying SMAs – and why?

Although SMAs are positioned for and largely used by <$2 million investors, they’re also crossing over into the high net worth market. Walter has a $40 million investor with 3 SMAs.

This client didn’t want a stock broking relationship and didn’t want something they had to bother with every day. They like the fact that it’s professionally managed and comes with an overlay of advice.

Stirling says he uses SMAs across the board.

There’s no real age bracket or dollar limitation. Obviously, they’re not good for people who want the control to stock pick. But apart from that, there really aren’t any limiting factors.

**Hands off accumulators**

SMAs work well for most accumulation clients with $100,000 upwards. These clients generally want to keep their advice costs to a minimum and are happy to leave investing to ‘the professionals’.

**Hands on accumulators**

SMAs are also ideal for those who like trading shares directly but don’t want to pay the retail cost of broker fees.

**Retirees**

Although not a primary target for SMAs, retirees with substantial assets are putting their core holding into SMAs and then leaving some satellites for income. These clients like the fact that they can control buying and selling and get the direct franking credits.
How to discuss SMA with your clients

You need to sit down with the client because SMAs are highly complex. Often a client struggles to ‘get it’ even when you’re sitting in front of them. It’s also important to simplify the message. Most clients don’t want and don’t need to look under the hood.

I talk to my clients about the benefits of dynamic asset allocation, compared to what they’re doing at the moment. I ask people,

“What would you want us to do if there was another GFC?”

They always say they would expect us to move in and out of assets as needed, as quickly as possible. At that point, selling dynamic asset allocation is straightforward. I simply say:

“We don’t have those levers to push and pull without a time delay – but what if we could use professionals to do that for us?”

Then I explain that, with an SMA, you get a highly tailored, institutional-quality investment that can pull levers and move your funds quickly. And you get this for next to nothing – SMAs often work out to have lower fees than you’re paying for your managed fund.

For some clients, I’ll go on to explain that, with an SMA, we’re in control of the asset and we can choose to hold on to distributions, depending on what works for our situation.

I often describe an SMA as being in between direct share ownership and using a managed fund, giving our client the ‘best of both worlds’.

I discuss SMAs as part of the solution I offer my clients. I don’t ‘sell’ them, I simply explain the benefits as part of my recommendation.

I inform my clients that their investment will be actively managed by professional financial analysts looking at different markets and putting their best ideas forward. Plus, the managers have preservation of capital front of mind.

With high net worth individuals, I often say to my clients,

“Let’s take our time and invest in stages. We don’t have to worry about what stocks to buy, we’ll look to use SMAs to take advantage of market trends.”

Then we have regular discussions about the market and look for market entry points that are favourable. It gives my clients comfort that I’m thinking proactively about their needs.
If you’re considering incorporating SMAs into your business model, here are three questions to help get you started:

1. **Which clients will benefit?**
   - Review the needs and preferences of your clients to identify those who would benefit from an SMA. Typically this will include people who like transparency in their investments, are sensitive to fees and not interested in stock picking. They may also have particular tax planning or legacy investment needs.

2. **What different skills will you be bringing to your clients?**
   - If you’re moving away from stock picking, what is the new value you are offering your client? Consider where your strengths as an adviser lie: is it in broader wealth planning, macro and sector strategy development, or in bringing together a team of specialists in your practice? Make sure to review whether your fee arrangements reflect the design of your services.

3. **Which SMA platform should you choose?**
   - There are a number of providers of SMAs, on platform and as a standalone product. The key question for choosing one is which best supports your business model? Some considerations include what existing Wrap platforms you use, diversity and performance of asset managers, and SMA/Wrap functionality.
For more information about SMAs with Macquarie, visit macquarie.com.au/wrapevolved