

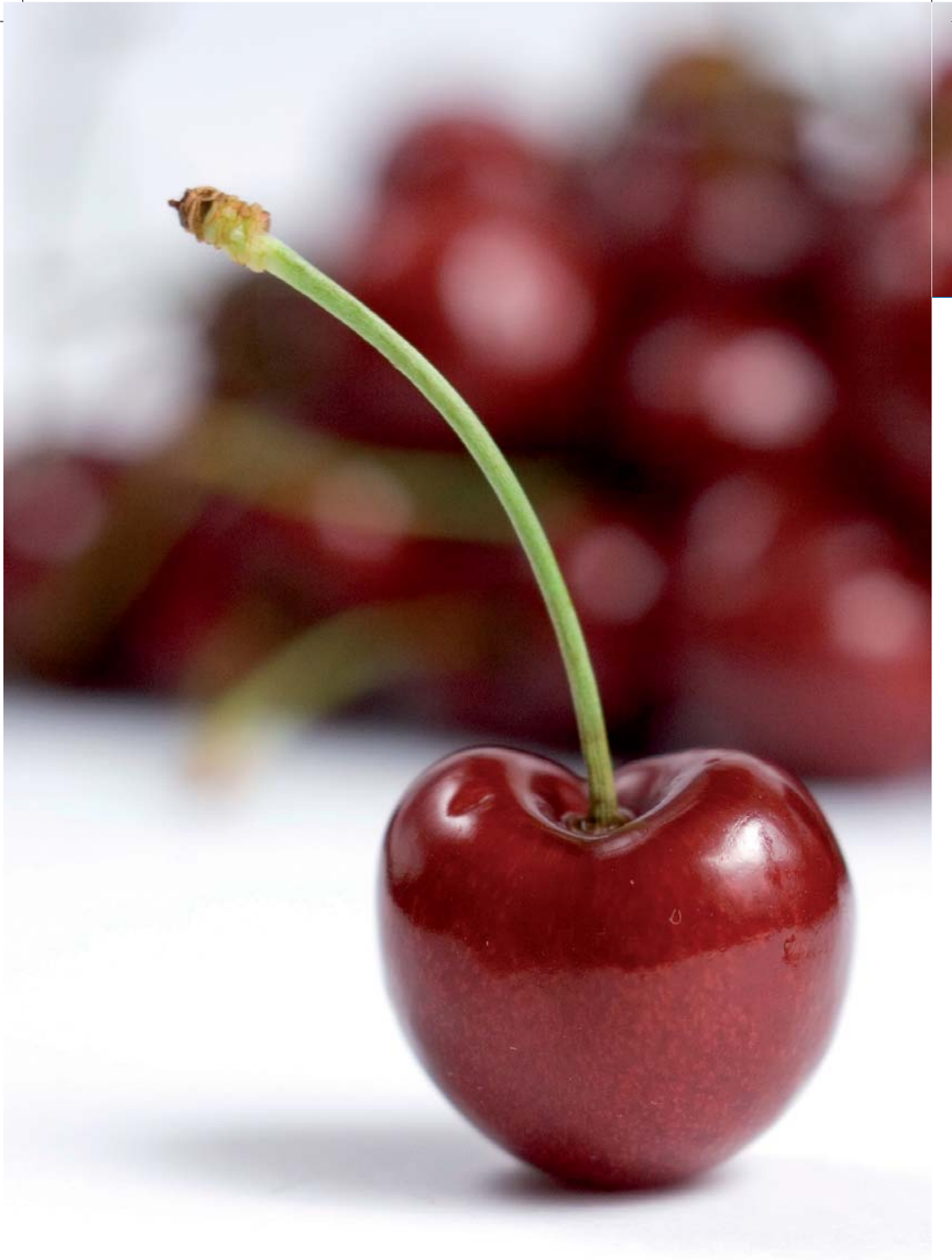


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The Citywire / Præmium Guide
to Separately Managed Accounts

2007



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1 | Chapter One

‘A week is a long time in politics,’ a former British prime minister pronounced with great profundity.

