FINANCIAL STANDARD GUIDE TO

MANAGED ACCOUNTS

GUIDE SERIES 1

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BLACKROCK MERRILL LYNCH INVESTMENT MANAGERS

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New technologies have given birth to the modern managed account which is cheaper, faster and available to ordinary investors, not just the wealthy.

INDUSTRY SNAPSHOT

LIGHTS. CAMERA. ACTION. The investment spotlight is on the burgeoning managed accounts (MAs) sector. More than 50 financial planning groups have signed up to offer MAs to their clients since 2005. Citigroup, BlackRock and Macquarie are just some of the major investment houses that are now offering them. The sector has made its mark in the industry and its footprint will only get bigger and deeper.

Managed accounts have existed in various forms for decades. A one-on-one relationship between a broker and his client is a **discretionary portfolio** service or a personalised **managed account** service. But the difference today is that new technologies have given birth to the modern managed account, which is cheaper, faster and available to ordinary investors, not just the wealthy.

There are two main types: separately managed accounts (SMAs) and individually managed accounts (IMAs). For those unfamiliar with them, this guide will go through the similarities and differences between the two. However, it is worth noting that with time, the distinction between them will continue to blur.

MAs are big business in the US. The sector is growing at a faster rate than managed funds, according to research firm Cerulli Associates. From close to US$470 billion invested in managed accounts back in 2003, the figure is predicted to reach more than US$2.6 trillion by 2010, with nearly five million US households using the product.

Why the growth? The key advantages of using managed accounts versus traditional managed funds and platforms are heightened transparency and flexibility. This guide will explain how they are more transparent, flexible and tax-effective compared to other investment vehicles (page 13).

Despite the growing popularity of MAs, there is a cross-section of the financial planning market that are unfamiliar with them or confusing them with the less flexible and more expensive MAs of the past. The aim of this guide is to banish the misconceptions and use a step-by-step process to understanding MAs.

TYPES OF MANAGED ACCOUNTS

THE BEST WAY to think of **managed accounts** (MAs) is to see them as another alternative to **managed funds**. You are still investing in shares and you are still tapping into the collective knowledge of investment professionals and experienced fund managers.

But that is just the starting point. As the investment industry continually search for new ways to serve investors, tried-and-tested investment products are injected with 21st century innovations. For example, the key difference between MAs and managed funds is that MAs are not sold in **units**. Because they are non-unitised, the investor can control the individual securities in their portfolio and **override** the decisions of the investment manager if they do not want certain stocks or they want to keep specific parcels to optimise their tax position (see next section: How SMAs work: a step-by-step guide).

In short, MAs tend to be more cost-effective and tax-efficient because both the adviser and the client can control the portfolio at stock level. With a managed fund, the investor has less control over the extent of capital gains or capital losses.

There are two types of managed accounts. **Individually managed accounts** (IMAs) are like the private share portfolios that have existed since the early days of the stock market. They are one-on-one relationships between the investor and the portfolio manager.

How do IMAs differ from traditional broker services? Broadly speaking, brokers can only service a limited number of clients (up to 50, in some cases) while IMAs are powered by investment houses or firms that are big enough to support a larger number thereby providing the service at a lower cost and with more bells and whistles than a small to mid-size broking firm can potentially provide. Another key difference is that conventional brokers charge transaction-based fees while IMA providers charge fees based on funds under management (FUM). The minimum investment in an IMA is $500,000, although some brokers might accept a lower sum. However, IMAs work best when the client has at least $500,000 in funds or more.

By contrast, **separately managed accounts** (SMAs) are a new phenomenon and were first introduced in Australia in the early 1990s. Unlike an IMA which is built from scratch, an SMA is made of a selection of managed funds called **model portfolios** housed under one account. Unlike a managed fund, however, the client owns the underlying shares, and hence, enjoys the benefits and flexibility that are lost once in a managed fund. Previously, the minimum investment in an SMA was $20,000 but this has steadily declined with some providers offering SMA products with no minimum requirements.

What are the legal implications of investing in an SMA versus an IMA? See below.

Table 1. SMAs vs IMAs

Separately managed accounts	Individually managed accounts
Financial product	Financial service
Client has beneficial ownership of shares	Client has beneficial ownership of shares
Client can tailor SMA to have a more tax-effective portfolio	Tailored to suit the client's tax profile
Made up of 'model portfolios'	Made up of individual shares
Does not require individual transaction reports	Full transaction reports required
No ASIC requirement for personal equities advice	Adviser must provide personal equities advice and therefore needs accreditation
No ASIC requirement for continuing personal advice	Every 13 months or less, the adviser must confirm that advice remains in the best interest of client (subject to legislative changes)

Source: DirectPortfolio Services, Financial Standard, iMap.

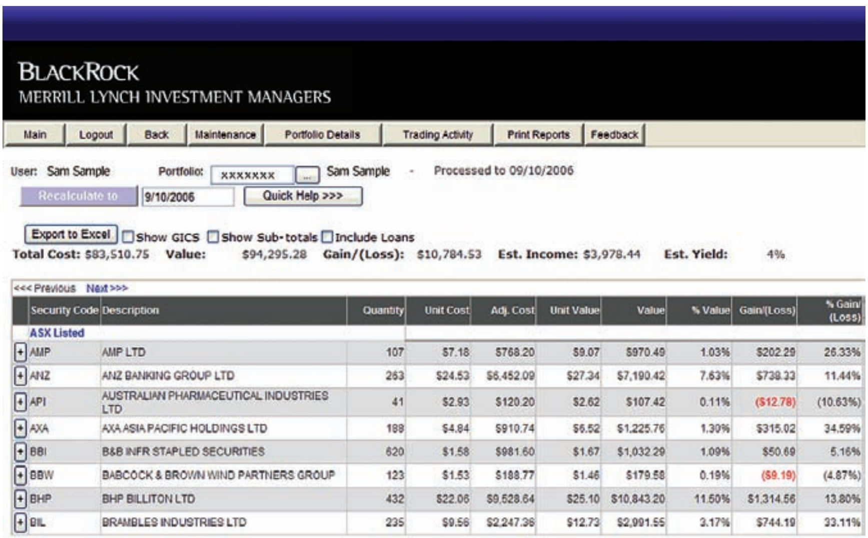
HOW SMAs WORK: A STEP-BY-STEP GUIDE

DIFFERENT MANAGED ACCOUNT PROVIDERS will have different products but the principles are fundamentally the same. Here is an example of how an SMA* using Praemium's technology will appear on an adviser's desktop.

STEP 1

Control over the underlying shares.

Here is a blended portfolio which shows the stocks that the client holds. As mentioned, the client has a **beneficial ownership** of each of these stocks. This is in contrast to a managed fund where the client owns units and not the underlying shares.



