# White Paper: The evolution of Separately Managed Accounts (SMAs)

**What do planners and investors really want?**

August 2015

# Now that SMAs have come of age, what are the planners who use them looking for?

**$2tn**

expected assets in the SMSF segment by 2033

Australia's wealth management sector faces disruptive changes on a number of fronts. Investors have become more educated and are more aware of key issues such as portfolio transparency and tax events. With assets in the self-managed superannuation fund (SMSF) segment expected to more than triple to over $2 trillion by 2033[1], the amounts of money involved are huge and are growing rapidly. All this is at a time where new technology is giving rise to new products and an ever-widening competitor set.

Australia's financial planners and dealer groups face major commercial pressures on their businesses. Following a wave of regulatory change, planners can benefit more than ever before from solutions that improve efficiency, lower administrative costs and help them to scale their businesses.

In this paper, we suggest that separately managed accounts (SMAs) can and will play a key role in helping planners to deal with these challenges. This is partly because SMAs simultaneously address the needs of dealer groups, planners and their clients. It is also partly because SMAs differ from some of the other products and asset classes that SMSFs and retail clients may consider: they have to be purchased through a planner, because only planners have access to the platforms that can accommodate SMAs.

Growing access to SMAs through platforms is a key reason why the question of what planners want is far more important now, in mid-2015, than it was 18 months ago, at the end of 2013. Over the course of 2014, the number of platforms through which SMAs may be accessed rose from 7 to 11. However, the number of planners using platforms which handle SMAs jumped from 10% to 25%. Since 2012, the number of planners who have access to SMAs through platforms has more than trebled.

In early 2015, JBWere commissioned a study with Investment Trends looking at how and why advisers were using (and not using) SMAs, and what the likely drivers of growth will be in the SMA sector in the future. The resulting research (*JBWere Investment Trends SMA Report 2015*), based on an online survey of 671 financial planners, provides some important insights into a sector that is poised to take off in the retail advice channel.

1 Deloitte, *Dynamics of the Australian Superannuation System: the next 20 years.*

# As of mid-2015, what do the planners really want?

**For many planners, the work involved with monitoring individual shares is too much.**

Direct shares remain an important part of the portfolios of Australian investors. However, the burden of work involved in monitoring individual shares is too much for many planners. (In the *JBWere Investment Trends SMA Report*, 48% of the planners surveyed said the work involved in monitoring individual stocks discourages them from investing further in direct shares). As a result, planners are looking for other solutions for their clients that offer the same benefits to the portfolio as direct shares.

**Partly for this reason, SMAs are becoming more popular.**

One outcome given the shortcomings of direct share investing is that SMAs are becoming more popular among planners. The planners who currently use SMAs expect that the percentage of their client funds which are invested in SMAs will double over the next three years.

**Financial planners recognise the advantages that SMAs offer to SMSF clients.**

Currently, over half of planners who use SMAs believe that SMAs are more appropriate for SMSF clients than direct shares. A majority of planners consider that SMAs offer advantages to SMSFs in comparison with managed funds. Relative to direct shares, the main advantages of SMAs are the lower administrative and compliance burden. Relative to managed funds, the main advantages include greater transparency, cost effective access to professional management and tax benefits.

**Presence of SMAs on platforms will be a key to the future growth of SMAs.**

Nearly all planners who use SMAs access them through platforms. Over the last year or so, the number of platforms through which SMAs can be accessed has increased from 7 to 11. More importantly, the number of planners who can now access SMAs on their primary platform has increased from 10% to 25% of those surveyed – a significant jump in SMA accessibility for financial planners nationally.

**Education could also promote take-up of SMAs.**

Some two thirds of planners can be encouraged to increase/begin usage of SMAs, if they are provided with additional support and education around SMAs from their dealer group. Education is required in two broad areas: the basics of how SMAs actually work, and how SMAs can be used to help clients and the planner's business.