If that is really the case, then it must surely be that a year is a long time in financial services, especially where brand new concepts and products are involved. This publication last year compared the introduction of the separately managed account (SMA) with the advent of Apple’s iPod/iTunes system for downloading and playing music. It explained how the SMA concept was taking root in Australia (and had been popular for some years in the US) and forecast that it would soon be reaching these shores.

In just the same way that Steve Jobs’ revolutionary system let you get straight to the meat of what you wanted from an artist – his or her music (and in particular just the tunes that you really like) without the hassle of buying it in a shop – so too did the SMA let an investor get what they wanted from a fund manager.

Is administration and custody really why an adviser or investor chooses one fund manager? Hardly. As we put it last year, ‘what an investor really wants is the unreplicable skill of a great fund manager to follow a mandate for his or her clients, with the focus on growth, value, income, caution or whatever.’

Which is what an SMA delivers, along with the added bonuses of greater transparency – you can really see what is inside an investment portfolio rather than just the edited and somewhat tardy highlights which most funds provide – along with some very impressive cost efficiency. For a full recap of the features which make SMAs so special, please see page six.





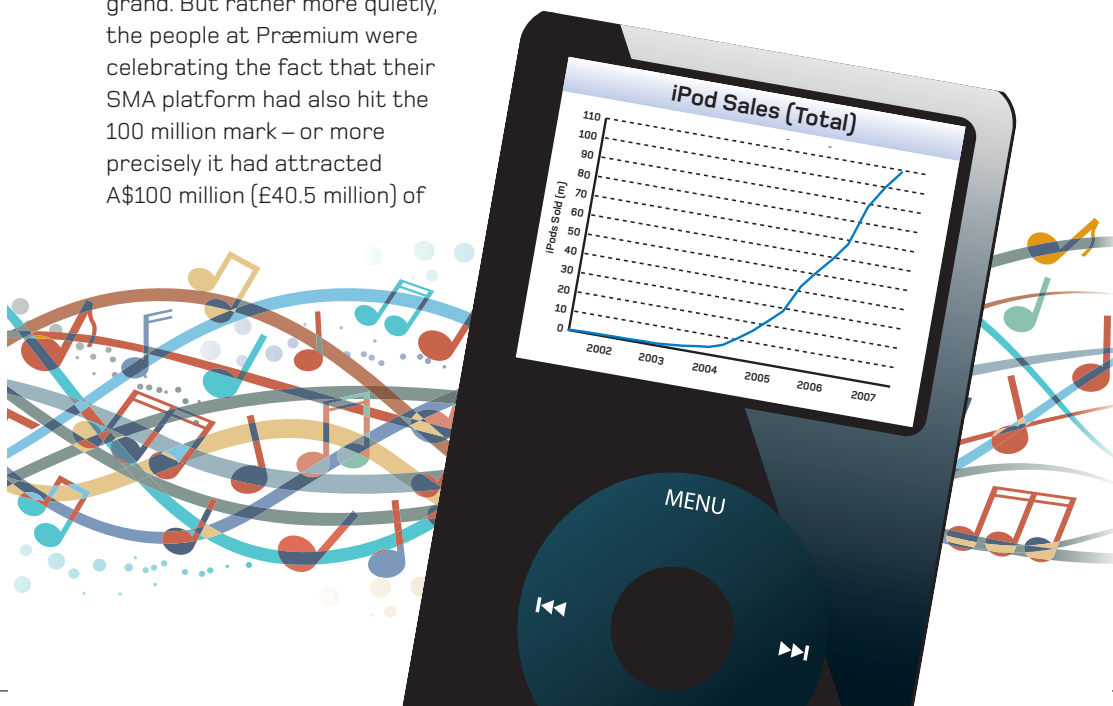
A year of milestones

April 2007 was quite a month for both the iPod and SMAs. Over in California, Apple celebrated the sale of the 100 millionth device. It had taken just five and a half years to reach the milestone and the transformation from a funny little white box to a word and brand that has almost universal recognition.