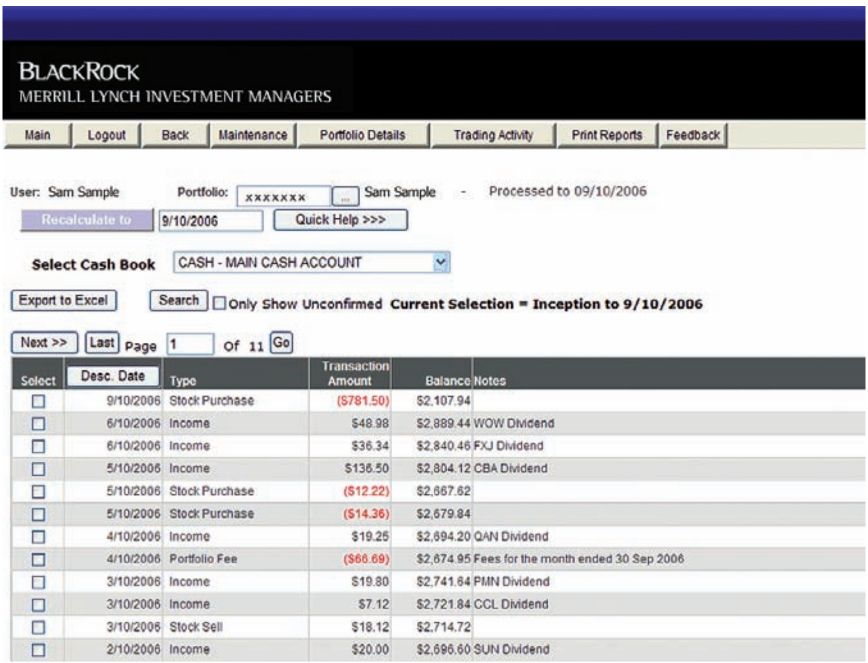
Security Code	Description	Quantity	Unit Cost	Adj. Cost	Unit Value	Value	% Value	Gain/(Loss)	% Gain/(Loss)
ASX Listed									
AMP	AMP LTD	107	$7.18	$768.20	$9.07	$970.49	1.03%	$202.29	26.33%
ANZ	ANZ BANKING GROUP LTD	263	$24.53	$6,452.09	$27.34	$7,190.42	7.63%	$738.33	11.44%
API	AUSTRALIAN PHARMACEUTICAL INDUSTRIES LTD	41	$2.93	$120.20	$2.62	$107.42	0.11%	($12.78)	(10.63%)
AXA	AXA ASIA PACIFIC HOLDINGS LTD	188	$4.84	$910.74	$6.52	$1,225.76	1.30%	$315.02	34.59%
BBI	B&B INFR STAPLED SECURITIES	620	$1.58	$981.60	$1.67	$1,032.29	1.09%	$50.69	5.16%
BBW	BABCOCK & BROWN WIND PARTNERS GROUP	123	$1.53	$188.77	$1.46	$179.58	0.19%	($9.19)	(4.87%)
BHP	BHP BILLITON LTD	432	$22.06	$9,528.64	$25.10	$10,843.20	11.50%	$1,314.56	13.80%
BIL	BRAMBLES INDUSTRIES LTD	235	$9.56	$2,247.36	$12.73	$2,991.55	3.17%	$744.19	33.11%

* The screens are provided courtesy of BlackRock and are taken from the Merrill Lynch Customised Portfolio Service.

STEP 2

Show me the money.

Select the **cash** option on the window and you can see the client's trading history, dividends that came in, fees paid and shares bought or sold.

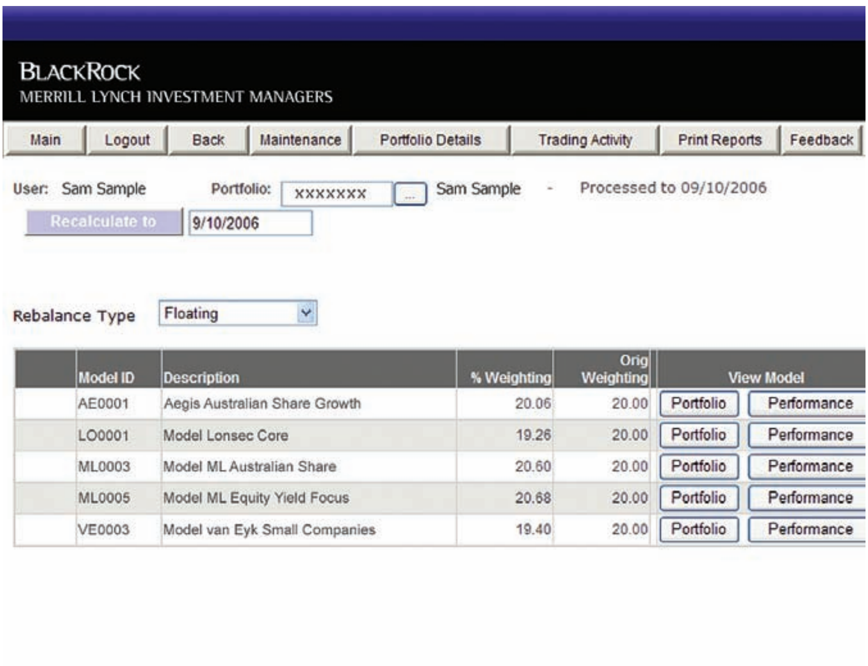


Select	Desc. Date	Type	Transaction Amount	Balance	Notes
☐	9/10/2006	Stock Purchase	($781.50)	$2,107.94	
☐	6/10/2006	Income	$48.98	$2,889.44	WOW Dividend
☐	6/10/2006	Income	$36.34	$2,840.46	FXJ Dividend
☐	5/10/2006	Income	$136.50	$2,804.12	CBA Dividend
☐	5/10/2006	Stock Purchase	($12.22)	$2,667.62	
☐	5/10/2006	Stock Purchase	($14.36)	$2,679.84	
☐	4/10/2006	Income	$19.25	$2,694.20	QAN Dividend
☐	4/10/2006	Portfolio Fee	($66.69)	$2,674.95	Fees for the month ended 30 Sep 2006
☐	3/10/2006	Income	$19.80	$2,741.64	PMN Dividend
☐	3/10/2006	Income	$7.12	$2,721.84	CCL Dividend
☐	3/10/2006	Stock Sell	$18.12	$2,714.72	
☐	2/10/2006	Income	$20.00	$2,696.60	SUN Dividend

STEP 3

What are model portfolios?

These are the intellectual property of the **model portfolio** managers selected by the planner or the client. For example, the Model ML Australian Share Portfolio has exactly the same investment strategy as the ML Australian Share Fund. The difference is that the client can see the breakdown of what shares are within this fund. The client is also the **beneficial owner** of those shares, as opposed to holding units in a managed fund.

