



Making comparisons across managed accounts

Why regulatory guidance is required

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Managed accounts or portfolios continue to grow in popularity among advisers. The technology offered by leading platforms enables transparency and, more importantly, portfolio personalisation at a scale not previously thought possible. Increasingly, it is recognised that some form of personalisation is key to delivering quality outcomes in retirement. So, if managed accounts hold the key to portfolio personalisation, let's take a look at some of the challenges advisers might face when trying to make meaningful comparisons across performance returns and fees.

Before we dive into the challenges, why is meaningful comparison and measurement important in this space? The Australian Prudential Regulation Authority (APRA) Choice Heatmap and MySuper Heatmap have brought into focus that the regulator expects trustees to be accountable for long-term net returns delivered for a particular risk profile and that fees should be scrutinised. So, advisers must oversee the net return outcomes of clients' portfolios and also monitor whether there are better value products available. Both are central to discharging their fiduciary duty. To do that, confidently comparing a client portfolio with an appropriate reference benchmark and comparing fees and costs is required. But is this easier said than done?

Different comparison points for managed accounts

Undoubtedly, personalisation can make comparison tricky. An individual's starting point and ongoing investment decisions affect return outcomes regardless of whether you are invested in a managed portfolio or a managed fund. But in a managed account, the platform's trading and rebalancing rules, the client's portfolio size, and their individual preferences, by way of exclusions, can also affect performance outcomes. How best to compare? There are a few levels of performance comparison worth considering:

- The investment manager's 'model' portfolio returns
- The platform's 'shadow' portfolio returns
- The client's actual portfolio returns

What is the difference between these three sets of performance returns?

First, let's simplify the issue of cash flows. Both the investment manager's model portfolio returns and the platform's shadow portfolio returns do not take into account cash flows, with the exception of dividends or distributions, which are generally assumed to be reinvested. Performance returns published are typically time-weighted returns, which is consistent with the approach taken for managed funds. We know that the differences between time-weighted returns and money-weighted returns can be material, but that is a separate paper.

The client's actual portfolio returns may be reported as time-

weighted, money-weighted, or both—this comes down to the platform's reporting functionality. So, the key differences between returns are the trading and rebalancing assumptions, the fees deducted between the three levels, and the application of rebates.

Trading and rebalancing: The investment manager

The investment manager's model portfolio is a 'paper' portfolio. The investment manager may rebalance at set intervals—for example, monthly or quarterly. They may also make changes to their portfolio and instruct the platform periodically. Some investment managers calculate their model portfolio performance simply by taking the model portfolio weight at the end of the month and multiplying it by the monthly return of the asset, effectively ignoring any intra-month trading. Other investment managers do not clearly disclose their performance return calculation methodology.

Key takeaway: Understand the trading and rebalancing assumptions that underpin the investment manager's model portfolio returns.

Trading and rebalancing: The platform

The platform's shadow portfolio returns are based on a hypothetical portfolio. Assumptions vary from platform to platform, but let's take a look at an example. Morningstar selected a platform that has a shadow portfolio which assumes a notional \$10 million portfolio. This shadow portfolio acts as a client proxy for performance reporting. The platform's trading rules balance the desire to minimise transaction costs with the desire to keep the portfolio within asset-class range limits and individual asset-weight limits. For example, on the platform selected, whenever a rebalance is triggered, minimum transaction sizes are applied to prevent very small trades from occurring, as shown in Figure 1.

Figure 1. Platform's client portfolio minimum transaction sizes

Platform stores different rules for different trigger events. The higher of the following will apply:

- ◆ 0.05% or \$10 for applications, increase, partial redemption, drawdown, ad hoc individual or portfolio rebalance
- ◆ 0.20% or \$50 for system scan or portfolio edits

Source: Morningstar, based on platform surveyed data.

In the managed fund world, part of the investment manager's job is to optimise trading for investors. Many investment managers finesse trades, tracking errors, and associated costs to the basis point. In the managed account world, this responsibility has shifted to the platform. And owing to the personalised nature of managed portfolios, there is a need for systematic rebalancing rules to apply.

There is no doubt that the speed and efficiency with which portfolios can be rebalanced through managed accounts is far superior to the 'old days' of records of advice being sent individually to clients or rebalancing only occurring as part of the annual review. But it is a less-optimised approach to how an investment manager can trade in a fund.

Key takeaway: Look at the trading and rebalancing rules across platforms. If charges are incurred for each transaction, a higher number of transactions will result in higher fees. This should be weighed against higher potential tracking error.

Assess the shadow portfolio returns of your investment manager's portfolios. The return results will typically differ owing to different rebalancing approaches and fees (which we will explore later). Refer to Figure 2.

Figure 2. Investment manager's model portfolio returns versus platform's shadow portfolio returns

	1 year %	3 years % (p.a.)	5 years % (p.a.)
iShares Enhanced Strategic Growth Model – Investment Manager Model	12.9	6.7	5.2
iShares Enhanced Strategic Growth SMA – Platform Shadow Portfolio	12.5	6.3	4.8

Source: Morningstar Direct. Data as of Sept 30, 2023. Please note, that the iShares Enhanced Strategic Growth Model and Portfolio have been used for illustrative purposes only.