As R and B singer Mary J Blige put it: 'It's hard to remember what I did before the iPod. The iPod is more than just a music player, it's an extension of your personality and a great way to take your favourite music with you everywhere you go.'

Meanwhile in Melbourne, Australia, the headlines and media coverage were not quite so grand. But rather more quietly, the people at Præmium were celebrating the fact that their SMA platform had also hit the 100 million mark – or more precisely it had attracted A\$100 million (£40.5 million) of

The people at Præmium were celebrating that their SMA platform had also hit the 100 million mark





All about...

Separately Managed Accounts

SMA's ...

are model portfolios which offer complete transparency to the shares and bonds in which the portfolios are invested

can be tailored to provide each client with the most suitable asset allocation profile by mixing and blending these models from one or more sources

strip down the art and science of investment to its basics – the intellectual property of the model portfolio provider

can be created by fund managers, wealth managers or indeed any party which feels it has the investment skills that people want

are held on an advanced wrap-type platform but obviate the need for double administrative costs by the model provider and the wrap provider

generally have lower costs than wrap-held investments

are far easier to shift from one SMA provider to another than portfolios are from one conventional wrap platform to another

embed value in the adviser's business rather than in the wrap platform

are especially suitable for investment advisers seeking to provide extra value-added services to their best clients

assets just 10 months after launch.

Now in the greater scheme of things, this was not earth-shattering. Personal savings and retirement plans in Australia alone have around A\$400 billion of assets sitting on them in conventional wrap platforms. This was no instant revolution.

However, two factors encouraged Australia's SMA promoters to believe that they were on to something important.

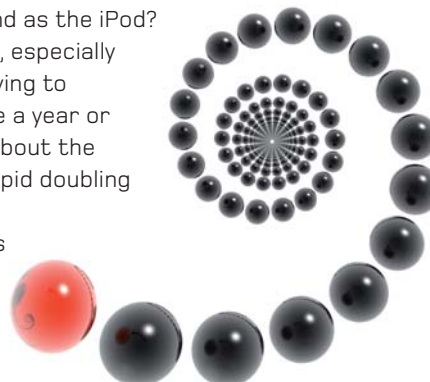
The first was that the second tranche of \$100 million came on to the Præmium platform with rather greater haste taking around one month to do so.

The second was that the SMA's debut replicated how the iPod got off the ground back in the autumn of 2001. Just 57,000 iPods went into users' pockets in the first complete quarter, a figure which more than doubled six months later. Fast forward to the second quarter of 2007 when a staggering 9.8 million models were sold. The total sales chart on page five the exponential growth quarter by quarter.

Who could predict such a thing?

Will the SMA follow the same growth trend as the iPod? Predicting the sales of financial products, especially innovative ones, is about as reliable as trying to estimate where the FTSE 100 index will be a year or so hence. But as one commentator said about the progress made so far in Australia: 'The rapid doubling of assets is proof of life for the SMA.'

Just as important as the asset numbers is the rapidly growing involvement of firms with the SMA concept in Australia. Some 30 firms, comprising asset



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management groups and financial adviser networks have thrown their hat into the ring as producers or distributors of SMA model portfolios.

On the fund management side, around 55 funds from 18 management groups have been made available for use in SMAs, giving users access to the same intellectual property that regular fund users have traditionally enjoyed.

Encouragingly, these funds have come from several household names including a couple – Merrill Lynch BlackRock and Citigroup - that are among the world's largest players in the asset management business.

Similarly on the financial adviser side, the interest has been ramping up at an encouraging rate. Australian Financial Services, one of the country's largest networks, for example, is one such participant, having developed two of its own models and offering two others from third parties.

