



**Sean Graham, Assured Support**

Sean Graham is a principal of Assured Support Pty Ltd and the architect for the OpenAFSL compliance platform. Since 1996, Sean has specialised in financial services law, compliance and risk management and has extensive experience in distribution, stockbroking, product manufacturing and advice. In addition to his consulting and policy roles with Suncorp, BT, the Association of Superannuation Funds of Australia (ASFA) and Mills Oakley Lawyers, he has held senior executive roles with the Millennium3 Financial Services Group and subsidiary companies, Commonwealth Bank and Colonial First State.

# 10 MANAGED ACCOUNT QUESTIONS ANSWERED

Sean Graham

Peter Turbach, MDA Guru, shares his domain expertise and addresses ten key questions.

## 1. Do you feel there is still a little uncertainty out there around advisers' requirements when providing MDAs to their clients?

Yes, because there are a number of conditions that must be complied with to operate an Managed Discretionary Account (MDA). This is in addition to meeting the best interest and other requirements that must be met when advising clients.

I find the ongoing client suitability review which is required annually the main issue. This is what separates MDAs, which is a service, from Separately Managed Accounts (SMAs) which generally are a product. Advisers need to realise that an MDA is a contract between them and their client and often with other outsourced parties involved.

Advisers are obligated to ensure the administration and management program remains suitable on an ongoing basis. I'd also suggest that there is still a degree of confusion about the types of managed accounts and their specific characteristics and advantages. Education is the best remedy for uncertainty.

## 2. Do MDAs benefit the adviser more than the client?

MDAs provide a number of benefits for both clients and advisers but

it may not be the right option for everyone as there are conditions. Certainly, the adviser can gain service efficiencies and these can be passed on to the client as better service or reduced costs.

With regards to service, the client can benefit by the adviser being able to act upon their administration and management decision in a timely manner, for example to benefit from a particular buy or sell price.

This can especially benefit retirees when they are travelling and hard to get hold of, or for those clients that do not wish to be heavily involved in individual stock selection decisions.

## 3. What level of client consent or instruction is necessary to trade? How should this be documented?

An administration and management program must be agreed upon between the adviser and the client, and is documented as part of the MDA contract. Once the MDA contract is executed there is no level of consent required on a trade-by-trade basis provided the trades are made in line with the administration and management program.

The Administration & Management program must be reviewed at least annually to assure client suitability. All changes to the portfolio must be reported quarterly to clients that do not have electronic access.

Many MDAs utilise model portfolios which are overseen by administration and management committees. Administration and management Committees may also communicate their changes and why they were made.

**The quote**

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**4. Do managed accounts have a future given the rise of Exchange-Trade Funds (ETFs)?**

An ETF is a managed administration and management scheme in which clients can purchase units, while a MDA is a portfolio service where the client maintains ultimate ownership of the actual assets.

ETFs can help with the portfolio management of managed accounts to enable cost effective diversification. They can be a great tool to reach international markets or bond markets that otherwise would be very expensive to do with the same level of diversification. Administration and management managers can concentrate more on asset allocation than stock picking to drive outcomes. ETF portfolios are driving the robo-advice wave at the moment.

MDAs provide a different type of service and often go hand-in-hand with the use of ETFs to manage exposure to different asset allocations. Therefore both MDAs and ETFs will remain relevant in the future.

**5. Will the rise of robo-advice invigorate or decimate the managed account space?**

In my view it will invigorate this space.

Robo-advice is allowing investors to diversify smaller amounts of monies cost effectively within a managed account. In the US firms like Betterment and Personal Capital together hold approximately \$15 billion dollars in assets under management and growing. We are seeing a similar trend in Australia combining robo-advice with a MDA service offering.

**6. What clients are best suited for an IMA? What clients best fit with an MDA?**

I consider an Individually Managed Account (IMA) as a style of administration and management portfolio management that can exist inside or outside an MDA contract. An adviser can make changes to a client's IMA portfolio without making changes to other clients with similar administration and management programs. This administration and management advice model.

A model portfolio may not suit large net worth clients as they may require more communication and are more sensitive to the tax treatment of the administration and management manager's decisions, and in those situations IMAs are more suitable. An IMA operated under a MDA contract could be perfect. Such services, though, are usually more expensive as they require more of the administration and management manager's time. Look for software to make this space more efficient in the future. Advisers that run with models on SMA platforms don't have the same level of flexibility that an IMA under an MDA contract can provide.