# SMAs vs managed funds and direct equities – The best of both worlds

## What are SMAs?

Separately Managed Accounts (SMAs) are a way of investing in equities and other listed securities while maintaining the benefits of professional investment management.

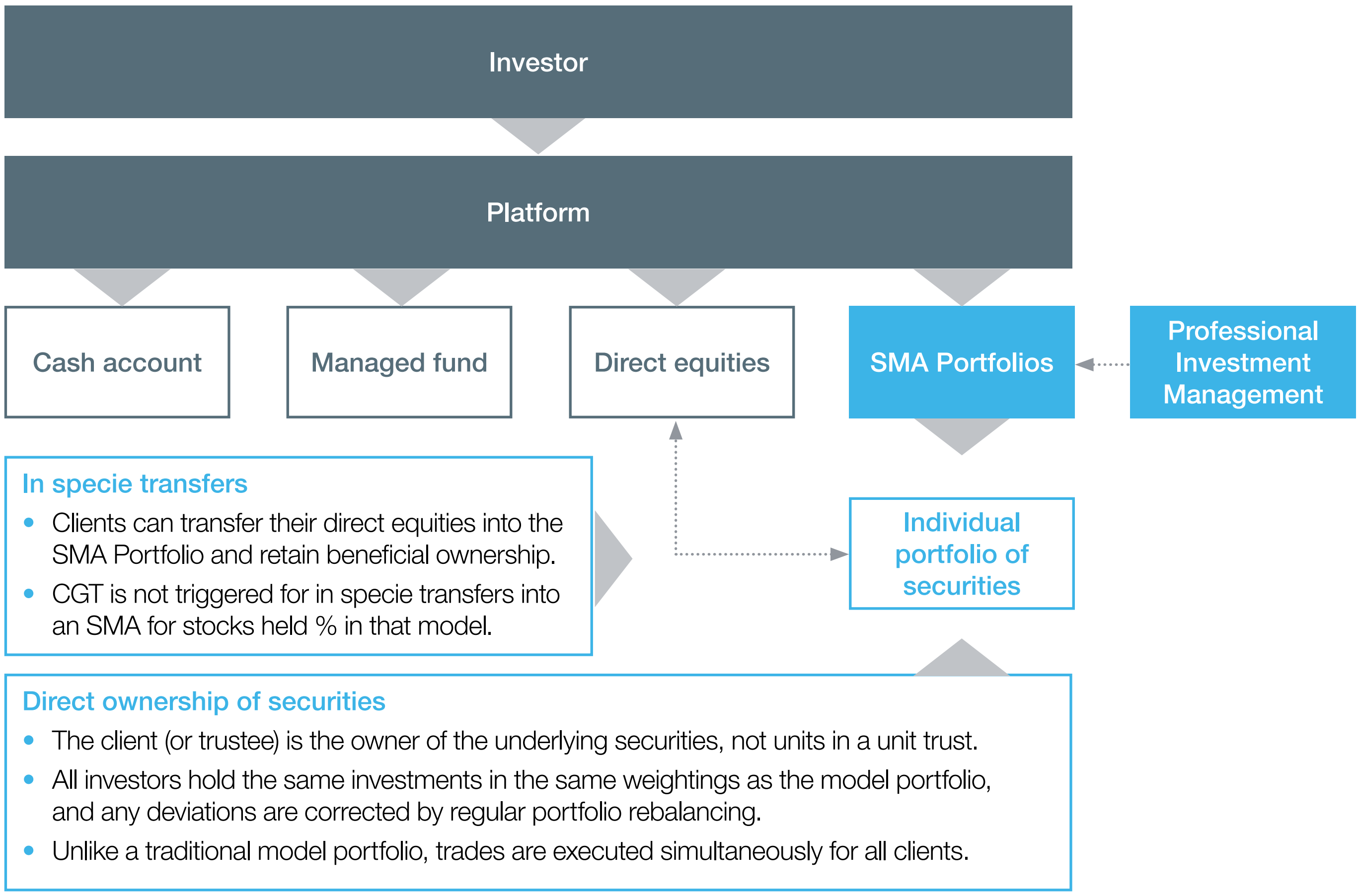
Like managed funds, they are financial products that are sold via a Product Disclosure Statement (PDS) and operate within a Managed Investment Scheme. However, SMAs are not pooled investment vehicles – the investor is the owner of the underlying securities. This direct ownership of the underlying securities is also one of the characteristics that sets SMAs apart from other popular retail investment products such as listed investment companies (LICs).