Trading and rebalancing: The investor

A \$10 million portfolio may not be representative of the average account balance, so the trades and transaction costs associated with the platform's shadow portfolio will likely differ from those of the investor's actual experience. Due diligence on the platform's trading rules for small clients, in particular, is critical. Investment returns for a \$50,000 portfolio will likely deviate from the platform's shadow portfolio. It is also important to recognise the return impact of clients with more bespoke portfolios—for example, exclusions the investor has elected or if an underlying fund in the portfolio soft-closed and new money was not able to be invested.

Key takeaway: It is not enough to accept the platform's shadow portfolio returns—make sure it is clear as to why the client's actual returns are different.

The impact of fees and costs

Fees and costs affect return outcomes. It is important to know what fees and costs have been deducted from returns to make meaningful comparisons in the return outcomes of the investment manager's model portfolio, the platform's shadow portfolio, and the investor's portfolio.

The challenge with fees and costs in the managed account space is that the Australian Securities and Investments Commission's (ASIC's) Regulatory Guide



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The quote

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Figure 3. Fees and costs comparison for iShares Enhanced Strategic Growth Portfolio across platform A and platform B

iShares Enhanced Strategic Growth Portfolio	3 years % (p.a.)	5 years % (p.a.)
Management Fees and Costs - Total	0.45%	0.36%
Investment management fees and costs	0.19%	0.15%
Indirect or underlying investment management fees and costs	0.27%	0.21%
Performance Fees	0.00%	0.00%
Transaction and Operational Fees and Costs - Total	0.07%	0.15%
Transaction Fees		0.14%
Transaction costs (underlying investments)	0.07%	0.01%
Total	0.52%	0.51%
Cost of product based on a \$50,000 balance	\$262	\$255

Source: Platform A - Product Disclosure Statement Issued Nov 29, 2022. Platform B - Product Disclosure Statement Issued April 19, 2023. Please note, the iShares Enhanced Strategic Growth Portfolio has been used for illustrative purposes only.

97: Disclosing fees and costs in PDSs and periodic statements (RG97), stopped short of prescriptive fee and cost disclosures for platforms, let alone managed accounts, making comparisons tricky. In fact, the external expert's review of RG97 recommended that ASIC look at platforms separately. The following provides a rough checklist to reference when considering what may be included or excluded from a performance return for a managed account portfolio.

Platform administration fees and costs

Managed accounts are housed on platforms that charge administration fees. These fees and costs vary depending on numerous factors, from the size of the account to cash levels held, to family grouping benefits available. The platform administration fees and costs disclosed in product disclosure statements (PDSs) are seldom those incurred by advised clients given the preferential pricing deals negotiated between advice businesses and some platforms. No doubt, the majority of advisers are well-versed in the complexity of comparing fees and costs between platform offerings, and the topic warrants its own paper.

Management fees and costs

Investment manager's fees and costs

Investment management fees are typically fees paid to the portfolio manager for designing and advising on portfolios. Akin to a managed fund, this may also include fees and costs paid to the responsible entity, or RE.

Indirect costs or underlying investment management fees and costs

The underlying investments selected by the portfolio manager may be an unlisted fund or exchange-traded fund that also charges fees and costs. Expect indirect costs to be lower for direct equity portfolios.

- Cash returns and associated costs

Some platforms may charge costs for the cash held by a portfolio and disclose it as an indirect cost. It is worth

paying attention to the headline cash rate on a net basis, as platforms take different approaches here.

- Rebates

Watch also how rebates are treated. For example, if the portfolio manager has negotiated rebates on the underlying funds, are the fees and costs presented inclusive or exclusive of these rebate deals? Some platforms take them into account in the product disclosure statement, while others do not.

The processing of rebates by platforms has caused such angst in recent years that some investment managers now offer 'managed account' unit classes that represent the wholesale investment levels associated with the offer. This also helps to ensure that investors are treated equally across this investment type.

Transaction and operational fees and costs

Platforms can charge costs for trading listed securities (domestic and international), unlisted funds, or exchange-traded funds (ETFs). This is to cover costs including settlement and brokerage. Buy/sell spreads of underlying funds may also be disclosed in this section. Again, piecing together what is in and out is critical to effective comparison.

A key challenge in comparing here are the assumptions applied to the number of transactions for the portfolio—that is, the more transactions assumed, the higher the disclosed transaction costs. The transactions for the previous financial year may be used, but if you think back to financial year 2020/21 and the volatility in markets through the COVID-19 pandemic onset, it may not be representative of the transaction costs that investors might incur in the future.

Disclosure timing

The timing of disclosure is a relevant thread. Depending on when the platform updates its product disclosure statement, this may affect the comparability of fees and

costs. Again, it is worth digging into the details to make sure it is as near an apples-for-apples comparison as possible. Refer to Figure 3.

The wrap-up

Comparing performance and fees across managed accounts is easier said than done. It is challenging! The lack of consistency between platform approaches and disclosures makes it tough, notwithstanding the added complexity that personalisation brings. It is worth considering how fiduciary duties are being discharged in this burgeoning area of the market. It would be nice to think that the industry could solve this itself, but commercial imperatives make agreement challenging. It may be time for RG97 to be expanded to include some more guidance in this space. **FS**

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