The benefits of managed accounts

While managed funds are the traditional investment tool most advisers are familiar with, managed accounts are increasingly being promoted as offering a number of valuable benefits, particularly when it comes to tax management.

For most financial advisers, the normal approach for investing client funds over the past few years has been managed funds, which are usually accessed through a wrap platform. But with investment products constantly evolving, this looks likely to change and there is growing interest in the newer managed accounts coming onto the market.

Managed accounts are a continuation of the evolutionary process in financial services that started with unit trusts and then moved to master trusts and wrap platforms as a way for smaller investors to gain access to a wide range of professional investment services.

The goal of these products is to provide the individual investor with access to the benefits of portfolio diversification, professional management and administrative control that are usually only available to institutional or high net worth investors.

WHAT IS A MANAGED FUND?

Most advisers are very familiar with managed funds, where the underlying assets are owned by the fund and the investor owns units in the fund. These funds operate with a legal trust structure interposed between the investor and the underlying securities.

Managed funds involve pooling the assets of a large number of investors into a single asset pool that is then invested on their behalf, with returns allocated to investors based on the number of units they hold.

While managed funds have been a very successful way for smaller investors to invest in assets and asset classes they would not otherwise be able to access, they do have some drawbacks.

Returns to investors are affected by the actions of other investors in the fund, so redemptions can cause the fund manager to sell assets to gain liquidity for payments, thus triggering a capital gains tax (CGT) liability.

That liability is shared among all investors holding units in the fund during the tax period, even those who did not hold units on the day the assets were sold.

Also, a run of redemptions can force asset sales at sub-optimal prices, reducing the overall value of the fund and lowering the unit price for all investors.

WHAT IS A MANAGED ACCOUNT?

Managed accounts were initially developed by brokerage firms in the US and claim to have a number of benefits over traditional managed funds.

They are usually divided into two types: individually managed accounts (IMA) and separately managed accounts (SMA).

The key feature of managed accounts as a group is that the underlying investment assets are held personally by the investor, either legally or beneficially. These products remove the pooling step and pass ownership onto the investor.

This ability to have ownership rest with the investor is only possible due to technological innovations allowing tracking of ownership from the underlying assets through the 'model' (or product) layer and onto each individual investor.

WHAT ARE THE BENEFITS?

Product promoters claim there are a number of key advantages managed accounts have over traditional managed funds.

One of the key benefits is portability and tax management, as the client owns the underlying assets directly through the nominee company that holds the securities in beneficial trust. This allows the securities to be moved in and out of the managed account on an in-specie basis so no CGT event occurs. In most cases, fees for transferring the assets are limited to the relevant administration charges, with no buy/sell spread.

Parcels of shares purchased at a particular time can be identified within a managed account and these can then be matched to sell transactions. This can be used to increase or decrease the CGT liability in the current tax period for offset gains or losses on other investments.

In some accounts it is possible to restrain the level of active trading to maximise the entitlement to imputation credits.

Managed accounts usually offer various investment strategies through model portfolios, similar to managed funds. The model portfolio is actively managed by the model manager, who makes changes to the composition and weighting of stock holdings.

The provider then sells and buys stocks from each investor's portfolio to rebalance

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the portfolio to reflect the new model settings. Unlike a managed fund, these individual transactions and holdings are visible to the investor.

Managed accounts also offer various filters that allow individual stocks to be 'filtered in' or 'filtered out'.

This means that if the investor so desires, a particular stock can be excluded even if it appears in the model portfolio. This is achieved by overlaying individual account instructions on the general model framework.

This capability also allows existing direct shareholdings to be transferred into the portfolio and they can continue to be held irrespective of their presence or otherwise in the model portfolio.

This is seen as a major advantage given the growing popularity of direct equity holdings among clients.

Managed accounts also offer more transparent transaction reporting than a managed fund, with all transactions reported to the client on the account statement. Unlike a managed fund, all fees and charges are individually listed. In addition, buys and sells and the range of securities held within the managed account are fully transparent.

WHAT ARE THE KEY DIFFERENCES?

There are a number of general differences between SMAs and IMAs, as well as a substantial difference in relation to the legislative framework under which they operate.

SMAs are generally viewed as being an alternative to managed funds, while IMAs are more likely to be an alternative to a full service advisory offering.

SMAs are typically seen as being at the lower end of the value scale with balances under $500,000. They tend to be higher volume, while IMAs are low volume but have a higher average value (generally over $500,000).

The high level of customisation and individual tailoring of mandates that occurs in IMAs means they are not usually scalable, while SMAs can be scaled due to their more limited portfolio tailoring.

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The level of customisation inherent in IMAs means any existing direct shareholdings can be easily incorporated. The client usually retains the legal title rather than just beneficial ownership, and all corporate actions and voting rights flow to them.

Although some of the newer SMAs claim to offer some of these services, most SMAs offer a model portfolio in the same way that different asset profiles are available through an investment manager.

SMAs are often referred to as an 'un-unitised managed fund' where the client owns the underlying shares and franking credits.

WHAT IS THE LEGISLATIVE FRAMEWORK?

A major difference between IMAs and SMAs is the legal framework under which they operate.

IMAs come under the managed discretionary account services (MDA) rules, while SMAs fall under the managed investment scheme rules.

The MDA regime is regulated under ASIC's Policy Statement 179, "Managed discretionary account services", and its accompanying class orders, which creates a fairly complex operating environment for IMAs.

The requirements on financial advisory practices offering products and services under PS179 may mean the practice needs to change its business processes and planners may need to upgrade their licence. Additional product accreditation in areas such as derivatives is usually required.

PS179 states: "Because of the individualised nature of the range of financial services involved, we will regulate persons contracting with retail clients to provide MDA services as providers of financial services rather than issuers of a financial product."

Under PS179, advice provision is tied to implementation and the client's statement of advice must be reviewed at least every 13 months, with the planner required to reaffirm that the investment program remains in the client's best interests. On the other hand, SMAs operate under the managed investment scheme rules that govern traditional managed funds or collective investment products (ASIC Policy Statements 130-136).

Using an SMA does not require an adviser to upgrade their licence from the normal product accreditation requirements. These products also utilise a normal product disclosure statement and application form process when clients invest. □

KEY FEATURE COMPARISON

MANAGED FUNDS	MANAGED ACCOUNTS (SMAS AND IMAS)
Assets pooled and owned by fund	Assets directly held by investor
Investor owns units in fund	Investor able to hold direct shares
Redemptions can trigger CGT liabilities	Redemption at investor's discretion and assets can be moved in/out on in-specie basis
Unexpected tax liabilities can be created	Tax benefits – purchase lots can be matched to sell transactions
Range of asset allocation strategies	Model portfolios offering various strategies and risk profiles
No control of individual holdings	Ability to overlay instructions for individual stocks on model portfolio
Opaque transaction reporting	Transparent transaction reporting