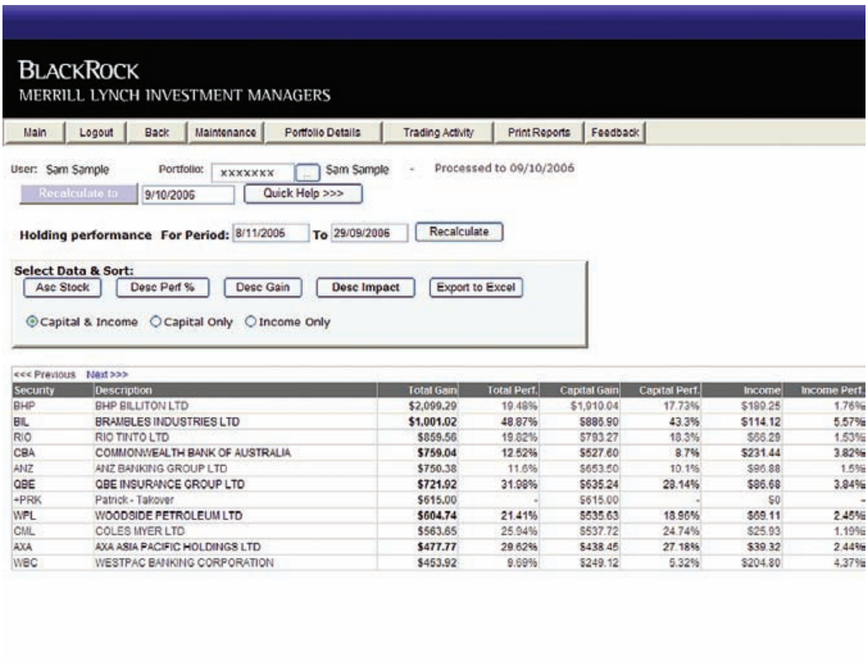


Model ID	Description	% Weighting	Orig Weighting	View Model	
AE0001	Aegis Australian Share Growth	20.06	20.00	Portfolio	Performance
LO0001	Model Lonsec Core	19.26	20.00	Portfolio	Performance
ML0003	Model ML Australian Share	20.60	20.00	Portfolio	Performance
ML0005	Model ML Equity Yield Focus	20.68	20.00	Portfolio	Performance
VE0003	Model van Eyk Small Companies	19.40	20.00	Portfolio	Performance

STEP 4

How am I performing?

The adviser or the client can also see which shares did well and which shares didn't in a **blended** portfolio (ie. the combination of all the model portfolios selected as illustrated on the previous page). Note how capital gains tax and losses are also automatically calculated and highlighted under the **Capital Gain** column.

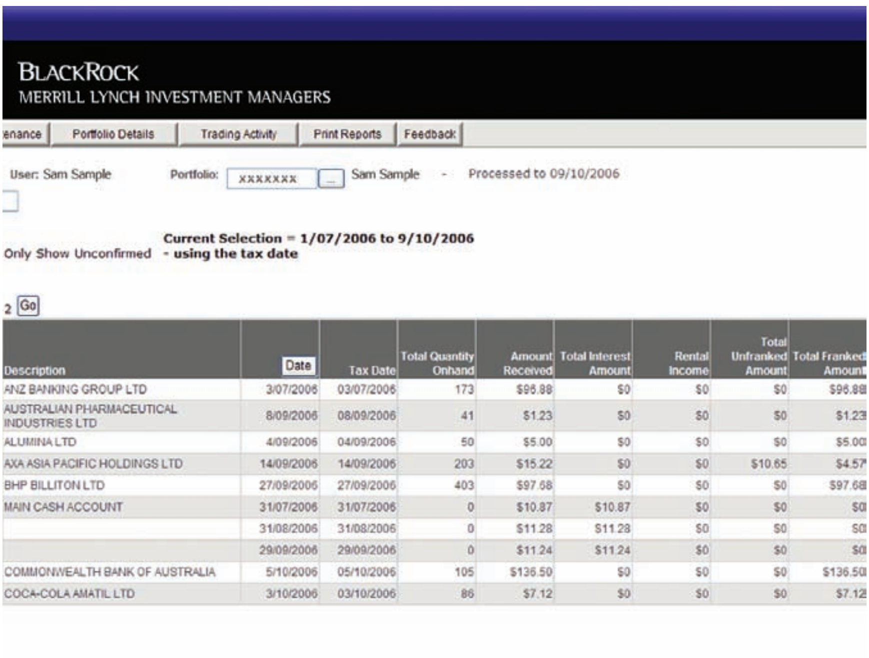


Security	Description	Total Gain	Total Perf.	Capital Gain	Capital Perf.	Income	Income Perf.
BHP	BHP BILLITON LTD	$2,099.29	19.48%	$1,910.04	17.73%	$189.25	1.76%
BIL	BRAMBLES INDUSTRIES LTD	$1,001.02	48.87%	$886.90	43.3%	$114.12	5.57%
RIO	RIO TINTO LTD	$859.56	19.82%	$793.27	18.3%	$66.29	1.53%
CBA	COMMONWEALTH BANK OF AUSTRALIA	$759.04	12.52%	$527.60	8.7%	$231.44	3.82%
ANZ	ANZ BANKING GROUP LTD	$750.38	11.6%	$653.50	10.1%	$96.88	1.5%
QBE	QBE INSURANCE GROUP LTD	$721.92	31.98%	$635.24	28.14%	$86.68	3.84%
+PRK	Patrick - Takover	$615.00	-	$615.00	-	$0	-
WPL	WOODSIDE PETROLEUM LTD	$604.74	21.41%	$535.63	18.96%	$69.11	2.45%
CML	COLES MYER LTD	$563.65	25.94%	$537.72	24.74%	$25.93	1.19%
AXA	AXA ASIA PACIFIC HOLDINGS LTD	$477.77	29.62%	$438.45	27.18%	$39.32	2.44%
WBC	WESTPAC BANKING CORPORATION	$453.92	9.69%	$249.12	5.32%	$204.80	4.37%

STEP 5

Monitoring tax.

Why wait until the end of the year to check your tax details?
With an SMA, the details are readily available online, when you want them.

