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Absolute discretion

'There must be a better way forward' has long been the cry of IFAs, discretionary fund management offers an alternative

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Key points

- How to better manage clients' assets was the topic of conversation being had in adviser firms around the country
- Using a third party investment expert means the IFA firm is not holding the risk on its books, a fact that pleases professional indemnity insurers
- There are three elements to consider when selecting a fund manager: their performance track record; their charges; and their ethos in delivering their services

There can be very few IFAs reading this article who in the height of the credit crisis in September and October 2008, when clients were seeing their wealth drop dramatically almost on a daily basis, did not look at their client portfolios and wonder if there was not a better way of doing things.

That period of time was a real eye opener for many IFAs in respect of the level of service they could provide in terms of managing their clients' assets and just where their strengths and weaknesses actually lay.

It was a real eye opener for clients too. They believed their IFAs would be constantly monitoring their investments – which, of course, was simply not possible with all clients – and would swiftly make changes to avoid trouble, which again was not the case, as the FSA rules restrict advisers and at that crucial time, saw them almost powerless to prevent their clients losing money.

Not surprisingly, how to better manage clients' assets was the topic of conversation being had in adviser firms around the country. In particular, how to make changes to their clients' investments quickly and across all relevant portfolios and, given all these issues, as IFAs were they best suited to make the key investment decisions?

One IFA firm decided to outsource the fund management to authorised experts who could make those instant decisions to switch in or out of funds or sectors, or move to safety in cash, and, at the same time, freeing up the IFAs time both to see clients and better support the advice process.

We know others have had similar thoughts and also have gone down this route because outsourcing of client investments to a discretionary fund manager delivers a number of benefits to the IFA business.

Markets

First, is the simple fact that fund managers concentrate on doing just that, managing funds. Accordingly, they are far more immersed in the markets and ensuring their investments perform well than an IFA could ever be, given that the IFA has to deal with clients and in many cases, run a business at the same time.

In fact this is one of the first benefits that accrues from outsourcing, the ability of individual IFAs to dedicate more time to working with their clients, identifying business opportunities and doing what they do best, building long-term relationships that will see the business continue to be successful in future years.

Similar efficiencies can be gained by the back office or administrative staff, who no longer have to undertake large amounts of investment research.

Business processes are streamlined and the operation of an IFA firm becomes more efficient and, even better, far more client orientated.

Furthermore, outsourcing takes the risk out of the IFA business. Using a third party investment expert means the IFA firm is not holding the risk on its books, a fact that pleases professional indemnity insurers.

An effective way of outsourcing is through the creation of model portfolios. These can be designed to meet a range of attitudes to risk, from cash-only through to the highly aggressive risk taker, although examination of a typical client bank is likely to show that few clients would consider themselves at either extreme of the scale.

The benefit for the client is that they are getting a discretionary investment service, without meeting a high minimum investment amount. Pooling the assets of a range of clients gives the fund manager the incentive to take on the business and to provide a more favourable charging structure.

Assessing the client's attitude to risk is essential. One way to go about this is to have the client undertake a behavioural finance risk assessment.

This can take into account what assets the client has available, what they want to achieve and in what time scale, whether those goals and aspirations are achievable in the respective time frames, and how much the client is willing to take risk in attaining those goals. From this the IFA can select the model portfolio best suited to the client.

Model portfolios also mean the IFA does not have to spend time asset allocating for individual clients, nor in selecting funds. The portfolios deliver the risk profile most suitable for the individual client and are balanced automatically by the fund manager on a regular basis to keep up-to-date with market movements.

Clients can receive fund fact sheets at regular intervals and when major changes are made to the portfolio.

Having decided on the investment proposition and the parameters to be applied, selection of the portfolio manager is, of course, paramount. Discretionary fund managers are cottoning-on to the fact that working with IFAs on pooled portfolios can bring in decent assets under management, particularly in current climes where asset values and, consequently, fund-based revenues are down.

There are three elements to consider when selecting a fund manager: their performance track record; their charges; and their ethos in delivering discretionary fund management services – in a working relationship it pays to be able to agree on issues and targets from the beginning and simply to get along with the managers running the money.

Next is the administration platform, the engine underlying the whole process. This has to be able to ensure when the fund manager rebalances the portfolios that those changes are reflected not just across all the portfolios but in the account of every client invested in those portfolios. It also needs an efficient client portal which will give easy access for clients to view the performance of their chosen portfolio(s) and their current wealth.

Having made the decision on the fund manager and the administration platform, the next step is to ensure all staff and advisers in the firm buy into the idea. Ideally, this is done after the first decision meetings as staff can bring considerable knowledge to the table and educating everyone on the concept greatly smoothes and accelerates the process.

Portfolio

This then just leaves selling the idea to clients. Perhaps not surprisingly, the idea of having their money run by a professional investment manager with input from their IFA, that changes to their portfolio can be made at the touch of a button, and it is all delivered at a reduced rate on a full

discretionary service, are concepts that clients quickly buy into. Ensuring the portfolio service operates an attractive total expense ratio is essential as clients want to know they are receiving value for money.

Taking the decision to work with a discretionary fund manager is not for every IFA firm. It is necessary to be able to bring decent assets under management to the table both to get them interested and to achieve acceptable levels of total expense ratio for clients, you should be looking to deliver in the region of £50m to £200m in assets.

Neither is discretionary fund management a panacea to running an investment IFA business, but it does recognise that in a highly regulated market IFAs need to prioritise just where they can add value for clients and where time, resources and skills, as well as regulatory restrictions, mean to truly manage investments on behalf of their clients those assets are better placed in the hands of the experts.