

Managed Funds - Master Trusts - WRAP Accounts –Wholesale Funds What do all these terms mean?

By Michael Lannon

With the New Year in full swing maybe its time you took a moment to update yourself on the types of investment products available to Australian investors.. If you are like most investors you are constantly confronted with a range of terms and acronyms for investment products that can be confusing or downright baffling. I am not sure if this is intentional or simply a result of an industry that creates new terms that are directed at investment advisers rather than the investors themselves.

In this article I will attempt to explain a bit of history of managed funds in Australia and explain the different types of investment products currently available. In most cases the products discussed are available for personal investment or for superannuation. My goal for this article is to help you differentiate between types of investment products and to educate you as to how to invest in the most cost effective manner.

Australian funds management history

In the late 80's and into the 90's the managed fund industry was dominated by brands such as AMP, BT, Colonial, Mercantile Mutual (now ING), Perpetual, National Mutual (now AXA) and the various bank brands. These large organisations dominated and marketed investment products that were largely in-house brands that covered the various asset classes as follows:

- Australian Shares
- International Shares
- Property
- Fixed Interest (Australian and International)
- Cash

as well as diversified funds or various combinations of the above asset classes. i.e.

- Income funds or Conservative funds
- Balanced funds and
- Growth funds

During this time the manufacturers (Banks and Insurance companies) utilised independent distributors such as financial planners and life insurance agents to sell their products. The products were referred to as managed funds and covered personal investment and superannuation. Entry fees of 5% were common and fund companies made good profits charging annual management fees in the vicinity of 2.0%-2.5% p.a.

In 1985 an entrepreneurial group looked at the market and realised that the marketing power was controlled by the distributors; the financial planners. Since the distributors had the power it seemed logical that they should be entitled to a larger share of the annual profits and not just sales commissions. The ASGARD master trust was launched to provide financial planners with a simple one stop shop for managed funds. Twenty years on ASGARD currently has over \$23 billion under administration.

The ASGARD master trust simply pooled the investments of individual investors and by aggregation they negotiated institutional or wholesale rates for fund management. The creation of master trusts had the effect of moving the large profits from the Manufacturers (fund companies) to the Distributors (financial planning groups). Throughout the 1990's master trusts were a new and growing phenomenon but most fund managers focused on selling their own retail funds to investors. BT sold BT funds, AMP sold AMP funds and so on. The mix of products sold by these companies today has been dramatically altered.

In the late 1990's and early part of this century the original manufacturers started realising the importance of distribution and realised that their profit margins were being eroded by distributors. As a result many of the largest fund companies began buying financial planning groups in order to have a

captive sales force. Subsequently the even larger banks bought the fund companies. Commonwealth Bank bought Colonial which included Prudential, Legal and General and Colonial First State. National Australia Bank bought MLC; St. George bought ASGARD and Westpac bought BT Funds Management.

The net result of this was that today over 70% of financial planners are owned by large institutions and the industry has been consolidated into a handful of major players that control manufacturing and distribution.

How does the fund management industry differ today from 10 years ago?

There are two key differences in the Australian funds industry today.

1. Fund companies now sell each others investment products and make profits from the administration side of the funds management business.
2. A number of new boutique fund companies have emerged that were founded by the talented managers that were once employees of the big fund company brands.

In the past fund managers sold mainly their own branded investment funds and competed with each other on their brand name. Most investors were familiar and comfortable with brands such as AMP, BT, and Colonial First State etc. Nowadays many fund companies have added the investment funds of their competitors to their offerings. Some have launched new master trusts along side their existing in-house funds while other have expanded their list of investment options. The following examples illustrate this point.

- Colonial markets the *Colonial First State Managed Funds* and the *Colonial First State FirstChoice Master Trust*
- Perpetual markets the *Perpetual Investor investment solution*-manager product
- ING has merged their in-house retail funds into a single master trust called *ING OneAnswer*
- Companies like BT and AMP have expanded their investment offerings to include between 50-70 investment options comprised of in-house funds and external fund managers. AMP and BT also have WRAP account offerings.

The second key difference in the Australian market is that in the past the individual funds managers were not part of the branding exercise. Unlike other parts of the world where individual talented fund managers were considered to be the key to a funds success the Australian fund companies managed to downplay the role of individual “**Investment Management Stars**” and sell the concept of a fund management team.