**7. Are MDAs a cost-effective option?**

Yes, MDAs are scalable and reduce administration however at the core of an MDA is a contract between the MDA provider and the client, so efficiency and costs will depend on what kind of infrastructure is used to

execute and maintain compliance. Components of the MDA compliance can be outsourced though the MDA provider remains responsible for the administration and management decisions and ensuring regulatory compliance is met.

**8. What does a business need to do to be able to operate an MDA?**

They need to hold or be authorised by an Australian Financial Services Licence (AFSL) with authorities to advise and deal in MDAs. There are some variations that can be looked at as far as outsourcing services and compliance. One scenario consists of the financial adviser acting as an administration and management manager and outsourcing the operations of an MDA to an MDA provider. Ultimately it is about finding what is right for the advisory practice. MDA Guru has the expertise and industry knowledge to assist in finding the right solution in today's regulatory framework.

**9. Where can it go wrong?**

Managing the risks surrounding a MDA is essential, for both advice and regulatory risks.

I believe the focal point for risk is ensuring client suitability of the MDA which is a task performed by the adviser. The MDA must be in the best interests of the client.

Where the adviser and the MDA provider are operating under the same AFSL, the risks are reasonably straight forward, and the MDA provider has maximum oversight.

Where the MDA provider utilises external advisers that operate under a separate AFSL, the adviser is responsible for knowing the client and ensuring that the MDA, including the administration and management program, is suitable for the client. However, the MDA provider holds the MDA authorisation under their AFSL and as such takes on all the risks of providing the MDA service.

MDA providers that are an outsourced service hold a high level of risk which can grow depending on the number and movement of advisers. How can the MDA provider keep track of the adviser's compliance which is normally only scrutinised by the adviser's AFSL? As these types of arrangements grow, how can MDA providers ensure that they are managing their compliance systems and processes appropriately?

Advisers also need to ensure that the MDA provider they work with has the appropriate authorisations and maintains compliance. There are systems available that can assist in managing such risks that will provide both MDA providers and advisers' AFSLs with the assurance needed, for example Assured Support has the open AFSL compliance platform that can be utilised for this purpose.

It is essential that both MDA providers and advisers consider their particular situation and risks, and implement appropriate systems and procedures to ensure compliance with regulatory and contractual requirements. This is where a specialist such as MDA Guru can assist

in determining what may be the best way to approach your situation.

#### **10. What are some scenarios in which Advisers are utilising Managed Accounts?**

When you see the term “Managed Accounts” it usually refers to two separate groups, SMAs MDAs, each of which is managed under different legislation of the Corporations Act. Both SMAs and MDAs are considered managed administration management investment schemes however MDAs have been given regulatory relief subject to meeting a number of conditions which eliminates the need from requiring a Responsible Entity (RE) or a Product Disclosure Statement (PDS). So, when you see SMA think product and when you see MDA think advice service.

What we are seeing today in the managed accounts industry is a jockeying for position from the large wrap platform providers to provide managed accounts at a level that suits their risk appetite. We are seeing a blend of administration and management managers and financial advisers utilising and driving the market. SMAs are perfect for large wrap platforms to help administration and management managers distribute their mandates and act as a market place. The wrap provider as RE of the SMA can manage risk at the fund level quite easily in comparison to managing the risk of client suitability where MDAs are concerned.

If an adviser wants to run with their own administration and management models they can approach wrap providers to act as RE and administer their model portfolios as a private client product. When changes to the model portfolios occur the adviser's client portfolios will also change accordingly as long as the RE signs off that the changes are suitable to the mandate. This approach is very scalable although limits the amount of mandates an adviser can provide to their clients as these platforms charge by the mandate.

An alternative to running models on SMA platforms and fitting your client's wealth into pre-determined categories is utilising the flexibility of an MDA where mandates can be tailored to clients as IMAs. The suitability requirement is managed by the adviser at the client level and not the fund level. Many advisers managed their MDAs on regulated wrap platforms under a ‘no action’ clause that provided a quasi-exemption from having to meet the MDA requirements. This expired in October of 2018.

Another alternative we are seeing is advisers running either model portfolios or IMAs off platform and on software designed to help them manage their MDAs. In the case of robo-advice we are seeing fintech start-ups building their own systems or piecing together the components to do so. There are many things to consider which is the best pathway to take for your practice and we can certainly help at MDA Guru. **FS**