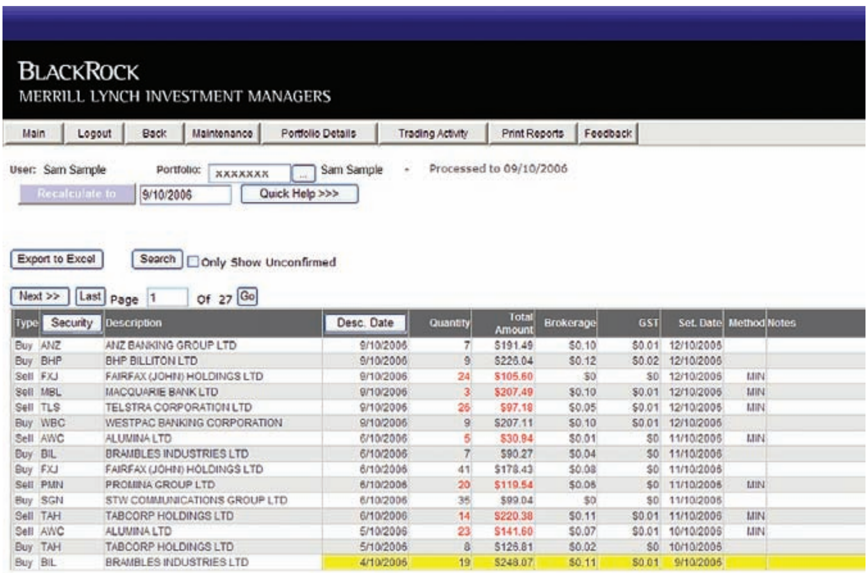


Description	Date	Tax Date	Total Quantity Onhand	Amount Received	Total Interest Amount	Rental Income	Total Unfranked Amount	Total Franked Amount
ANZ BANKING GROUP LTD	3/07/2006	03/07/2006	173	$96.88	$0	$0	$0	$96.88
AUSTRALIAN PHARMACEUTICAL INDUSTRIES LTD	8/09/2006	08/09/2006	41	$1.23	$0	$0	$0	$1.23
ALUMINA LTD	4/09/2006	04/09/2006	50	$5.00	$0	$0	$0	$5.00
AXA ASIA PACIFIC HOLDINGS LTD	14/09/2006	14/09/2006	203	$15.22	$0	$0	$10.65	$4.57
BHP BILLITON LTD	27/09/2006	27/09/2006	403	$97.68	$0	$0	$0	$97.68
MAIN CASH ACCOUNT	31/07/2006	31/07/2006	0	$10.87	$10.87	$0	$0	$0
	31/08/2006	31/08/2006	0	$11.28	$11.28	$0	$0	$0
	29/09/2006	29/09/2006	0	$11.24	$11.24	$0	$0	$0
COMMONWEALTH BANK OF AUSTRALIA	5/10/2006	05/10/2006	105	$136.50	$0	$0	$0	$136.50
COCA-COLA AMATIL LTD	3/10/2006	03/10/2006	86	$7.12	$0	$0	$0	$7.12

STEP 6

Saving up on broker fees.

For those who like trading shares directly but don't want to pay the **retail** cost of broker fees, MAs offer an alternative. Note below the savings from the **brokerage** column. According to Praemium transaction costs can effectively fall to zero within an SMA as a result of the SMA provider netting the buy and sell transactions across all portfolios in the SMA prior to placing orders on the market.

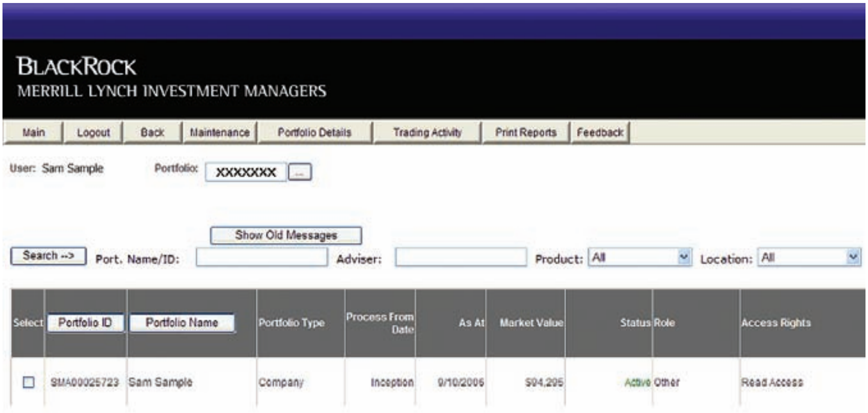


Type	Security	Description	Desc. Date	Quantity	Total Amount	Brokerage	GST	Set. Date	Method	Notes
Buy	ANZ	ANZ BANKING GROUP LTD	9/10/2006	7	$191.49	$0.10	$0.01	12/10/2006		
Buy	BHP	BHP BILLITON LTD	9/10/2006	9	$226.04	$0.12	$0.02	12/10/2006		
Sell	FXJ	FAIRFAX (JOHN) HOLDINGS LTD	9/10/2006	24	$105.60	$0	$0	12/10/2006	MIN	
Sell	MBL	MACQUARIE BANK LTD	9/10/2006	3	$207.49	$0.10	$0.01	12/10/2006	MIN	
Sell	TLS	TELSTRA CORPORATION LTD	9/10/2006	26	$97.18	$0.05	$0.01	12/10/2006	MIN	
Buy	WBC	WESTPAC BANKING CORPORATION	9/10/2006	9	$207.11	$0.10	$0.01	12/10/2006		
Sell	AWC	ALUMINA LTD	6/10/2006	5	$30.94	$0.01	$0	11/10/2006	MIN	
Buy	BIL	BRAMBLES INDUSTRIES LTD	6/10/2006	7	$90.27	$0.04	$0	11/10/2006		
Buy	FXJ	FAIRFAX (JOHN) HOLDINGS LTD	6/10/2006	41	$178.43	$0.08	$0	11/10/2006		
Sell	PMN	PROMINA GROUP LTD	6/10/2006	20	$119.54	$0.06	$0	11/10/2006	MIN	
Buy	SGN	STW COMMUNICATIONS GROUP LTD	6/10/2006	35	$99.04	$0	$0	11/10/2006		
Sell	TAH	TABCORP HOLDINGS LTD	6/10/2006	14	$220.38	$0.11	$0.01	11/10/2006	MIN	
Sell	AWC	ALUMINA LTD	5/10/2006	23	$141.60	$0.07	$0.01	10/10/2006	MIN	
Buy	TAH	TABCORP HOLDINGS LTD	5/10/2006	8	$126.81	$0.02	$0	10/10/2006		
Buy	BIL	BRAMBLES INDUSTRIES LTD	4/10/2006	19	$248.07	$0.11	$0.01	9/10/2006		

STEP 7

Participate or leave it to the experts.

Advisers might want the option to adjust their client's portfolio, be it for *in specie* transfer of existing shares, adding new shares bought outside the SMA or **blocking** the SMA model portfolio manager from selling certain parcels of shares. Alternatively, both the adviser and the client might choose an SMA for the cost advantages alone and elect to leave the investment making decisions to the model portfolio manager. Whether you prefer a passive or an active approach to your portfolio, an SMA fits the bill.



TAX AND FLEXIBILITY ADVANTAGES

THE MAIN DRIVER behind the growth of managed accounts is that it is a great tax vehicle. Let's take for example the case of investing in Commonwealth Bank (CBA) shares. If a fund manager decides to sell them it might have capital gains tax implications affecting not just one investor but all the investors in the managed fund. By contrast, suppose that same managed fund is adopted as a model portfolio in an SMA, a planner might decide to choose the **lock** option (ie. don't sell) for a client who might be worse off from the CGT costs. Similarly, an IMA won't lose out as the IMA provider has already tailored the portfolio to give the individual client the maximum tax advantages.