Given SMAs are based on model portfolios, entry level is relatively low, and for any one client, several model portfolios can be blended in order to achieve the client's specific objectives.

| | Managed funds | SMAs | Direct equities |
|---|---|---|---|
| Professional management | Yes | Yes | N/A |
| Multi-manager | Yes | No | N/A |
| Accessible via wrap platforms | Yes | Yes | Yes |
| Management fees | Yes | Yes, usually lower | No, just brokerage |
| Pooled investments/ unitised | Yes | No | No |
| Unit prices | Yes | No | No |
| Individual investor accounts | No | Yes | Yes |
| Individual cost base for calculation of CGT | No | Yes | Yes |
| Dividends flow directly to investor | No | Yes | Yes |
| Transparency | No | Yes | Yes |
| Investor has beneficial ownership of assets | No | Yes | Yes |
| In specie transfers | No | Yes | Yes |
| Able to decide on corporate actions | No | Yes | No |

Source: JBWere Investment Trends SMA Report 2015

# How does an SMA work?



## Case Study – Vikas Modgil, Knowledgebank IQ (KBIQ)

*Vikas joined KBIQ and purchased a book of clients from a retiring adviser who had used direct shares and managed funds for his clients' exposures to local equities. He quickly realised that he needed support in managing the direct share portion of the clients' assets.*

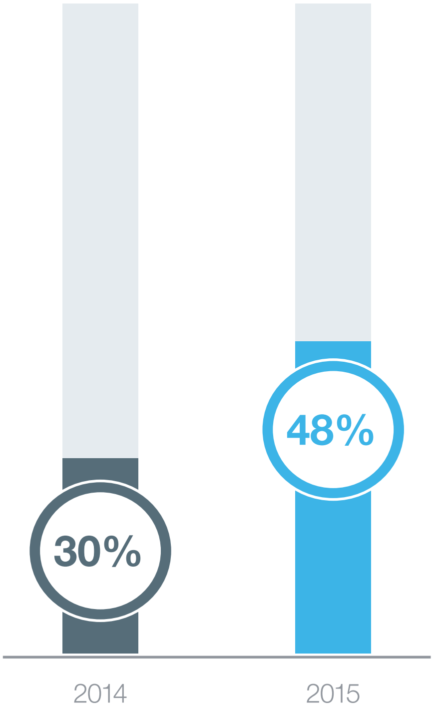
*"The clients typically had five or six direct shares in their portfolios, and they agreed that they needed more diversification," Vikas explains. "My challenge is that I am a financial planner, not a share analyst. I realised that direct shares were almost certainly not the best solution."*

*JBWere introduced Vikas to SMAs, which he realised would enable him to provide the clients with the benefits of professional management and, at the same time, allow him to focus on client relationships and growing his new business. He also realised he could transfer his clients' managed fund holdings into SMAs too, saving the clients money through reduced fees and improving the performance of their investments.*

*"SMAs solve a lot of problems," Vikas says. "The clients have properly diversified portfolios. They have access to professional management at a much lower cost than would be available through managed funds. And their investment decisions are made in a timely manner."*

*Besides the obvious value Vikas was able to add to the client experience, through using SMAs, his business is now also scaleable, meaning he can freely grow new clients without worrying about capacity issues.*

# For many planners, the work involved with monitoring individual shares is too much




Number of planners who cite work involved to manage direct equities as a barrier to further usage

Direct shares are an important asset class for Australian investors. As of the end of March, SMSFs held $193bn – or just under one third of total assets under management of $595bn in direct shares[2].