On the fund management side, around 55 funds from 18 management groups have been made available for use in SMAs

So what's the attraction?

Just as the iPod had its boosters among the ranks of early adopters, so too do SMAs. One of those is Derek Bennett, vice president of Merrill Lynch Equities in Australia.

Bennett is particularly impressed with the progress of SMAs so far, particularly in the context of a country where wrap platforms have become far more entrenched than they are yet in Britain. 'Take-up so far has been very good when you consider how dominant other technologies have been for so long,' he says. 'It can take a long time for advisers to move from one technology to another. Wraps have become absolutely everything over here [in Australia] and hold a massive chunk of retail money'

But it is the future prospects for SMAs that get Bennett more excited. 'We think that SMAs will be the next

generation for retail investments with new money going into this technology over time,' he says. 'Advisers will see the SMA technology giving their clients a transparent view of what they own which will be a complete contrast to the opaqueness of the conventional unit trust structure. It provides a much better experience for clients and advisers will begin to send new money there.'

As in Britain, Australia is seeing the burden of financial planning fall increasingly on individuals' shoulders. While pension (known locally as superannuation) contributions are compulsory in Australia, there is wide scope for individuals to choose whether to accept responsibility (usually with an adviser) for determining where and how it is invested. Bennett says that the country is seeing a 'massive shift towards people running their own money which will bring a greater percentage of superannuation money towards SMAs.'

Working for an American company, Bennett has seen how SMAs have been a huge success in the US and predicts the same for Australia where, as in Britain and in contrast to the US, the emphasis is on low cost rather than premium pricing.

'I think that within 10 to 15 years the SMA will completely dominate the space for the way individuals run their money.'

If that prediction comes good the future for SMAs looks very bright indeed.





2 | Chapter Two

At the heart of every ambitious independent financial adviser is the burning desire to do more for their clients.

Yes, there is an element within the industry that is quite happy to sell as many commission-heavy products as they can, take the money up front and move on to the next customer. In cases such as these, follow-up with the original client is not so much a case of a careful re-examination of their current financial position and needs, but more an opportunity to see if another product can be sold or if the original one can be rebrokered, to trigger more commission payments.

Nice work if you can get it and there are a lot of advisers who still do. But for the other growing element of the financial advice business, there is more to life than that. It is these advisers who have reshaped their businesses, often at significant financial cost to begin with, with two aims.

First they want to offer a better and more holistic service to their clients in which they recommend investment products on the basis of their carefully-assessed needs over the medium and long term.

And second, they want to help develop the value that is inherent in their own business – if you like, practising what they preach by seeking the optimal path towards long-term financial security. This is best achieved by ensuring that as much of the value-added elements that come with offering financial advice remain inside the business rather than leaking outside to other players. Only by doing this can a financial adviser get as much value as possible when he or she comes to realise the value of business through a sale or a merger at some point in the future.



Enter the SMA

On both these counts, advisers may find it profitable to see how the concept of SMAs can help their clients and their business.

To see how this may happen, it is useful to look at SMAs in the context of wrap platforms and the advantages that they offer to advisers. Indeed in Australia, SMAs are sometimes referred to as 'super wraps' because of the extra facilities they offer to advisers.

Probably the most significant benefit that wrap platforms in the UK have brought to financial advisers is the administrative burden that they have lifted from their shoulders. Sign up to a competent platform and transfer as many clients' investments as possible to its care and the benefits are soon evident.

Switching between funds becomes far simpler while the reporting and valuation tools available to the adviser enable a much better service to be offered to clients. Not all wrap platforms are perfect but they generally represent an improvement on what went before. Even if the adviser was only the messenger between a client and an incompetent life company which took three weeks to come up with a valuation, history has proven many times that is the messenger that gets shot first.

But for all the benefits that wrap platforms bring – and perhaps because of them – they also arrive with their own problems.





The view from Down Under

'We have been using managed accounts for a long time and are now just starting to use the most advanced type of SMAs.

