IMAs and SMAs explained

Hugh MacNally

Individually managed accounts (IMAs) and separately managed accounts (SMAs) enable clients to access direct international and domestic equity portfolios with greater control and transparency. However, the differences between and benefits of IMAs and SMAs are perhaps not well understood.

First, it is important to know the differences and benefits between an IMA, an SMA, managed funds and other investment structures.

> An IMA is a service—each investor's portfolio is individual and tailored to their requirements.

Further, it is a discretionary management agreement whereby clients delegate the day-to-day investment decisions and implementation of their chosen investment strategy to a portfolio manager while retaining the full beneficial ownership of their investments. As mentioned, portfolios are bespoke and tailored to meet each client's investment requirements, taking into consideration their individual preferences, taxation circumstances and investment objectives.

A client can transfer an existing portfolio 'in specie' [that is, in its current form] without triggering any tax consequences. These holdings will be incorporated into the client's individual portfolio and professionally managed.

An IMA may be described as 'bespoke' or 'tailored to each client', but what exactly does that mean? How does a portfolio manager put together an IMA?

Constructing an IMA

The construction of an IMA is a highly personalised service. The portfolio manager will initially meet with the client to discuss their investment objectives, then, in consultation with the client's adviser(s), agree upon a core investment strategy (for instance, consideration of growth or income requirements, Australian and/or international equities mix) and their broader investment requirements.

The client discusses their taxation status, investment restrictions, environmental, social and governance considerations, and, if any existing holdings are to be included in the portfolio, via an in-specie transfer. The portfolio manager then builds a portfolio tailored to meet the client's investment objectives and requirements and actively manage it, going forward.

In addition to quarterly and annual reports, the portfolio manager meets with the client on a regular basis to discuss the portfolio and explain the reasons for any changes to it. In addition, the functionality exists for reporting to be made available online 24/7 via a secure portal.

IMA examples

The best way to describe how an IMA works, and is tailored to each client's requirements, is to give examples. These examples are based on practices and approaches used by Private Portfolio Managers (PPM).

Example 1
Client scenario
The client has an existing portfolio that has incurred large capital gains on securities that might have been held for some considerable time. Maybe they inherited some of the holdings, and, as such, there are significant capital gains tax consequences if the holdings are sold. In addition, the client is a senior employee of a listed company and has a large exposure to their employer security through an employee share scheme (ESS). The client may not want additional exposure through their portfolio or superannuation fund to that company.

IMA solution
The portfolio manager would construct an IMA portfolio to initially carve out both the ESS company exposure and those securities with large capital gains from the portfolio, and then over time actively manage the bespoke portfolio to give the client a more balanced and diversified portfolio overall.

Example 2
Client scenario
The client is paying a high personal tax rate and has equity investments both inside and outside their self-managed superannuation fund, for instance, in a family trust or in their personal name.

IMA solution
In consultation with the client's adviser(s), the portfolio manager may structure the IMA portfolio(s) so the family trust holds the securities that are expected to generate long-term capital gains, and the superannuation fund holds securities that are more likely to generate income (particularly franked).

As such, the trust might hold the majority of the US securities' component (as they often generate capital gain rather than income), and the superannuation fund might focus more on domestic securities, as they produce more income and maximise the benefit of franking in the superannuation fund—the object being to create for the client a well-diversified Australian and global equities portfolio with maximum efficiency from a taxation perspective.

These examples are for illustrative purposes only and each client's individual circumstances need to be taken into consideration in conjunction with the advice from the client and their investment advisers. However, they demonstrate the individually tailored nature of an IMA and the clear benefits to those clients in the scenarios described.

An SMA is a product—each investor gets the same portfolio

Under an SMA, a client invests in a model portfolio managed by a professional investment manager. All trading, administration and investment reporting is taken care of for the client by the platform administrator. The client's financial adviser will assist the client in determining whether an SMA is suitable to meet their investment requirements and which SMA or SMA models to select.

Think of an SMA like buying a quality suit off the rack. Every suit is the same, and few changes can be made. It is up to the investor to determine what is best.

There are clear benefits of an SMA for a client. An SMA provides access to a professional manager and its research capabilities with the benefits of direct share ownership. Unlike a managed fund, each client is able to see exactly what investments are in their portfolio. Tax events and transaction costs are not shared across clients, and the cost base of the client's investments will be the date of their investment in the model portfolio.

Further, a model portfolio is typically a high-conviction portfolio, with the total number of holdings in the model limited to 20–25 securities, whereas in a managed fund the number of securities is typically not specified and is often much greater.

Finally, as an SMA model is administered on a platform, the client does not need to manage the trading, corporate actions, or any administrative aspects of their portfolio. Clients receive online access to their model portfolio as well as regular reporting for taxation purposes. The client pays investment management and administration fees.

SMAs are suitable investment products for clients who want a direct investment portfolio without having to spend time selecting, managing and monitoring their portfolios, as both the investment management and administration are handled by professionals. International SMAs enable clients to have direct access to international equities without the complexities and costs of managing international trading, custody and currencies.

As an illustration, PPM's SMAs are structured under a managed investment scheme with the appropriate disclosure provided in a product disclosure statement by the platform provider. All compliance and administration is taken care of by the platform provider. Clients, in consultation with their financial adviser, can determine what model would best suit their investment requirements.

Benefits of IMAs and SMAs

The advantages of IMA and SMAs over other available investment structures are clear for clients. Table 1 on the next page details the key features of IMAs, SMAs and alterative investment structures. Direct ownership, transparency, cost and tax effectiveness are the core benefits IMAs and SMAs offer in relation to investment management solutions for clients. **FS**

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An IMA is a service—each investor's portfolio is individual and tailored to their requirements.

Hugh MacNally, Private Portfolio Managers (PPM)

Hugh is PPM's chairman and founder, responsible for management of portfolios and analysis of investment opportunities. Previously, he was the investment manager at Permanent Trustee Company, handling portfolios on behalf of estates, individuals and charities. Prior to that, Hugh was an analyst and later investment manager at APA Assurance. He is a Harvard Business School Owner/President Management program graduate.

The quote

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Table 1. Key features of SMAs and IMAs compared with other common investment structures

Feature	Managed funds	LICs	ETFs	SMAs	IMAs
Tax efficiency	Poor	Moderate	Good	Good	Excellent
Portability	None	None	None	Good	Excellent
Managed to a particular tax outcome	No	Sometimes	No	No	Yes
Transparency	Poor–moderate	Moderate	Good	Excellent	Excellent
Direct ownership	No	No	No	Yes	Yes
Embedded tax liability	Often	Often	Sometimes	No	No
Capital losses can be applied to:	Future gains within structure	Future gains within structure	Future gains within structure	Any current or future gains	Any current or future gains
Variety of investment options	Excellent	Good	Moderate	Moderate	Moderate
Portfolio construction	Manager's discretion	Manager's discretion	Manager's discretion	Model portfolio	Manager's discretion
Tailored management	No	No	No	No	Yes
Management fee tax deductibility	No	No	No	No	Yes

Source: PPM