The flexibility extends far beyond the tax implications. A managed account can also be tailored to suit an investor's risk profile, ethical bent and other interests. For example, a model portfolio might have an investment in ANZ shares but the client might work for the bank and already own ANZ shares. That client can hang on to the model portfolio but drop ANZ in exchange for another bank's shares, such as CBA.

Or a client might have had a bad experience with Telstra services and think that could reflect on Telstra's share price. That client can also elect not to have Telstra on his portfolio without losing the benefits of hanging on to the intellectual property of a model portfolio that included Telstra shares.

FLEXIBILITY

- ***In specie* transfers into a model**
- **Delete or swap stocks to meet specific criteria, eg. ethical considerations**
- **Minimise trade sizes to reduce the volume of transactions**

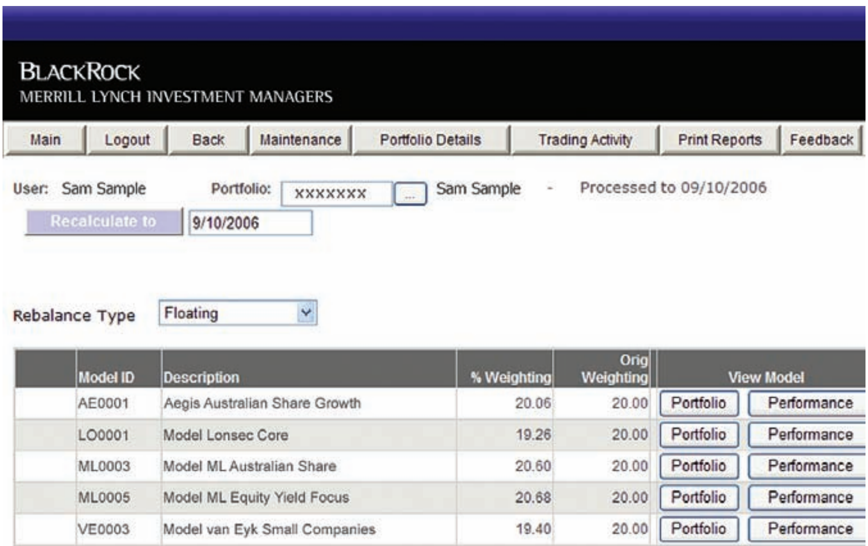
TAX ADVANTAGE

- **Parcel selection to optimise CGT**
- **Lock or freeze tax parcels to prevent selling**
- **No embedded CGT liabilities incurred by previous investors**

UNDERSTANDING MODEL PORTFOLIOS

What is under the SMA bonnet?

ADVISERS CAN PICK AND CHOOSE a selection of model portfolios for their client. In BlackRock's case, there are more than 50 model portfolios to choose from including those managed by Aegis, Lonsec and Tolhurst Noall to name a few, and the list is still growing. Dealer groups who have white-labelled SMAs can approach fund managers whose portfolio they want to include in their range.



CHOOSING THE RIGHT MA FOR YOUR PRACTICE

IMAs ARE PERFECT for ultra high net worth individuals who want a customised portfolio and one-on-one relationship with the portfolio manager. As IMAs are built from scratch, the IMA holder is not constrained by the choices made by the underlying fund manager of an SMA.

But for those who can't afford the fees and meet the cut-off point that makes an IMA economic, an SMA is an excellent alternative. It relinquishes some control because you start off with the shares chosen from the model portfolios but you can still incorporate your own requirements such as selling or buying shares based on your tax profile, ethical considerations or cashflow needs.

In the past, the minimum funds required to invest in an SMA was $100,000 and upwards of $500,000 for an IMA. But thanks to new technologies, the minimum investment required continues to fall (BlackRock's SMA for example has no minimum).

To understand how SMAs compare to investing in shares directly or through managed funds, see the Easy Guide on page 28.

Finally, a financial planner also needs to consider whether a managed account is ideal for a client who already has a self-managed super fund (SMSF), another investment vehicle that has grown in popularity in recent years.
Like MAs, SMSFs also offer investors more control over their assets. According to Praemium, 70 per cent of their funds under administration are sourced from SMSFs, which suggests a growing number of financial planners and accountants with SMSF clients are recognising the benefits of MAs.

PERFORMANCE AND FEES

THE GROWTH OF THE MANAGED ACCOUNTS SECTOR in Australia is underpinned by three key trends. First, a growing number of investors are demanding **after-tax returns** instead of **relative returns**. Second, the fee models adopted by managed account providers have made MAs more accessible to the average investor. Third, Australian investors love the control they have when investing in shares directly.

But while the reasons for the sector's growth is clear, explaining how MAs perform is not quite as straightforward. For example, there is no MA equivalent (yet) of the managed funds performance surveys released by research firms on a monthly or yearly basis. These surveys allow investors to do their own comparison on which funds perform best and on what fees.

Rainmaker Fee Comparison*

Fees and other costs	Wrap A	Wrap B
Establishment fees	nil	nil
Contribution fees	0 – 5.0%	0 – 5.0%
	—	—
Withdrawal fees	nil	nil
Termination fees	nil	nil
Management costs (ongoing)		
$0 – $50,000	0.79%	1.12%
$50,000 – $200,000	0.79% – 0.70%	1.03%
$200,000 – $500,000	0.23%	0.70%
$500,000 – $1,000,000	0.23%	0.43% – 0.51%
$1,000,000+	0.09% – 0.00%	0.35% – 0.37%
Management costs – member p.a.		nil
Management costs – investment	0 – 6.0%	0.18% – 9.21%
Switching fees	—	—
	nil	nil
	$30.50	$75 paper based
Buy/sell spreads^	n/a	n/a
Additional adviser service fees	0 – 2.0%	0 – 2.0%
Total Expense Ratio (TER)**	2.06%	2.48%
	$1,067	$1,285

Source: Rainmaker Information

^ The buy/sell spread shown is for the default investment option or equivalent balanced investment option.

* This is an indicative comparison of fees only. Charges will vary depending on your wrap or MA provider.

By contrast, the performance of an IMA or an SMA is driven by two factors: the customised tax management for that individual investor (which boosts returns) and a stock-picking strategy that is less constrained by a benchmark index.

In an IMA, the share selection is tailored specifically for the individual so there is no need for filler stocks (shares that a fund manager might hold to reduce the risk of deviating away from its benchmark) while an SMA is often made up of best-of-breed model portfolios and shares can be added or sold at the client's discretion (again, this could be for tax purposes or personal preference).