However, it appears that usage of direct shares has hit a ceiling. When asked why they recommend direct shares, the average number of advantages mentioned by planners in 2015 was 6.3, which is the lowest since 2010, when the number was 5.9. Moreover, the number of planners mentioning any of the various advantages of direct shares (such as dividends, franking credits, capital growth potential, liquidity, ease of transaction etc) has fallen. The sole exception has been transparency – the number of planners mentioning this advantage has increased slightly to about 50%.

This is reflected in flows of new client money. Direct shares have accounted for 25-27% of flows annually since mid-2013. By contrast, the percentage flowing to managed funds has grown from 44% in May 2013 to 51% in early 2015, which illustrates the extent to which direct share inflows have plateaued.

It is also noteworthy that the number of planners who provide advice to their clients in relation to direct shares has reached a plateau of around 56%. Conversely, the number of planners who do not currently provide advice in relation to direct shares and who have no intention of doing so in the future has grown from 20% in 2014 to 22% in 2015.

At the same time, the work involved in monitoring individual shares is cited by 48% of planners who are currently using direct shares as being a barrier to their further usage of direct shares. In 2014, the corresponding figure was 30%.

Among planners who are potential (although not actual) users of direct shares, the work that is involved in monitoring individual shares is also the biggest barrier to usage, and is currently identified as such by 40% of planners.

2 Australian Taxation Office (ATO), Self-managed super fund statistical report, March 2015

# SMAs are becoming more popular among financial planners

**20%**
2015

**17%**
2014

Increase in the number of advisers using SMAs over the last 5 years

**+23%**

advisers who may start using over the next two years

Separately managed accounts (SMAs) remove much of the work involved for planners who use direct shares for their clients. Over the last five years, the number of planners who actually use SMAs and who intend to continue to do so, has risen from 17% to 20%. Another 23% of planners say that they may start using SMAs over the next two years.

Among the planners who actually use SMAs, the median has 7% of their client funds in SMAs, while the average has 13%. For this group, the corresponding figures in 2018 are expected to be 17% and 24%. The rise in these figures likely reflects an increase in the number of clients who use SMAs on the recommendation of their planners. In 2015, 21% of these planners' clients use SMAs. The number has been increasing since the beginning of 2015, when it was 15%.

As mentioned above, the likely drivers of this strong growth are the administrative benefits that SMAs offer planners in comparison to direct shares. In essence, stock selection, portfolio rebalancing, administration and after-market support are outsourced to the manager of the SMA, as well as all responsibility for handling of corporate actions. This means there is no need to provide clients with individual Statements of Advice (SoA) or Records of Advice (RoA) every time the compositions of model portfolios within an SMA change.

This is a major point of difference between SMAs and direct equity investing. In a directly invested portfolio, a planner is responsible for researching and determining the appropriate response to a corporate action. The planner must prepare a SoA or a RoA, communicate with the clients, gain their approval, and implement the change for each client. In essence, the planner takes on the role of investment manager and administrator for every corporate action or stock change. For planners with dozens of clients holding multiple share investments – direct equity clients tend to hold an average of 12 shares each – this process makes it impossible, once they reach a certain level, to further grow their business or have time for quality conversations with clients.

Dealer groups also benefit from use of SMAs, ensuring that direct equity investment businesses are much more scalable. The lower costs involved with SMAs, combined with the benefits of professional portfolio management that they provide, should result in better outcomes for clients. In addition, pressure on back office and settlements staff is much reduced by SMAs, in some cases allowing these employees to be redeployed as para-planners or to other revenue-generating roles.