'We are using SMAs because they enable our advisers to offer discretionary style management to clients without any change in the adviser's qualification and licensing requirements. In that sense it really is a step up for firms such as ours. The traditional discretionary market was really very specialised while this enables us to go to a far wider market.

'The SMAs that are now available really present a turnkey solution for any adviser who wants to put a client into a tailored portfolio. I think that they are the simplest and neatest product that I have seen for many years.

'Apart from certain tax advantages which I recognise are local to the Australian market, SMAs also give a great deal extra to the investors who use them. They have a portfolio that is professionally managed like a conventional fund but they can also see what stocks they own and can see when they are bought and sold.

'In short they are able to see exactly what is going on inside their portfolio without the hassle of owning individual stocks. In a unit trust you just get a unit price which moves up or down every day without any real knowledge of what is going on inside the fund.

Justin O'Kane is a Melbourne-based adviser for AAA Financial Intelligence, an Australian financial planning group.



By being so useful, the platforms develop a power of their own and suck up much of the value-added created by advisers who take a new approach to running their business.

Wraps increase value in an adviser's business by helping them move from an initial one-off income stream to a recurring income stream based on funds under influence (advice). The reliability of this recurring asset-based income stream attracts a higher multiple than the initial one-off revenue stream.

It is hard to estimate these things but a rough guess might put half the value accruing from wraps to the platform itself and half to the adviser. To offer an illustration, a client might get a regular valuation statement that comprises a cover letter from the adviser along with the detailed facts and figures from the platform provider. Should the client decide to consider using another adviser, he or she will probably realise that it is not rocket science to effect that change while keeping his or her investments intact on the same platform. The adviser's best-laid plans to increase assets under influence are truly gone awry.

Now imagine an adviser who offered the same access to investment opportunities via their own SMA. These could be drawn from the SMAs offered by established asset managers and blended into the asset allocation profile suitable for the client. As part of this service, the SMA can be fully branded by the adviser as an integral part of their business. So what the client sees in the relationship with



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the adviser is a full soup-to-nuts service of a kind only available to those wealth managers who have taken the expensive and administratively difficult step of establishing their own Oeic or unit trust.

Funds under influence are now funds under management with the SMA helping to deliver this uplift in value to the IFA.

It should be pointed out that the IFA is not actually doing the investment management with an SMA and does not therefore require any further licences or qualifications to use one. The investment models are provided by professional, experienced investment managers which could range from household fund manager brands to boutique and specialist experts to whom they could not usually gain access.

The SMA service is branded by the IFA but the underlying investment models retain the brand of the investment manager – still providing a distinction between financial advice and investment management.

So where is the wrap platform in all of this, along with its associated costs? Well essentially the SMA IS the platform. In fact for the first time the product and its administration are merged into one.

This offers two distinct advantages for advisers. The first is that the costs of a like-for-like product obtained through an SMA are generally lower than through a wrap with the SMA's single administration, custody and back office systems replacing the two layers previously provided by the wrap and the fund provider.

The second advantage is that clients see an adviser-branded investment service that leaks a minimal amount of added value to other players along the financial food chain.

Follow that logic through and it is likely to mean that the value of an IFA's business is enhanced over the medium and long term as potential buyers see where the power resides – in the relationship between adviser and client. If that happens, then the SMA could be the catalyst that at last properly rewards advisers for all their hard work.



3 | Chapter Three

Anybody who has organised a large-scale party knows the feeling only too well...

You've hired the venue at some cost and organised the food, wine and music, all pitched to perfection. And as the clock strikes 8 o'clock, you get this terrible gnawing feeling in your stomach:

What happens if nobody turns up? What do I do with all the mountains of canapés and champagne?

It is a feeling that must strike a chord with anybody involved in setting up a radical new departure in business, such as SMAs. By the time SMAs get launched in the UK, the technology will be firmly in place along with all the regulatory permits needed to get the show on the road.

