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Advisers can be fund managers

Financial planners can also put together a good portfolio, writes **Sam Henderson**

Illustration: Igor Saktor

US industry expert Nick Murray believes financial advice and funds management should be strictly separated. Advisers should stick to the technical strategic decisions and keep away from the tactical investment management.

The Australian financial planning market is a little different to the American market as it's tied closely to the superannuation industry which, coupled with financial planning, has undergone a renaissance in the past five years as a result of intense regulation coupled with continuing compression of fees. Regulation of the industry has led to an improvement in the education of Australian advisers. Investment management is a subject in the diploma of financial planning curriculum.

Moreover, for those better-educated advisers who have studied an undergraduate business or commerce degree, subjects such as corporate finance, statistics and investment analysis are an intrinsic part to the course major of finance or accounting. In fact, these are the same subjects studied by analysts who work for the fund managers and make the share-buying decisions.

If we have a look at the structure of the industry, we may see why some "experts" profess the expertise of fund managers and to differentiate the role of client management between financial planners and fund managers.

In fact, most banks have large financial planning departments and funds management teams. They also own the investment platforms that allow advisers to access wholesale managed funds and shares via a trustee structure — the wrap platforms or master trusts.

Most advisers rightly use these structures to manage their clients' funds, as advisers are not licensed to have direct access to clients' funds for security reasons.

It may make little financial sense to the major banks to cannibalise their own business and one may conclude that it benefits them to have segmentation of services within the industry. But times are changing as industry super funds put significant pressure on fees.

The client management layers created by the banks are certainly responsible for the level of fees paid by clients, which is typically around 2.4 per cent in total accounting for the adviser, fund manager and wrap platform — we call this fee the total client management expense ratio. These exclude entry fees and buy/sell costs and include GST.

The banks often serve as a breeding ground for budding boutique financial planners who do their "apprenticeship" there and then start their own businesses after a few years' experience. One of the key frustrations experienced by these planners is the lack of flexibility in what products they can recommend for a client as sales targets of their own products must be met.

AT A GLANCE

REGULATION: Control of the financial planning industry has led to better educated advisers.

SEGMENTATION: Banks splitting up services have contributed to higher fees for clients.

BOUTIQUES: Smarter, smaller advisers have started managing their clients' money directly.

SMAs: This new role for boutiques will drive the growth of separately managed accounts in Australia.

However, in a boutique practice, this is likely to be more flexible and may include direct shares as well as managed funds. So it appears the boutique financial advisers, smaller groups that are independently owned and possibly better educated, tend to go down the path of managing their clients' funds directly, as it makes them more fee competitive and products can be tailored to the client.

For example, if your clients are retirees then they will pay no tax on income, no capital gains tax and no tax on earnings, so fully franked blue chip shares may certainly have a place in their portfolio given their benefits of franking credits and the elimination of tax.

A boutique financial adviser is capable of deriving the same fee for themselves and cutting out the middle men such as the fund manager and perhaps even the wrap platform to do (at least) an equivalent job of managing a client's funds at heavily reduced fee.

For example, the boutique adviser can now manage a client's fund via a separately managed account (SMA), which provides the security required by law but excludes the wrap platform and much of the fund manager fees.

While SMAs are big business in the US, they are just catching on in Australia, and there is little doubt you will be hearing more about them in good time. They will allow an adviser to manage a client's funds for significantly less than 2 per cent. Typically, clients are charged about 1.5 per cent plus GST, which includes everything (adviser, fund manager and wrap), as opposed to 2.4 per cent in traditional master trust structures. Traditional structures are also fraught with volume bonuses or cash kickbacks from the big banks, which add to advisers' bottom lines.

The strict regulatory regime now requires advisers to disclose all relationships to a client and clients are not happy about paying for services that add questionable value. Nor are they amiable to kickbacks of any kind, since it's the client who ultimately pays for it.

Most managed funds don't in fact outperform the index (average share market performance), yet they charge a premium to manage your funds — and what is the adviser doing if someone else is managing the funds anyway?

Thus, it is in fact the client who is seeking advisers to manage their money better, more efficiently and at a lower cost.

And it is therefore the client who is driving the trend for financial planners to participate in the investment process, possibly as a result of fee compression and certainly as a consequence of the strict regulatory environment in which we operate. The key is that the adviser is educated and experienced in the process of investment management and not just doing it to reduce fees and appease the client.

So while Murray may well be correct in suggesting most of financial planners are probably not well placed to directly manage their funds, we are seeing an emergence of the highly educated, experienced and specialised financial adviser who is capable of not only providing the best in strategic advice, but also the ability to manage a client's investments while keeping fees to a minimum.

The Australian financial planning industry will evolve over the next few years, riding on the themes of fee compression, service convergence, disclosure and demanding clients. The latest fall-out in financial markets will only precipitate great change at great speed.

Sam Henderson is managing director and senior financial adviser at Henderson Maxwell