## Case Study –
## Wayne Lear, Shield Wealth

*Wayne was running $150m in direct equities for clients. He and his back office colleagues were struggling with settlements, corporate actions and other requirements. As a result, Shield Wealth had effectively closed its doors to new clients.*

*JBWere introduced the SMA concept to Shield Wealth as a way of freeing up resources that could be used to grow the business, rather than spending all their time dealing with day-to-day admin.*

*"Basically, I was looking for increased capacity", says Wayne. "I wanted to be able to take on new clients, to reduce back office expenses and to provide the clients with greater peace of mind. Every time there is a corporate action, we had to down tools, sometimes for days, to manage them.*

*"With SMAs I don't have to do that. I am also finding that the transactional side has dropped off dramatically – I don't have to spend 45 mins to do a single trade.*

*By moving their direct equity clients into SMAs, Wayne and his colleagues were able once again to write new business, with equities portfolios run for Shield Wealth's smaller clients being directed towards either the JBWere Income SMA or JBWere Growth SMA, according to the clients' investment objectives. Wayne's clients are also now receiving detailed monthly performance reports that exceed the reports that Shield Wealth had previously been able to provide on a quarterly basis.*

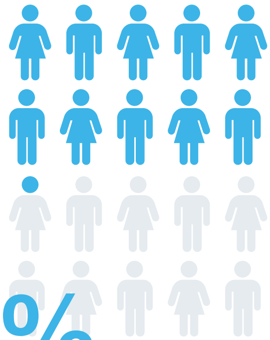
*Wayne has been able to spend a lot more time focusing on the top end of his client base, which is where most of the business's referrals and revenues come from. JBWere also works with Wayne by assisting him with semi-annual client presentations and market/SMA updates.*

*"Using SMAs, I was able achieve the outcomes that I had been seeking," says Wayne. "The transparency of SMAs meant that I had the tools to provide clients with accurate and timely advice on income, capital gains and tax.*

*"If I had to put a dollar term on how much moving to SMAs has saved my business it would have to be getting close to a quarter of a million to half a million dollars in admin costs.*

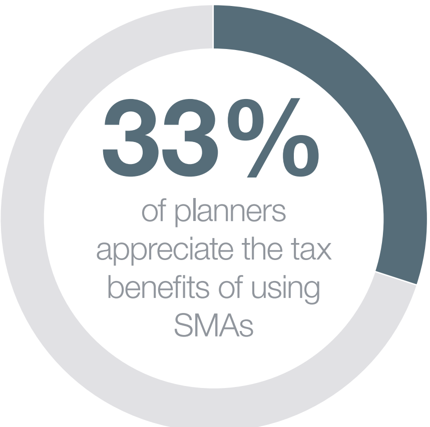
*"This has also led to a significant reduction in my back office. Prior to the Global Financial Crisis, I had 13 staff running 140 accounts. Now we would have the same number of accounts but I only need four staff".*

# Planners recognise the advantages that SMAs offer to SMSF clients



**51%**

of advisers who use SMAs believe they would be more appropriate for their SMSF clients than direct shares




Planners who currently use SMAs recognise that they have significant advantages for SMSF clients. Currently, just over half of planners who use SMAs believe that SMAs are more appropriate for SMSF clients than a portfolio of direct shares. Interestingly, planners believed SMAs were most appropriate for their SMSF clients with balances of between $100,000-$250,000, and $250,000-$1 million, which would appear to indicate that far from being a tool for high net worth investors only, they are a good fit for an ‘average’ SMSF client, whose balance is usually around $500,000.[3]

When asked to identify the reasons why they recommend SMAs for these clients, the planners give numerous, and often multiple, answers. Some 75% of answers relate to the general theme that SMAs are more efficient than holding managed funds. Just over two-thirds of answers (67%) relate to the theme that SMAs are more efficient than holding direct shares