But even if everything moves forward smoothly like a perfectly tuned car, what happens if nobody is on board in the shape of fund managers who are willing to make the fruits of their intellectual property available to be used in SMAs?

You can see the arguments from some in the asset management business as to why they might want to refrain from getting on board the SMA bandwagon.

There is extra work involved at the beginning to set an SMA facility up. It is not a guaranteed winner (no new business ever is and risk-aversion can become ingrained in all kinds of businesses – remember the old saying in the computer industry that 'Nobody ever got fired for buying IBM?').

On top of that, Business as Usual is generally pretty good right now. Ordinary unit trust/OEIC sales may wax and wane with the investment cycle, but other channels of distribution seem set for long-term growth. New pension rules have directed more and more self-invested money

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into unitised funds; investment bonds, offshore and onshore, are now being more attractively priced and marketed by insurance companies, while the inexorable rise of defined contribution company pension schemes is another source of demand which seems set for continual growth. So what's not to like with the status quo?

Chickens and Eggs

The short answer is that, as far as most asset management groups are concerned, there can not be enough distribution channels through which to sell their products. And while the SMA industry in Britain is a chick that is currently barely breaking out of its shell, its potential to become an animal of some stature is so great that fund managers will not want to miss out.

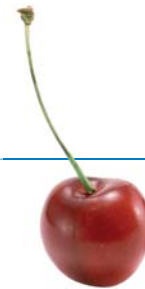
If the trajectory of the SMA industries in the US and Australia is anything to go by, then the potential for extra distribution will be a massive driver to get asset management groups interested.

What tends to happen is that independent advisers and wealth managers for high net worth individuals show growing interest in SMAs and can demonstrate that they have some meaningful assets at their disposal. At this point the asset management industry sits up and takes notice. There will be one or more front runners who can spot the potential to earn money ahead of the pack, at which point the rest tend to follow.



A view from

this side of the pond



'OLIM (founded in 1986) is a specialist UK equity manager, successfully running about £500 million for a select group of Oxford colleges and collective vehicles.

'We run concentrated portfolios with higher than average yield but avoid concentration in sectors representing more than 10% of the market. This has reduced volatility while giving strong outperformance over the years.

'Why are we actively interested in now offering our asset management services via SMAs?

'The conventional route to obtain retail investors is too expensive – we don't like 3% up front charges. The SMA route offers a chance to widen our distribution network without the need for steep front end charges – it should be cheaper for the underlying investors.

'In addition, the nature of the SMA appeals to us. The prospect of investors knowing what they own within an investment vehicle is attractive. It should encourage them to think about investment as owning part of a company rather than just units in a fund. This should also promote long-term investment; companies don't really change as much as stock market volatility suggests. Once investors see what they own they may realise this.

'Of course as we speak SMAs have not yet been launched in the UK so we don't know if they will be as successful as they have been internationally. But, we feel that they offer a new distribution opportunity that allows us to deliver real value to investors.'

Dominic Fisher is a director of OLIM Limited (www.olim.co.uk)