In short, there are no hard and fast rules about how a managed account performs as there is no specific benchmark to compare them with. Ask your

Wrap C	Wrap D	BlackRock's SMA***
nil	nil	Adviser discretion
0 – 4.4%**	0 – 5.125%**	Adviser discretion
Deferred contribution fee option also available	Deferred contribution fee option also available	
nil	nil	Adviser discretion
nil	nil	Adviser discretion
0.825%	1.23%	0.6%
0.605%	1.08%	0.6%
0.605%	0.87%	0.6%
0.440%	0.46%	0.44%
0.440%	0.46%	0.33%
nil	nil	nil
0.15% – 2.75%	up to 3.52%	0-0.6%
—	—	
nil	nil	0
nil	nil	0
0.14% / 0.14%	n/a	0
0 – 2.2%	up to 1.65%	Adviser discretion
2.15%	2.45%	
$1,114	$1,269	

*** Management fees for this service are tiered. For example, an investment of $600,000 would incur a 0.6% fee on the first $500,000 and a 0.44% fee on the remaining $100,000.

** The Total Expense Ratio (TER) calculations use the following assumptions: a $50,000 account balance, a $50,000 salary, the investment management fee is taken from the default investment option or equivalent balanced investment option and includes all disclosed performance based fees.

The key areas to look at are the MA provider's technology, ease of integration, fees, product features, legals and customer support.

managed account provider about their track record, investment strategies and, if you prefer, why not ask for a couple of client referees? Broadly speaking, MA clients tend to have more control over the performance of their portfolio thanks to the more tailored tax management and reduced fees (see table on page 16).

Meanwhile, it is interesting to note how SMA fees have evolved in Australia. In the US, they are sold as a **premium service** by the agents of major investment houses such as Morgan Stanley, Merrill Lynch and Smith Barney. The premium charge is justified by the enhanced investment experience demanded by investors. SMA clients in the US want a more transparent account rather than having their money co-mingled with that of other investors in an opaque unitised structure.

But in Australia, wraps and platforms have served the financial planning industry well enough that the sales argument for SMAs must be based on cost savings, not just on control and after-tax returns.

While earlier SMAs in Australia failed to make headway, the technology has finally arrived to allow MA providers to scale the business, automate the processing and charge fees that are on par or lower than wraps or platforms. On page 16 is a comparison chart that can help planners consider the best fee structure forward for the needs of their clients.

THE QUEST FOR BENCHMARKING

By Alex Dunnin
Director of Research
Rainmaker Information

ONE OF THE NECESSARY EVILS of wealth management is the need for independent research and ratings before products can be listed on a planning group's recommended or approved products list.

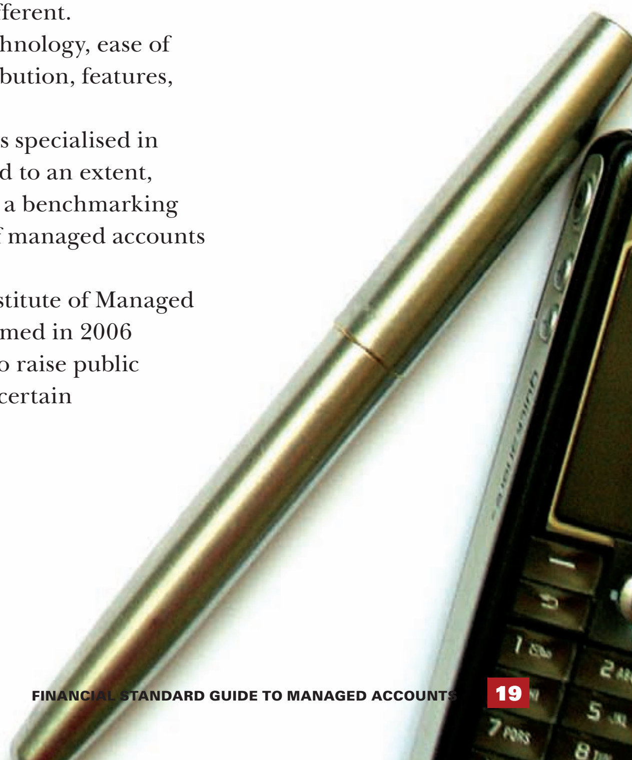
As managed funds and now super funds have an established arsenal of research firms rating them, it is inevitable that some would sooner or later turn their attention to managed accounts.

But rating managed accounts is not all that different to rating other funds in that you use a multi-dimensional approach. The parameters or features you focus on is what makes the method different.

The key areas to look at are technology, ease of integration, fees, marketing and distribution, features, legals and customer support.

Rainmaker Research, which has specialised in rating and comparing super funds, and to an extent, fund managers, is currently exploring a benchmarking method to compare the recent wave of managed accounts providers entering the market.

An industry body called the Institute of Managed Account Providers (iMap) was also formed in 2006 (see www.imap.asn.au) whose goal is to raise public awareness on the sector and establish certain industry standards.



USING TECHNOLOGY TO DELIVER SERVICE

Sponsored statement by Praemium Ltd

Arthur Naoumidis
Managing Director, Praemium Ltd

INTEREST IN AUSTRALIA in separately managed accounts (SMAs) has been gathering momentum rapidly over the past couple of years. Reports frequently cite the US experience particularly among the wirehouses where funds inflow into managed accounts is reportedly greater than that of the mutual funds.

Why should you be interested in separately managed accounts and what exactly are they?

In a nutshell we are talking about platform based investment vehicles that combine the benefits of collective investment with individual beneficial ownership of the underlying assets.