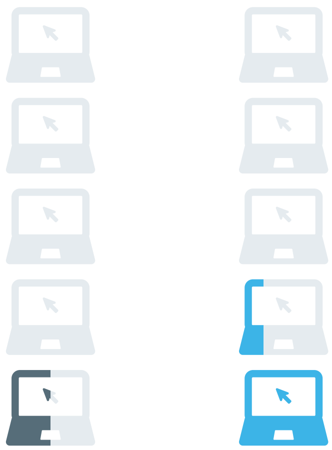
In addition, over half of planners who are interested in recommending SMAs, but have not done so before, believe that SMAs are more efficient than both direct shares and managed funds. In relation to managed funds, the main perceived benefits of SMAs are that they allow the client to see the underlying shares in the portfolio and that they provide a cost effective way of accessing professional funds management. Total management fees in an SMA generally run at around 0.40%-0.60% of assets managed, well below that of an average managed fund.

Nearly one third of planners also appreciate the tax benefits/savings of using SMAs relative to managed funds. SMA investors do not buy into tax events; meaning there is no risk of taxable gains being realised (and distributed) as a result of adverse cash flows. In addition, the investor can make in specie transfers of stock in both directions, meaning they can combine stocks already held with those that are inside the SMA, without having to sell and repurchase those securities.

In relation to direct shares, the main perceived benefits of SMAs are that they represent a lower administrative burden, with less pressure on the planner to monitor the performance of individual stocks, as this process is outsourced to a professional manager. Around 30% of planners also note that SMAs have a lower compliance burden and that they are the most effective way of implementing model portfolios.

3 Australian Tax Office SMSF statistics, December 2014

# Presence of SMAs on platforms will be a key to the future growth of SMAs



**10%**
2013

**25%**
2014

**Increase in platform accessibility**

Number of planners that can now access SMAs on their primary platform

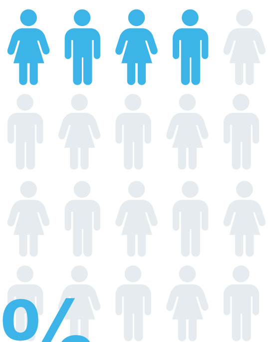
An important question for planners who already use SMAs is: **What prevents them from placing more of their clients' investments in SMAs?** On average, each planner provided two answers to this question, although there was no restriction on the number of responses that could be given. Nearly one quarter of responses from the planners who currently use SMAs indicate that there is no barrier to them increasing their usage.

For those who did indicate a barrier to usage, over 20% of responses relate to the unavailability of SMAs on the platforms that the planners use. This matters, because nearly all planners who recommend SMAs access them through platforms. Almost 20% of planners who are potential users of SMAs also indicated they do not have an SMA on their dealer group's approved product list, which would also create a significant barrier to being able to recommend an SMA to clients. Other responses from planners include:

- a lack of knowledge about SMAs;
- insufficient research on SMAs;
- lack of client demand;
- a preference for managed funds, ETFs or direct shares;
- cost;
- an insufficient range of portfolio managers; and
- the restriction of usage of SMAs to clients with higher balances.

Over recent years, the number of platforms through which SMAs are available has grown from just one in 2007, to 5-7 in 2009-2013, to 11 in 2014. The most recent increase has been most significant, because it has been accompanied by a surge in the number of planners who are using these platforms from 10% in 2013 to 25% in 2014. The addition of SMAs to more of the major dealer group platforms in the coming years should see similar surges in SMA take-up.

