Managed discretionary accounts in 2021

Head to head

This paper reproduces a Q&A session conducted by Assured Support between its managing director, Sean Graham, and Peter Turbach, partner at MDA Guru. It captures these two leading industry practitioners' respective views on the present state of managed discretionary accounts (MDAs).

Question 1: Are MDAs overhyped and overused?

Peter

No, not at all. Any hype is a reaction from a group gaining huge efficiencies for their practice which leads to lower costs for clients and advisers being able to make active portfolio changes when the time is right. This can lead to better investment performance and lower costs for clients. There are many practices that are yet to see the light.

Sean

A little bit. There is no doubt that using an MDA, or what I prefer to describe as a discretionary facility, can provide huge efficiencies to practices and simplify portfolio management; but not every client situation requires an MDA, and sometimes there are better options.

I think that discretionary facilities provide significant benefits to clients, licensees and advisers when they are used correctly, but too much of their promotion focuses on the significant benefits to the licensee/practice rather than on the real benefits they provide to clients.

They can also create, or maximise, a range of conflicts that often work to a client's detriment. I appreciate that some of our clients tackle this tension in a pragmatic and effective fashion by using the time they save on administration to build better engagement with their clients and provide more tailored, more considered personal advice.

I would not be able to call myself a lawyer if I did not offer you an entirely contradictory position at the same time; because of their experience with old-school platforms, advisers often fail to appreciate the real capabilities of MDA services and properly utilise their full capability. Thankfully, experts like Peter Turbach, [Mason Stevens' managing director] Tim Yule and [Institute of Managed Accounts Professionals' chair] Toby Potter are helping licensees and advisers uncover the hidden value of these facilities.

Question 2: What are the key things to know before using an MDA?

Sean

The first thing to know is that an MDA is not a product like a savings account, but is in fact, an arrangement or a facility that allows portfolio assets to be actively managed at the discretion of the MDA provider, subject to limitations and the terms of the agreement.

It is a broad concept that encompasses separately managed accounts, individually managed accounts, managed discretionary portfolio services and investment advisory programs. ASIC [the Australian Securities and Investments Commission] treats it as a financial product, but they recognise it involves a range of functions including advice, custody and trading.

It is important to understand the type of facility/arrangement you will be using, its capabilities and the role and obligations you will be assuming: are you going to be the MDA provider, an external MDA adviser, an external MDA custodian?

You also need to consider, at some point, whether you are appropriately authorised to either provide an MDA, for which you must check your AFSL [Australian financial services licence] conditions, or provide an MDA on a regulated platform.

If you are an adviser, check your authorised representative agreement, and licensee's policies, to ensure that you can provide an MDA or even contract with a provider. Initially, there is even more regulatory documents involved with an MDA than with other retail advice, so you need to know what documents you will need to develop and what documents, such as your Financial Services Guide, need to be amended.

Given the level of attention MDAs receive, you should anticipate that your licensee, or the MDA provider, may mandate that your MDA advice and particularly the initial recommendation is reviewed or pre-vetted prior to presentation. Although ASIC suspended its MDA project [based on the regulator contacting MDA providers regarding better regulation practices] in 2020 due to COVID, in all likelihood it will continue to closely monitor this space.

Once you have got the fundamentals nailed, you need to have a firm idea as to whom you will offer the facility, at what cost and you will manage this advice process. MDA facilities can be cheaper than retail equivalents, but you will also need to understand that active management and frequent trading can increase costs and create other complications for you and your client.

Peter

Communicating to your client is going to change. In the past, you would spend a lot of time during reviews explaining investment changes that are about to happen and why. Now, time can be better spent reinforcing client goals and/or strategic planning. Ongoing economic updates and portfolio changes can be communicated broadly to clients monthly between client reviews.

Question 3: What are the key things to learn once you start?

Peter

MDAs are not for every client. Breaking down your client value proposition into a few different service categories is key to managing operations efficiently and hitting the right price points for your fees. Clients that require a lot of contact and individualised portfolio management should be paying more for their adviser's time.

Sean

Peter's right on point.

It is critical that you are clear on the value proposition and that you have clearly identified the clients for whom this may be an appropriate solution. I would also suggest that you ensure your clients benefit from the efficiencies the MDA provides in terms of effective portfolio management, but are they getting any advantages from the time you are saving? If you are contacting them less, but charging them the same, whose interests are you prioritising?

If you want a follow up issue, remember to check that the arrangement remains appropriate. Appreciate that you have a formal responsibility to do that annually, but please do not treat that responsibility as a 'tick-box' process.

Your client is trusting you to manage their portfolio without requiring their ongoing oversight, so do not lose sight of the value, and fragility, of that level of trust.

Question 4: What are the key things to practice on an ongoing basis?

Sean

At the risk of being seen to pimp FASEA [the Financial Adviser Standards and Ethics Authority], do not forget to practise client care and assiduously look out for conflicts and consequences and implications that might impact your clients.

Keep an eye on the fundamentals such as advice process, efficiencies, costs and appropriateness and make sure that you are regularly checking that the MDA is delivering on its promise to your clients and providing real benefits.

Peter

[That is,] making sure the investments and their weights align with the client's investment program [and] making sure the client's investment program aligns with their risk tolerance and goals.

Question 5: What are the main lessons to be learnt from your MDA experience?

Peter

This brings us back to above, breaking down your client value propositions to refine your operations. When to use a model portfolio approach versus an individually man-

The quote

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aged account (IMA). There is room for both in a practice, and both can filter down from the advisory's investment committee.

A well-managed practice can utilise both MDAs with IMAs and model portfolios. This provides a good opportunity to revitalise your Financial Service Guide (FSG). I see many FSGs full of just boring disclosure which does not shout out your great services. Take this opportunity to market your practice and break down your services into categories that align with your costs and time. A good FSG goes a long way in helping clients to make an informed decision, which is paramount to acting in the client's best interest.

Sean

Peter is a responsible manager for a number of MDA businesses, and has helped many more implement MDAs, so he has a solid understanding of the opportunities and the risks.

I am positively disposed to MDAs, and I think that competent and capable advisers can use them to provide significant benefits to their clients, but I think they can be mis-sold, misrepresented and misused.

In addition to advisers recommending MDAs to clients who do not need them and who would not, in relative terms, benefit from them, they often conceal inherent conflicts. I am not suggesting that every recommendation is inappropriate, most are not, but we have seen arrangements that principally seem designed to maintain the profitability of the licensee.

Do not default to the MDA and take care to make sure the recommendation is, and remains, appropriate.

Question 6: What do you see as the key MDA risks?

Peter

With larger dealer groups, making sure advisers maintain ongoing suitability of the client's investment program. This is the key weak spot when you compare an MDA to a separately managed account (SMA). With an SMA, which operates like a managed account, an adviser only needs to recommend the suitability once at the point of purchase.

However, with an MDA this needs to be done at least annually. The advantage of an MDA compared to an SMA is that an MDA is more flexible and can be tailored to individual client needs.

Once you issue an MDA, you have crossed the line between advice and product. An MDA is a managed investment scheme by ASIC definition, however, with relief from providing a Product Disclosure Statement or involving a Responsible Entity. This means that AFSLs [licensees] need to be aware of any possible conflicts of interest and avoiding conflicted remuneration.

Sean

Although ASIC suspended its MDA project in 2020 due to COVID, it will likely continue to closely monitor this space. MDA facilities can be cheaper than retail equivalents, but you will also need to understand that active management and frequent trading can increase costs and create other complications for you and your client.

It is this conflict issue of client priority that I see as a bigger risk than inappropriate advice.**FS**