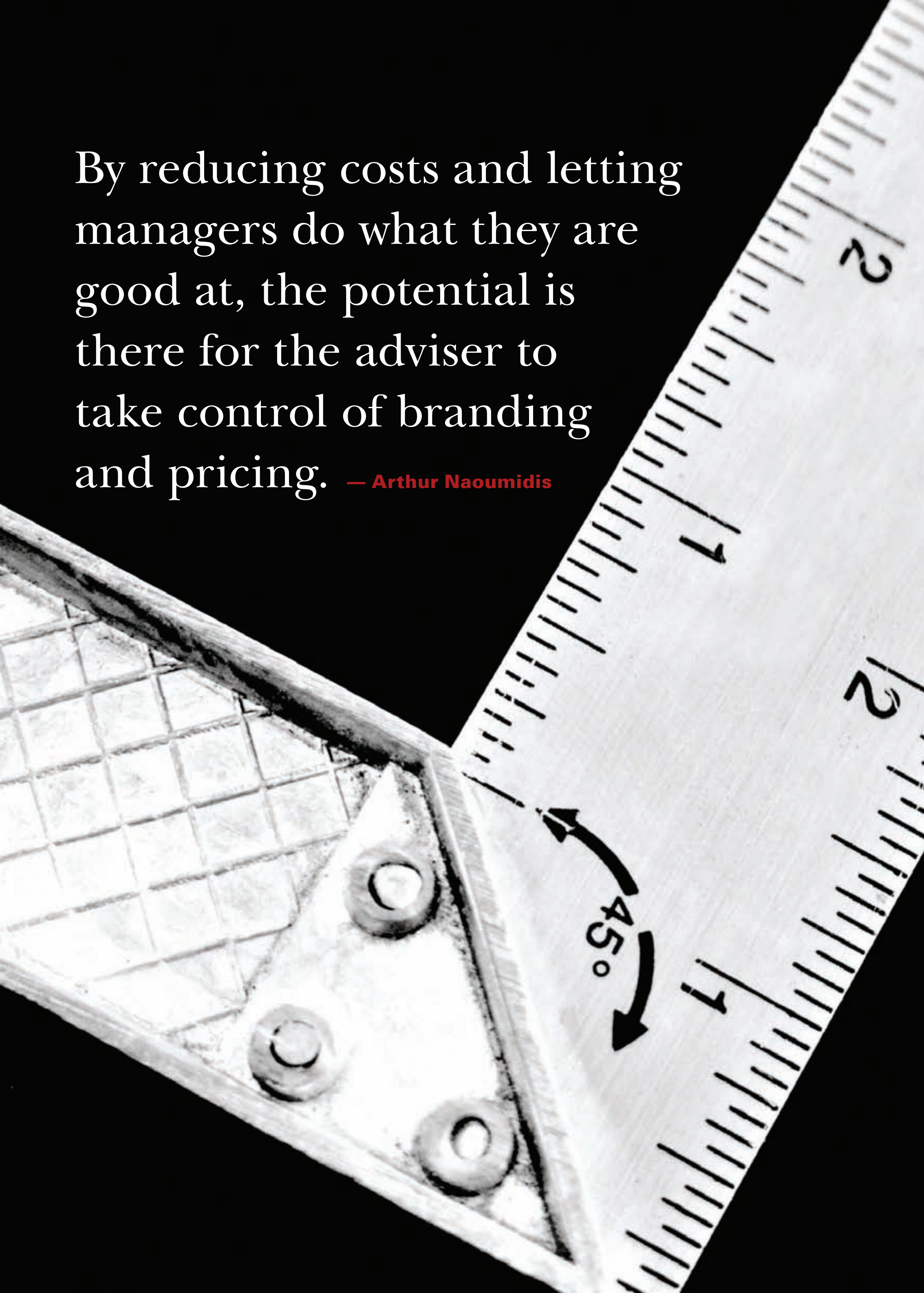
Modern SMA technology enables investors to access the portfolio models created by recognised fund managers outside the traditional unitised collective investment structure. The result is the ability to tailor portfolios to the personal needs of the individual and to control the tax consequences of their transactions.

The SMA platform provides the interface for the fund manager to make adjustments to their model and to monitor the individual investments.

Retrospectively, the evolution into SMAs in Australia today began in the early 1980s with retail investment in unit trusts providing professional investment management, which was difficult for independent financial advisers (IFA). Custody based retail trusts that pool investors money solved this problem. But, as the number of funds grew so the burden of administering them collectively grew.

Enter Master Trusts, an umbrella to manage multiple funds. Again within a custody structure overarching the individual funds, Master Trusts were expensive. This innovation too encountered problems, this time for the investor. When moving from one Master Trust to another the investor fell victim to capital gains tax on each occasion.

By reducing costs and letting managers do what they are good at, the potential is there for the adviser to take control of branding and pricing. — **Arthur Naoumidis**



Enter Wrap platforms which replaced the Master Trust ownership structure with a pooled custody IDPS legal structure. Providing similar administration to Master Trusts but without the tax problems for the investor, who could move funds within the Wrap without triggering a CGT event. The cost however remained high as the Wrap too had a custody structure overarching the individual managed funds internal custody. Again, two custody fees.

Technology, while aiding administration, was still not delivering cost efficiencies.

Enter the Separately Managed Account (SMA), the next and latest logical step in delivering professional investment management and administration but now under a single custody structure.

How does this occur? By eliminating the unit trust structure and using only the intellectual property of the fund manager. This is coupled with scalable processing technology that allows the investor to own securities directly as selected by the fund manager and having the technology perform the processing functions.

In getting rid of the administrative back office component of the fund manager, SMAs unlock the fund managers true value, that is their ability to select investments according to particular mandates. By reducing costs and letting fund and portfolio managers do what they are good at, the potential is there for the adviser to enter the delivery chain one rung up the ladder and take control of branding and pricing.

Praemium V-Wrap evolved from a desire to provide low cost, scalable, highly automated, tax focused portfolio services deliverable on-line. Using the Microsoft. Net platform, Praemium created a service capable of maintaining detailed records of transactions and corporate actions, integrating a variety of external data including cash accounts, listed securities and managed fund data, calculating the treatment of tax parcels, reconstructing, revaluing and recalculating on a daily basis. Central to the operation of V-Wrap is capital gains tax optimisation, a process of tax parcel selection to minimise or accelerate CGT.

With hundreds of enhancements over the past four years and the addition of integrated portfolio modelling, automated rebalancing, transaction netting and order placement, Praemium's SMA technology emerged. Praemium partnered with a leading US SMA provider in BlackRock (formerly Merrill Lynch Investment Managers) and set about customising the technology for the Australian SMA market. The result is a fully flexible SMA platform catering to a wide range of internal and external portfolio models and a product that is easily branded for dealer groups and fund managers.

BlackRock’s SMA currently has in excess of 50 portfolio models managed by 18 model providers and is accessible by advisers from more than 30 dealer groups via their approved product list.

This highly scalable single product line has the potential to generate billions of dollars of business while delivering previously unavailable advantages to investors. These include lower cost, customisation, portability, tax effectiveness, transparency and a richer more enhanced investment experience than in a unitised managed investment environment.

In summary, SMAs are non-unitised managed funds. They use technology to process the intellectual property of fund and portfolio managers to deliver a customisable investment solution for the individual investor.

They process transactions, apply the appropriate fees for the SMA operator, the model provider, the dealer and the adviser. They deliver low management costs, eliminate one layer of custody fees and the easy on-line access suits the investor, so everyone gets a piece of the chocolate.

CASE STUDY

WHY CHOOSE AN SMA?

USING BLACKROCK'S SMA as an example, how much better would an investor be in an SMA compared to a Wrap or a portfolio of traditional managed funds?

Let's assume that the adviser recommends that their client switches fund managers on 50 per cent of their portfolio every four years. The same portfolio model is also used in the SMA as in the managed funds chosen.

Market assumptions:

- Gross performance is the same in SMA as in the managed funds because the same models are used.
- The investor pays the adviser the same SMA fee as the managed fund commission the adviser receives.
- The investor is on the top tax rate of 46.5 per cent.
- Average growth is 10 per cent.
- There is a 75 per cent commonality between portfolios when they are changed.
- Discount rate is 7.5 per cent.
- Initial investment is $100,000.

Exactly how much better are they?

Over the full life of their investments: $22,765.
Or in terms of value added today for choosing an SMA: **$10,578** or **10.58 per cent**.