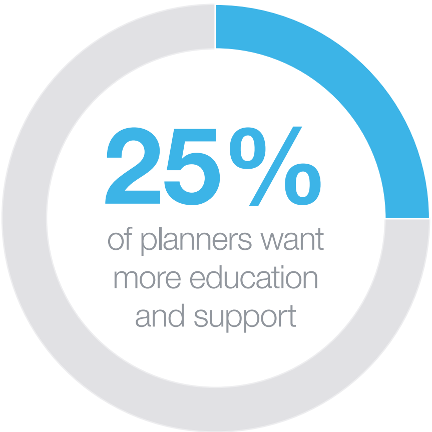
**The opportunity**



**20%**

of planners who are potential users do not have SMAs on their dealer group APL

# Education could also promote take-up of SMAs




Looking at the barriers to greater usage of SMAs that planners have indicated, it's clear that they have a hunger for greater knowledge of SMAs. Around 25% of all financial planners (both current and potential users of SMAs) say they want more education and support, while over 15% say there is not enough demand from clients to justify recommending them – another factor that would be tied to a lack of education in the market as to what SMAs are and the benefits for clients.

Some two-thirds of planners can be encouraged to increase or begin usage of SMAs. When asked to identify the factors that would prompt them to lift or begin usage of SMAs, the average planner provided around three responses. One third of responses relate to encouragement from the planner's dealer group and/or education. Another 28% of responses relate to greater access to SMAs and lower fees.

The education that the planners need pertains to two broad areas. One is basic information on how SMAs actually work. This includes a review of their advantages and disadvantages, their tax implications, costs, and differences from other investment products. The other main area is how SMAs can be used to help clients and the development of a planner's business. This includes the performance and risks of SMAs, the usage of SMAs for client portfolios and how SMAs can improve the planner's business model. Some 60% of planners want basic information, while 46% want to know more about how to use SMAs.

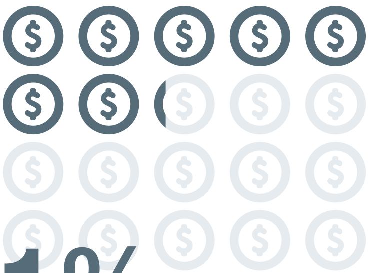
Importantly, planners who are current users of SMAs still want to know more about them. The tax advantages alone are a topic about which one third of current users want more information. These findings indicate that both SMA providers, and dealer groups, must support advisers with a much more comprehensive range of educational materials around the basic features, uses and advantages of SMAs if they are to achieve a significant level of growth in the market. While the potential is there, particularly among existing users who would like to allocate more client funds to SMAs, providing advisers with more reference material to confidently explain SMAs to their clients will unlock this potential and allow inflows to SMAs to be less inhibited than they have been in previous years.

As SMAs are still a relatively unknown quantity within dealer groups, it makes sense for SMA providers to lead the charge in terms of educating and supporting advisers to increase take-up of SMAs for their client.

# What does the future hold for SMAs?

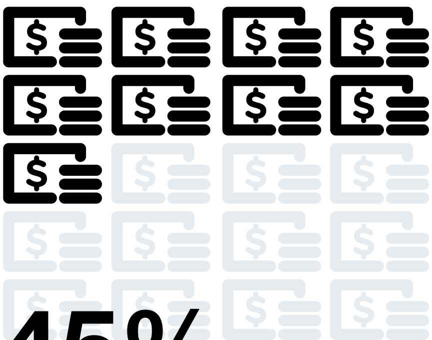
**70%**

of potential SMA users want access to international equities



**41%**

of potential SMA users want access to Fixed Income SMAs



**45%**

of potential SMA users want access to Multi-Asset SMAs

The strengths and benefits of SMAs are such that the trends that are in place will likely continue, with assets held in SMAs experiencing a sustained increase over the next few years. As positive experiences and outcomes become commonplace, greater demand for SMAs from SMSF and other individual clients will be a strong driver of the increase in assets under management.

Among planners, SMAs will likely no longer be seen mainly as vehicles for high net worth investors. More than half of planners who were considering use of SMAs said that they would like SMAs to be cost-effective for their low balance clients.

Further, SMAs will not just be seen as providing access to Australian equities. Among planners, nearly 70% of potential SMA users would like SMAs that offer access to international equities. Significant numbers also want fixed income/hybrid securities SMAs and/or multi-asset SMAs.