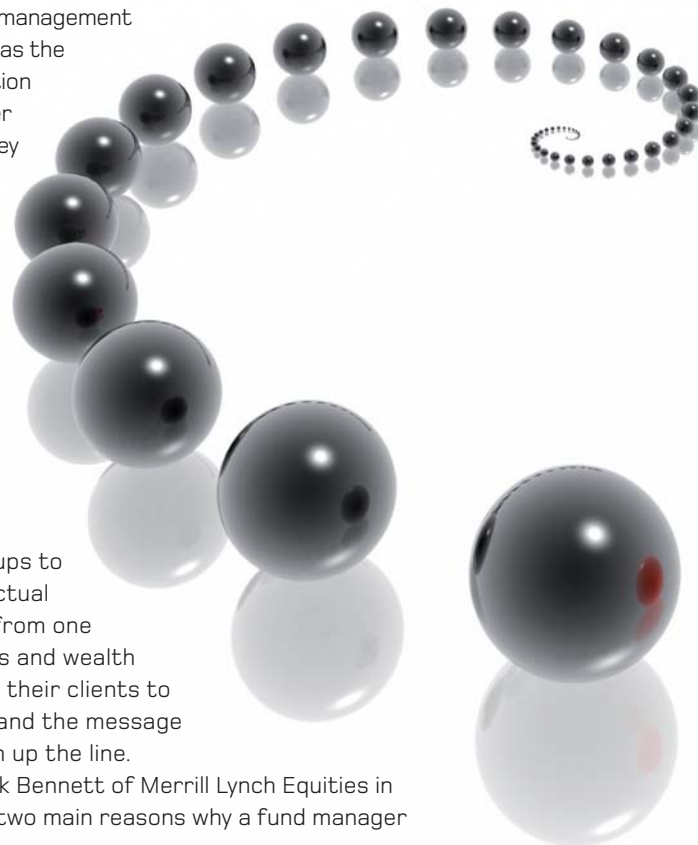
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The evidence is clear from the US, the largest and oldest SMA market by some distance. According to figures from industry monitoring businesses such as Financial Research Corp, and Cerulli Associates, retail SMA assets grew from \$185 billion (£91 billion) in 1996 to around \$870 billion this year. Depository Trust & Clearing Corp reckons the industry will hit \$1.5 trillion by the end of this decade. That is real money.

It is bottom up demand that is driving demand in the US – and with it fund management group participation – as the baby boomer generation starts to take greater control over the money it will need to finance the biggest retirement wave in history.

Something similar is happening in Australia, albeit on a much smaller scale, where growing distribution has persuaded the number of fund groups to provide their intellectual property for SMAs from one to 18. Adviser groups and wealth managers work with their clients to create the demand and the message soon gets passed on up the line.

According to Derek Bennett of Merrill Lynch Equities in Australia, there are two main reasons why a fund manager



would not pass up the chance to get involved with SMAs.

'First, you won't get less money for what you do,' he says. 'With SMA technology your intellectual property can be sold at a significantly lower margin because you essentially just send an email to the SMA platform provider outlining your portfolio movements. There's no custody or administration charges involved. Your value is in your intellectual property and that is where you make your money.'

The second reason? Far simpler. 'You probably won't have any choice,' he says. 'As we like to put it here "distribution is king". If you're a fund manager and you want to sell your product then you need someone to sell it for you. Of course you can say no but there will be others who say yes.'

Bennett admits that the shock of the new still may deter some participants at first, but that is soon overcome. 'Yes, it is very different compared with the way that you are used to doing things. But you just have to take one step back and work out the cost efficiency of distributing your product using SMAs.'