BLACKROCK CASE STUDY WORKINGS

1.	**INVESTMENT DETAILS**	
	What per annum growth are you expecting over 20 years?	**10%**
	What turnover do you expect the investment strategies you select to generate?	**25%**
	What is your initial investment?	**$100,000**
2.	**SWITCHING**	
	How much of the portfolio would you expect to switch every four years?	**50%**
	What level of commonality would you expect as you switch fund managers?	**75%**
	What buy/sell spread would you expect to pay in a managed fund?	**0.18%**
3.	**TAX**	
	What tax rate applies to the portfolio?	**46.50%**
	What percentage of transactions will attract the lower CGT rate?	
	a) Under managed funds	**40%**
	b) Under the SMA	**50%**
4.	**FEES**	
	What brokerage do you expect to pay within the managed funds you choose?	**0.25%**
	What platform fees to you expect to pay?	**0.79%**
	What MER do you expect to pay on the managed funds you choose?	**0.85%**
	What investment fees to you expect to pay on the models you choose?	**0.60%**
5.	**PRESENT VALUE**	
	What rate do you want to use to calculate the present value of your savings?	**7.50%**

take into account an individual's financial circumstances. An assessment should be made as to whether the information is appropriate in individual circumstances and consideration should be given to talking to a financial or other professional adviser before making an investment decision.

No guarantee as to the capital value of investments in the Fund(s) nor future returns is made by BlackRock.

Past performance is no indicator of future performance. Long term performance returns show the potential volatility of returns over time. The value of investments and the income from them can fall as well as rise and is not guaranteed. You may not get back the amount originally invested. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially.

GLOSSARY

Beneficial ownership	When an investor has a vested and indefeasible interest in the assets held in their personal portfolio.
Blending	When an investor chooses a number of model portfolios, in the proportions of their choice, to construct their personal portfolio.
Compulsory cash component	The percentage of cash held within the account to facilitate trading and payment of fees.
Corporate actions	An action taken by an entity for the purpose of giving an entitlement to holders of a class of the entity's securities.
Fixed model portfolio weighting	When the SMA provider makes trades during rebalancing to ensure the proportions of the personal portfolio, attributable to each model portfolio, remain as originally selected.
Floating model portfolio weighting	When the model portfolios perform differently from each other, relative to the proportion of their personal portfolio, and move (float) away from the model portfolio weights that were originally selected and are not adjusted by the SMA provider.
Holding lock	When an investor transfers an existing stock holding into the SMA and fixes this holding at a level of their choice. When the investor's personal portfolio is rebalanced, the nominated stock holding is maintained at, or above, the selected level. This is often used to protect tax parcels.
Individually managed account (IMA)	A managed account where the professional investment manager manages investment portfolios and implements different investment decisions across the accounts based on the personal circumstances and objectives of each investor.
iMap	Institute of managed account providers. The industry body representing managed account professionals set up in 2006. See www.imap.asn.au
Inherited tax liabilities	When an investor purchases a pooled unitised fund, they also buy the realised and unrealised gains. Accordingly, a portion of the price may be attributed to previously derived Capital Gains Tax (CGT) income. The investor would then be entitled to a distribution of this income which would be taxable.
***In specie* transfer**	When an investor's existing stocks are transferred into their personal portfolio.
Intellectual property	From an SMA perspective, this is the stock picking strategy of the model provider.
Managed discretionary account (MDA)	An umbrella term used to refer to any services where the clients hand in their money or other assets to the MDA operator and give that operator the discretion to manage those assets on their behalf.
Managed investment scheme (MIS)	Also known as 'managed funds', 'pooled investments' or 'collective investments'. It is a scheme where money is pooled together with that of other investors in exchange for an interest in the scheme.
Minimum trade size	When securities in a personal portfolio are only traded if the trade size meets the specified size. It is the smallest trade that can be done in a personal portfolio.

Model portfolio	An investment strategy selected by the adviser and managed by a model portfolio manager on an ongoing basis.
Model portfolio manager	The manager of the model portfolio (referred to as the model portfolio adviser, model provider or the fund manager).
Netting	When buys and sells are matched and off-set against each other. Can be done at both portfolio and scheme level.
Nominated representative	Generally a financial adviser, or professional adviser, who will provide all instructions to the SMA provider on behalf of the investor.
Non-beneficial ownership	As opposed to beneficial ownership. Usually when the clients invests in shares within a unitised managed fund.
Personal portfolio	An investor's account into which their investments are allocated within an SMA. A personal portfolio is generally constructed using a selection of model portfolios and a compulsory cash component.
Rebalancing	The process where a client's actual holdings are compared to the updated model portfolios and changed accordingly.
Rebalancing date	Usually each business day before the market opens.
Responsible entity	The licensed entity or body that operates a managed investment scheme or separately managed account.
Sell-down	When securities are sold at the client's discretion.
Separately managed account (SMA)	A portfolio made up of securities that are beneficially owned by the individual investor and managed by professional managers or model portfolio managers. Unlike investing in a managed fund, an SMA investor can add, delete or 'lock' shares in an SMA.
Substitution	When an investor substitutes an individual security with another ASX listed security, cash, or pro-rates across the other securities in the personal portfolio.
Unified managed account (UMA)	Comprehensive portfolios of individual separate accounts and packaged products, such as mutual funds and exchange-traded funds (ETFs), with a complete asset allocation in a single account.
White-labelling	Also called 'badging'. When a party, independent to the SMA provider or responsible entity (such a dealer group, accountant or broker) badges the SMA service as their own service (eg. the third party can choose their own name for their service, the model portfolios they wish to offer, and fee structure).

Source: This glossary is compiled from definitions provided by the Australian Securities Exchange (ASX), Australian Securities and Investments Commission (ASIC), IMAP and BlackRock.

EASY GUIDE

A comparison of SMAs vs managed funds vs direct equities

FEATURE	SMA	MANAGED FUNDS	DIRECT EQUITY
Professional fund management	✔	✔	✘
Immediate application and redemption of funds	✔	✔	✔
Traded every day	✔	✔	✔
Wholesale execution	✔	✔	✘
Low minimum investment	✔	✔	✘
Corporate actions administered	✔	✔	✘
Tax reporting	✔	✔	✘
Access via a PDS	✔	✔	✘
Fee transparency	✔	✔	✔
Ability to view underlying shares	✔	✘	✔
Equitable performance fees	✔	✘	n/a
Minimise CGT when switching	✔	✘	n/a
In specie transfers	✔	✘	✔
Avoid embedded CGT	✔	✘	✔
Automatic tax optimisation	✔	✘	✘
Netting of transactions	✔	✘	✘
Blended individual portfolio	✔	✘	✘
Select minimum trade size	✔	✘	✔
Exclude stocks from portfolio	✔	✘	✔
Download tax parcels to accountant	✔	✘	✘

Source: 2020 DirectInvest

præmium
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BlackRock
Merrill Lynch
Investment Managers

Financial Standard
a Rainmaker Information company