In addition, increasing demand will lead to greater numbers of SMAs and providers, driving a larger variety of offerings in the market and facilitating easier blending of portfolios and tailoring of solutions for adviser clients. It is also likely that dealer groups will more commonly see SMAs as central to their development of scalable business.

So, what will SMA managers need to succeed in this rapidly evolving market? As ever, a proven track record of excellent investment performance will likely be necessary, but not sufficient. Transparency of investment process will also be important, as this is a key facet driving the current shift in Australia's investment landscape towards direct, DIY investment processes.

An SMA provider who can supply regular, consistent and detailed reporting of account performance to advisers and investors will undoubtedly add greater value to the client SMA investment experience and provide a differentiation point for investors considering an SMA over direct equities. For instance, JBWere SMA provides planners with a complete pack containing detailed portfolio weightings, performance and stock changes and sales tools to assist planners in their conversations with clients. They also provide the clients with detailed monthly performance reporting which analyses the portfolio, its structure and performance with detailed commentary on stocks of interest in the portfolios.

A recognised brand will also be valuable, because it will increase the comfort level of investors, as well as their advisers, in taking on a new product category. Lastly, and perhaps most importantly, a large range of product offerings (in terms of asset classes and strategy) will be a major strength, making it easier for advisers to blend SMAs in order to produce tailored solutions that are ideal for the needs of particular clients.

Ultimately, by offering the 'best of both worlds' – access to reputable and efficient professional management, combined with low management costs and transparency of holdings – it's clear that SMAs are set to take off as a mainstream investment vehicle for managing client portfolios.

# About JBWere

175 YEARS 1840–2015

Established in 1840, JBWere is a leading Australian private wealth manager who provides bespoke wealth and investment advice to Australia's most successful people, companies and non-profit organisations.

Quality research is at the core of JBWere's business. The JBWere Investment Strategy Group (ISG) undertakes in-house research across a diversified suite of asset classes including Australian Equities, International Equities, Australian and International Fixed Income, Cash and Alternative Investments. Supporting the team's research is a wide range of views including those from National Australia Bank (NAB), Goldman Sachs Australia and external industry research. The breadth of market views and in-house expertise, coupled with JBWere's Charter of Investment Independence, enables the model portfolio managers to confidently navigate changing market conditions and deliver an objective outcome. The JBWere ISG adheres to a well-defined portfolio construction methodology with extensive risk management tools.

The team's proven track record is a result of its consistent strategy of investing in high conviction portfolios. The JBWere ISG picks the best blue-chip stocks and better-quality bonds and hybrids and invests for the long term.

JBWere is 80.1% owned by National Australia Bank Limited and 19.9% owned by Goldman Sachs Australia Pty Ltd. This unique strategic alliance provides organisational strength, significant depth of global investment and economic experience, capital security, strong governance, systems and asset platforms.

The NAB Group offer 12 SMA portfolios under the JBWere (7), Antares (4) and Redpoint (1) brands. In May 2015 we launched the JBWere Listed Fixed Income SMA that focuses on investment grade listed hybrids, subordinated bonds and preference shares as well as introducing the Antares Property SMA and Redpoint Industrials SMA. The industry leading breadth of our SMA offerings enable us to cater to all risk/reward profiles and client needs.

# NAB Group suite of SMAs

| Fixed Income | Australian Equities | | | | Listed Property | Multi Asset Class |
|---|---|---|---|---|---|---|
| | Index | Income | Growth | Core | | |
| JBWere Listed Fixed Income | Antares Blue Chip Top 20 | JBWere Income | JBWere Growth | JBWere Leaders | Antares Property SMA | JBWere Multi Strategy |
| | | JBWere Industrials | JBWere Small Companies | Antares Core Opportunities | | |
| | | Antares Dividend Builder | | | | |
| | | Redpoint Industrials | | | | |

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