As the industry matured individual fund manager “Stars” became recognised for their investment expertise and the distributors were very aware of who these stars were. In the US Peter Lynch was a famous fund manager for his role with the Fidelity Magellan Fund. George Soros gained fame for his role in shorting the British pound. On a local level Kerr Nielson (founded of Platinum Asset Management) was recognised as a key factor in BT’s success during the 1987 crash.

In recent years a number of fund managers have left large organisations to form boutique fund managements operations. Peter Morgan, founder of 452 Capital, was formerly employed by Perpetual Funds Management. Other boutiques like Investors Mutual, NavraInvest, PM Capital, and Smallco have emerged founded by former employees of large fund management organisation. Those of you that read the financial press will be aware that Consolidated Press Holdings has backed a number of boutique fund managers in recent years. Many of these boutique fund managers are only available on a wholesale basis and can only be accessed by investors with large amounts to invest or via investor platforms such as master trusts and WRAP accounts.

What is the difference between a master trust and a WRAP account?

The Oxford dictionary of Australian investment terms defines a master trust and a WRAP account as follows:

Master Trust

An investment vehicle that enables individual investors or superannuation funds to channel money into

one or more underlying investments—most commonly wholesale pooled funds operated by professional investment managers. Master trusts usually allow access to a selection of fund managers and investment markets while consolidating investments into the one fund. Master trusts can generally be categorised into two distinct types: (a) discretionary funds, where the individual investor selects the underlying investment product(s) and fund managers from a list drawn up by the master trust manager or promoter; or (b) fund of funds, where the investor selects a general risk profile, for example, growth or capital stable, but the master trust manager or promoter selects the underlying investments from among a range of products managed by one or more managers.

Wrap Accounts

Wrap accounts are a recent phenomenon that have quickly gained momentum. Wrap accounts are similar to master trusts, except that they act as a custodial service with investments in assets made under an individual's name. Wrap accounts consolidate various investments under one administrative umbrella. These investments may be in either managed funds or direct investments. The name 'wrap' is drawn from the fact that the administration 'wraps around' a portfolio of investments.

What is the difference between wholesale and retail funds and institutional funds?

Traditionally a retail fund is a fund that is available to individual investors with initial minimum investments as low as \$1500 - \$5000 and subsequent investments as little as \$100. Typically a retail investment fund has annual management fees of 1.7%-2.5% p.a.

Wholesale funds or mezzanine funds were established to target investors with amounts over \$100,000 to invest. Those investors were entitled to lower fees (averaging 0.80% -0.90% p.a.) as larger balances were more profitable. It was the creation of wholesale funds that really allowed the development of the master trust and subsequently WRAP accounts. In recent years the minimums for wholesale funds have been lowered to as little as \$25,000.

Institutional funds are funds that target investment mandates such as superannuation funds and wealthy private investors with minimums of \$5,000,000 plus. Until recently these funds were not accessible by individual investors but now some are available via investment platforms like WRAP accounts

What is the main difference between a master trust and a WRAP account?

The key difference between master trusts and WRAP accounts is the portability of the underlying investments and the taxation treatment of the underlying assets.

In many master trusts the underlying (investment options) wholesale funds are specific to that master trust. This means that you have to sell the underlying investments in one master trust to invest in another master trust. If you owned funds in the Colonial First State FirstChoice Master Trust you could not transfer them to similar funds in the Perpetual WealthFocus product. Instead you would have to sell the underlying investments in one product and repurchase them in the other product resulting in capital gains tax.

In most cases investment WRAP accounts are a custodial service so investors that own Perpetual Wholesale Industrial Share Fund in one WRAP account could "in specie" transfer to another WRAP account or custodial service without triggering a change of ownership or capital gains tax. It is important to note that in the case of superannuation WRAP accounts the assets are owned by the Trustee of the super fund and as such cannot be transferred "in specie". Changing from one superannuation WRAP account to another results in a change of the Trustee and hence a sale of the underlying investments with the corresponding 10% capital gains tax applicable to super funds. Hopefully the government will pass legislation to remove this inefficiency and allow portability between account providers.

