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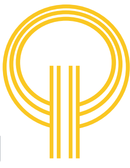

Governance | Strategy
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# IN CONTEXT THOUGHT LEADERSHIP SERIES

## Good Governance is Gold

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When the term 'governance' is mentioned the first reaction is normally one that brings up the dread of another set of over-burdensome compliance obligations. However, governance and compliance are very different things. Good investment governance at its core is about how to make good investment decisions and good decisions lead to good outcomes and good business.

There are four key pillars to successful investment governance and therefore good investment decision making:

SKILLS:
having skilful investment professionals at the core of the investment process

RESOURCES:
the tools and advice considered in decision making, including external resources

TIME:
more time focussing on strategic decisions through thoughtful consideration

PROCESS:
a clear process and decision criteria

Having the right mix of these in place positions self-determined advice and wealth firms well to build out a private label managed accounts portfolio and should deliver better outcomes for clients.

Therefore, as a firm moves to implement a managed accounts program there exists a key set of governance considerations:

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What mix of internal and external skills and resources will be employed to both set the appropriate mandate and undertake the ongoing management of the program? Who has the investment skill and what is your portfolio management technology?

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How much time will be dedicated in the form of Investment Committee meetings and other research and review including due diligence on managers and securities? Do you have sufficient resourcing to conduct fiduciary level due diligence on fund managers and securities?

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What processes, framework and delegations will be in place to inform decision making? How will you stick to the strategy when markets turn against your approach? How do you make portfolio trade-offs between risk, return, fees, diversity, complexity and sustainability?

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## THE RIGHT DECISION FOR THE RIGHT REASONS

We believe all decision making should have client best interests as the core criteria, irrespective of any legal or compliance obligation. We have conviction that a successful managed accounts program will be based on delivering better client outcomes as opposed to those 'force fed' from dealer groups or vertically integrated offerings from wealth firms designed to supplement revenue. The risk to firms operating under this model is significant from a conflicted remuneration and best interests' perspective, as recently highlighted by industry the publication Professional Planner:

"Vertically integrated practices that are being baked into the burgeoning managed accounts sector will eventually come under focus as part of ASIC's ongoing review into the area, which was stalled during the pandemic but only temporarily." – Professional Planner June 2021

## THE PLATFORM'S PERSPECTIVE

Whether the responsible entity (RE) of a managed account is an external provider or the platform's own RE, they need to consider the approval of a private label managed account from a fiduciary perspective for your clients.

Some of the required analysis and documentation includes:

- The investment philosophy employed in the development of the portfolios
- Stress testing
- Scenario analysis
- Historical track record
- Research and due diligence on the managed funds, ETFS and securities used
- Details of the investment process
- Business and corporate considerations including business continuity, disaster recovery and cyber security
- Review of the capability and experience of the personnel making the investment decisions

For superannuation trustees of the platforms in particular the requirements need to meet the standard set by Superannuation Prudential Standard 530 – Investment Governance. The Context team collectively have extensive experience working in the Superannuation environment, so we fully appreciate reasons behind why the well-governed platforms take these requirements so seriously – it is acting in the end client's best interest. Therefore the 'model manager' appointed by a responsible entity needs to meet the standard of a professional manager. For many groups considering adopting an internally managed program without an external partnership, it is important to remember that the responsible entity and/or superannuation trustee needs to think and act as a fiduciary. Does your proposed solution stack up to this standard?

"The responsible entity and/or superannuation trustee needs to think and act as a fiduciary. Does your proposed solution stack up to this standard?"

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# DETERMINING THE RIGHT MODEL FOR MODEL MANAGEMENT

There are three primary structural models that can be used to implement a private label managed accounts program, each of which will be suitable in a different context for different firms and business models.

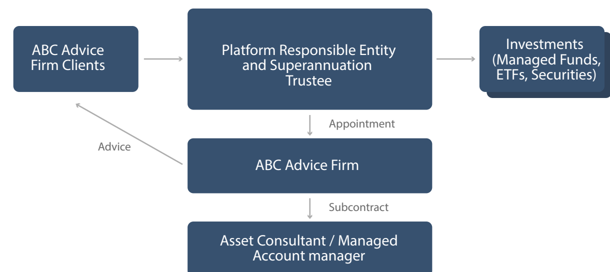
We outline our perspective on the different models along with their strengths and weaknesses:

## OPTION 1 – GO IT ALONE

- ✓ Suitable for wealth management firms with a significant internal team, access to professional resources, strong governance and a well-resourced Investment Committee.
- ✓ Maximises control
- ✓ Truly unique to the firm
- ✓ Aligned with pre-managed accounts value proposition
- X Risk of conflicted remuneration
- X Vertical integration
- X Solely reliant on internal resources, platform will need to consider capability and track record of internal team
- X Highest operational risk

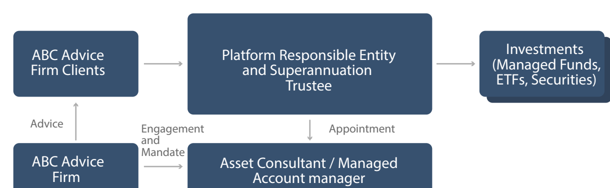
## OPTION 2 – COLLABORATE

- ✓ Suitable for wealth management firms with some internal resources, a formal Investment Committee and some internal investment speciality, most commonly a direct share investment program.
- ✓ Greater flexibility to appoint and remove model manager or asset consultant
- ✓ Can incorporate the intellectual capital of the internal team and the provider
- X Risk of conflicted remuneration
- X Lower efficiency given potential duplication
- X Requires very clear specification of roles, responsibilities and decision making. Platforms will need to consider both advice firm and manager capability.




## OPTION 3 – DELEGATE

- ✓ Suitable for most financial advice firms seeking to develop a private label managed account program
- ✓ Maximises use of external expertise
- ✓ Maximises efficiency
- ✓ Lowest risk of best interests compliance findings
- ✓ Lowest operational risk
- X Need to ensure appropriate arrangements are in place with responsible entity and model manager to enable manager replacement without moving clients
- X Risk of drifting towards an 'off the shelf' solution



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## PARTNERING DOESN'T MEAN GIVING UP CONTROL

There is a common misconception that partnering with an asset consultant or model manager means 'handing over the reigns' of your client's investments.

This is where it is important to engage the right type of model with your managed accounts partner so that the customised managed account remains exactly that, customised to the context of your firm and not drifting towards the 'off the shelf' solution your provider may offer on platform.

The example delegations matrix below, shows that an advice firm operating under 'option 3 – Delegate' still has overall control of setting the mandate and providing oversight of their managed accounts but leaves the day-to-day operations of the portfolios to the model manager.

| AREA | ITEM | ASSET CONSULTANT / MODEL MANAGER | ADVICE FIRM INVESTMENT COMMITTEE |
|---|---|---|---|
| Product and Mandate Design | Investment Beliefs | Recommend | Decide |
| | Objectives | Recommend | Decide |
| | SAA and Ranges | Recommend | Decide |
| Portfolio Construction | Dynamic Asset Allocation | Decide | Inform |
| | Manager Selection | Decide | Inform |
| Implementation | Manager Termination | Decide | Inform |
| | Interim Portfolio Management | Decide | Inform |
| | Rebalancing | Decide | Inform |

IMPORTANT INFORMATION

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