Over there and over here

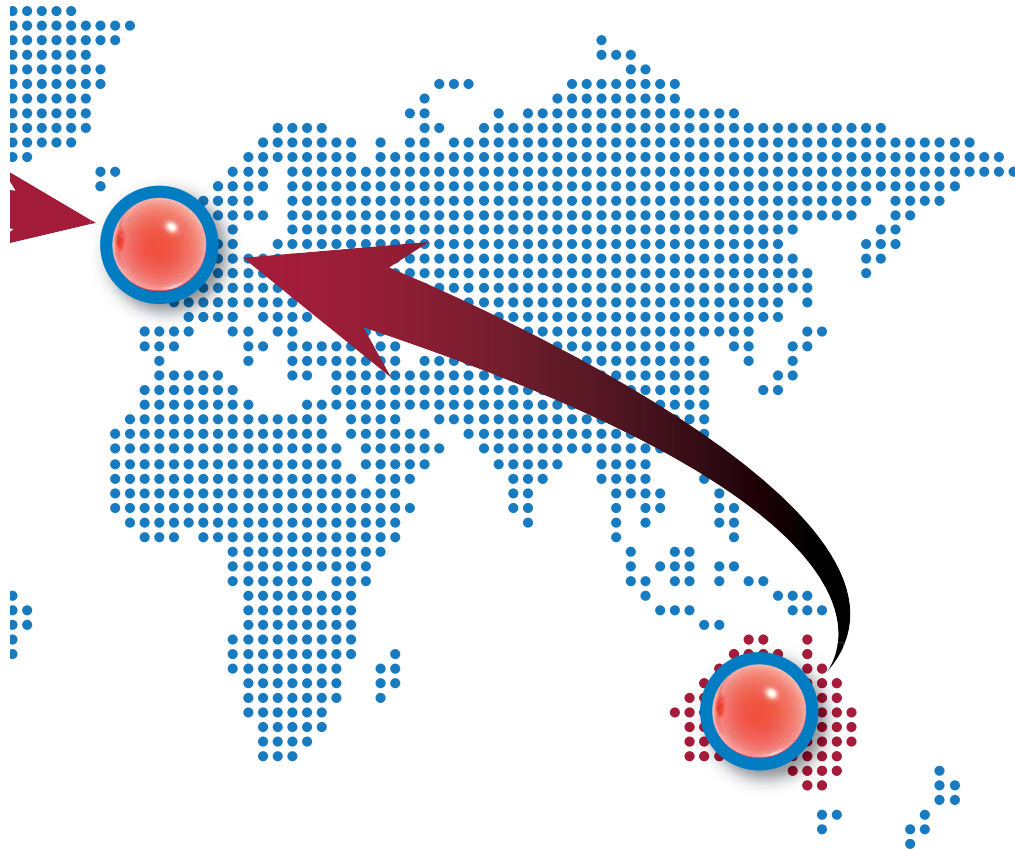
Will the same thing happen when SMAs are introduced into Britain? You cannot of course predict the future from what has happened in the past, but the omens are positive, based on what has happened in the US and in Australia.

The prospects look good. The fund management business in Britain is every bit as ultra-competitive and innovative as it is in those other two markets.

Initially the choice of fund managers available through SMAs may be somewhat restricted. But as forward-thinking wealth managers begin to take up the idea, others will respond by joining the fray. That in turn will stimulate the profile of SMAs and broaden interest among advisers.

It is likely to be not so much a chicken and egg situation. More one of a virtuous circle.





Separately Managed Accounts in the UK

As a leading provider of portfolio administration and SMA platforms in Australia, Præmium is now bringing SMAs to the UK. Pete Burtonshaw, Managing Director of Præmium Ltd, explains that Præmium is adapting the Separately Managed Account (SMA) concept to suit the UK market.

Præmium's success in Australia was founded on taking a successful US concept, adapting it to conform to domestic tax and regulatory regimes and delivering it in a way that benefited the local market's distribution dynamics.

We've done it once, now we're doing it again.

Præmium is working with a small number of select partners to create a product that delivers an SMA capability as a UK regulated collective investment scheme.

Our objective is, once complete, that this product will support a number of implementation options and will provide the following benefits:

- White-label the SMA (as many firms currently do with OEICs)
- Will be eligible for distribution by any qualified adviser, like any other retail fund
- Eligible for inclusion within tax-wrappers
- Provides valuation, tax and performance reporting services for fund manager, adviser and client
- Enables access to multiple investment models within a single fund, supporting personalised asset allocation and model portfolio development
- Reduced cost of investment in professionally managed funds
- Gives real value to the adviser and investor

If you would like to be part of the SMARt evolution please give us a call.

The pay less get more solution...

Præmium delivers cost efficient administration and investment services for financial planners, wealth managers, accountants and stockbrokers.



Separately Managed Account service



The independent online portfolio administration service

To find out more about Præmium's services, you can contact us in the following ways:

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Email: enquiries@praemium.com

Web: www.praemium.co.uk

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