What companies are the main providers of WRAP account Services?

The previously mentioned consolidation in the investment industry in Australia is a result of increasing downward pressures on management fees and the need to create more and more economies of scale. The cost of creating a profitable WRAP account or portfolio administration platform is substantial and a

successful platform requires a large volume of funds in order to be economically viable. As a result the WRAP account market is dominated by four major providers.

These are **ASGARD eWRAP**, **BT Portfolio Services**, **Macquarie WRAP** and the most recent entrant **Oasis Asset Management**. Asgard has over \$23 billion in funds under administration and on the other end of the scale Oasis has approximately \$4 billion in funds under administration.

Each of these providers (manufacturers) has created several badged version of their WRAP account. **BT Portfolio Services** has several badged version with **Zurich** and **Count** using the BT portfolio administration service. **Macquarie** also has a number of adviser groups using the Macquarie Wrap account. In fact ING recently outsourced the administration of its Wrap account to Macquarie.

ASGARD has a number of badged versions of its eWRAP account with the AMP owned Hillross Financial Planning using **Portfolio Care – The Investment Service** and the Australian Independently Owned Financial Planners using a badged version called **Personal Choice eWRAP**.

Over the past year a number of older style master trusts have been revamped to allow access to direct shares and are now effectively WRAP accounts. These include **IOOF Max Portfolio Service** and the **Navigator Personal Investment Plan**.

What are the advantages and disadvantages of WRAP accounts?

The Australian Securities and Investments Commission defines a WRAP account or portfolio administration service as an IDPS or Investor Directed Portfolio Service. The irony of this government definition is that until recently investors could only access WRAP accounts via a financial planner and as a result incurred the often unnecessary fees such as sales commissions and exorbitant annual adviser service fees. In my opinion the main disadvantage of WRAP accounts has been the mandatory requirement to use an adviser in order to access these portfolio administration services. Those of you that are my regular readers will know my mantra:

“Pay a professional hourly fee for advice and execute your own investment transaction through a discounter.”

In the late 1990's when 2020 DIRECTINVEST was a pioneer in giving investors direct access to managed funds with a 100% rebate of entry fees the financial planning industry was upset that we were levelling the playing field in favour of investors. The refusal by the manufacturers (Wrap account providers) to allow direct access to WRAP accounts is an example of protecting the distributors at the expense of the customers.

I am pleased to announce that now investors can access the **Personal Choice eWRAP** and **Personal Choice Super eWRAP** with the option of using an adviser. This empowers the investors to take advantage of WRAP accounts without incurring fees for unnecessary or unwanted advice and the ability to pay for financial advice on an as needed basis. **Instead of being “Wrapped up in Fees” you can be “Rapt about WRAP accounts.”**

WRAP account can provide significant advantages to investors wishing to simplify their investments and their administration. Some of the advantages of wraps account are:

The convenience of all your investments in one place. Investment platforms can combine your managed funds, other investments and even margin loans or shares into one package, which you can often access over the internet. Those of you who run your own DIY super funds are familiar with the complexity of administering investment portfolios.

Consolidated reporting. This is very useful around tax-time — you'll get one report and statement for tax purposes and you may also receive regular reporting updates. Tax reports can help you save substantially on your annual accounting fees.

Greater diversification and choice. You can spread your risk among different asset classes and a much wider range of fund managers than would otherwise be possible for most investors. Many wrap accounts allow investors access to over 300 funds and the any ASX listed share.

Wholesale funds. Some 'boutique' and wholesale fund managers aren't available to retail investors and can require starting amounts of anywhere from \$500,000 to \$100 million. Wraps and master trusts can pool your money with thousands of other small investors to access these wholesale funds, which generally have lower management fees than retail funds. In fact some WRAP accounts negotiate lower wholesale fees and pass along the savings to investors.

With approximately 80% of all new investments going into some sort of Master Trust of Wrap account it is highly likely that you are affected by these products. Hopefully this article has helped you to understand some of the key facts about master trusts and WRAP accounts.

Next month I will prepare a fee analysis of the most popular WRAP accounts and highlight some of the traps and pitfalls that you can avoid when investing.

If you have an investment question or a topic you would like to see covered in this column please email me on mlannon@2020DIRECTINVEST.com.au

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