



Good governance is gold

Chris West

When the term 'governance' is mentioned, the first reaction is normally one that brings up the dread of another set of overburdensome compliance obligations. However, governance and compliance are very different things. Good investment governance at its core is about how to make good investment decisions. Moreover, 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 focusing 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:

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

- How much *time* will be dedicated in the form of investment committee meetings and other research and reviews, including due diligence on managers and securities? Do you have sufficient resourcing to conduct fiduciary level due diligence on fund managers and securities?
- 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?

The right decision for the right reasons

All decision-making should have clients' best interests as the core criterion, irrespective of any legal or compliance obligations.

A successful managed accounts program needs to 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.

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, exchange-traded funds and securities used
- details of the investment process.
- business and corporate considerations including business continuity, disaster recovery and cybersecurity
- 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 Australian Prudential Regulation Authority Superannuation Prudential Standard 530: *Investment Governance*. It is important to fully appreciate the reasons behind why well-governed platforms take these requirements so seriously—they are acting in the end client’s best interests.

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?

Determining the right framework 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. The following sections outline Context Capital’s perspectives 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
- ✗ Risk of conflicted remuneration
- ✗ Vertical integration
- ✗ Solely reliant on internal resources, platform will need to consider capability and track record of internal team
- ✗ 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
- ✗ Risk of conflicted remuneration
- ✗ Lower efficiency, given potential duplication
- ✗ 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
- ✗ Need to ensure appropriate arrangements are in place with responsible entity and model manager to enable manager replacement without moving clients
- ✗ Risk of drifting towards an ‘off-the-shelf’ solution.



The quote

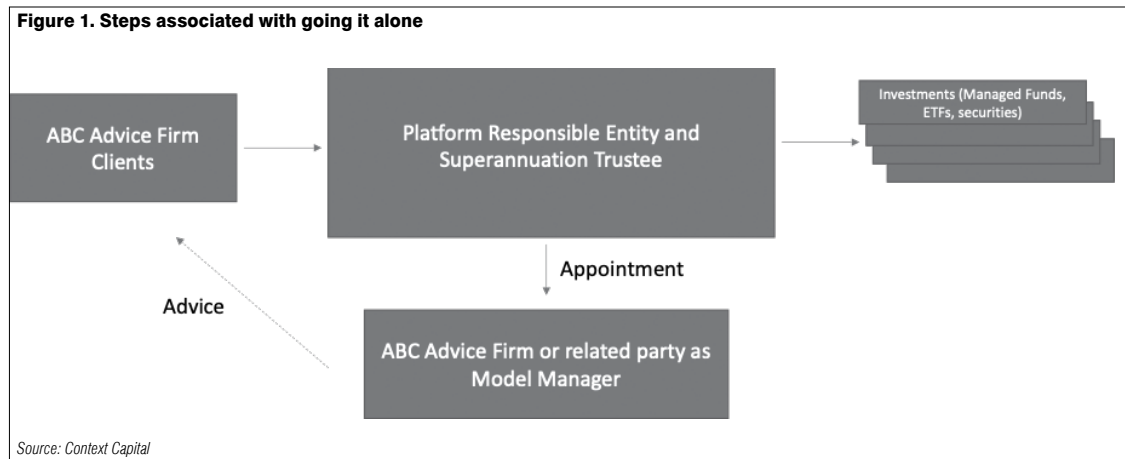
Governance and compliance are very different things.



Chris West, Context Capital

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Figure 1. Steps associated with going it alone



Source: Context Capital



The quote

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Partnering does not mean giving up control

There is a common misconception that partnering with an asset consultant or model manager means 'handing over the reins' of your clients' investments. This is where it is important to engage the right type of model with a chosen 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 a provider may offer on-platform.

The example delegations matrix depicted in Table 1 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.

There is no one-size-fits-all solution

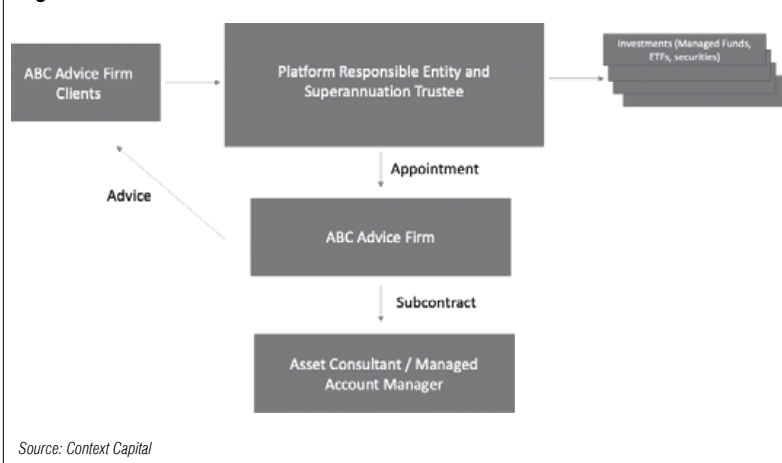
Ultimately the right governance for a managed accounts program should come down to the context of the firm and its client base. It is, however, critical for success to ensure client outcomes are at the centre of decision-making and a strong governance approach is employed. **FS**

Table 1. Example delegations structure

Area	Item	Asset consultant/ model manager	Advice firm investment committee
Product and mandate design	Investment beliefs	Recommend	Decide
	Objectives	Recommend	Decide
	Strategic asset allocation 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

Source: Context Capital

Figure 2. Collaboration in action



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Figure 3: The delegation process

