



Compiled by  
Michael Lannon

# A beginner's guide to understanding separately managed accounts

**Welcome to a New Year!** I hope everyone had a happy and safe summer holiday. Although many resolutions have been made and some already ignored I would like to encourage you to resolve to take a greater interest in your investments and superannuation in 2007. Let's face it: 'It is your money and no one cares more about it than you'.

In my first article for the year, I'm going to provide some insight into separately managed accounts. Until recently, many financial advisers and investors would not have considered a separately managed account as a vehicle for investments. The bulk of information on separately managed accounts came from the USA where this type of investment has only been an option for high net worth individuals with access to minimum investment amounts of \$500,000.

However, in the last few years changes in technology have made separately managed accounts more affordable for the average investor, with minimum investment amounts as low as \$5,000. Furthermore, when considering the addition of blended portfolios and other features, the attractiveness of separately managed accounts to the Australian retail investor has significantly increased.

Separately managed accounts take managed funds to the next level. The investment is professionally managed like an individual portfolio with many key advantages:

- The securities in the account are visible and portable just as they would be if they had been purchased directly.
- The underlying shares are owned, not units in a fund.

As a result the investor can manage the tax position and – in most cases – dividends and franking credits.

Some separately managed accounts will also allow the investor to further customize their portfolio by prohibiting certain stock, substituting one stock for another or even freezing tax parcels to prevent the unwanted realisation of capital gains. That is certainly an advantage over an average managed fund.

In practice, however, your investment in a separately managed account is allocated across one or more existing investment models. These investment models have been provided by investment specialists and they vary in focus – in much the same way that managed funds vary in their risk and return objectives.

Within a separately managed account there may be models with different levels of risk and return each with a different emphasis. This is how separately managed accounts ensure that the diverse investment needs of all account holders are met.

The investment models in a separately managed account dictate the options available to the individual investor and will also determine how attractive a separately managed account is to that investor. Evaluate the models or options available within a separately managed account to determine whether it has the focus and flexibility required in investment goals. The design and choice of models for a portfolio would normally include three main steps:

- Models are created by investment professionals, researchers or fund managers and provided to dealer groups for use in the separately managed account.
- A range of models is selected by dealer groups to be included in their separately managed account.
- The investor or financial adviser select the model or models that best matches the investment strategy and allocates the appropriate weightings.

## "Separately managed accounts take managed funds to the next level."

A separately managed account service would normally be offered by a dealer group or a fund manager and be made available to you as a retail investor only through your financial adviser.

Separately managed account services have an entity in the background with custodial and administrative responsibility. Typically, the investor would apply for an account in a separately managed account, similar to applying for units in a managed fund. However, there are some key differences and advantages:

- As a separately managed account holder, *the investor owns the underlying stock in the separately managed account*

*portfolio*, i.e., beneficial ownership is retained. Securities can be viewed through a web-based application, simply by logging onto the internet with a username and password.

- A separately managed account portfolio can be invested across a number of models within the separately managed account or a single diversified model like the ASX Top 20 model.
- The investor can enter a separately managed account with cash or securities. If a portfolio of shares is owned in the investor's name, Capital Gains Tax (CGT) can be minimized by transferring stock (*in-specie*) directly into a separately managed account without realising any capital gain on the stock.

Fees vary widely across separately managed accounts and need to be checked closely for the given service. Generally, a separately managed account will have a fee structure that includes one or more of the following types of fees: administration; management; performance; adviser (unless you choose a direct option); and brokerage. Some fund managers may add transaction, custody and account maintenance charges that are higher for small investors than would normally be the case in a managed fund.

### "Fees vary widely... and need to be checked closely for the given service."

The costs of investing in a separately managed account may be slightly higher (depending on the service chosen) than direct trading, but there is a wide variation between separately managed accounts. For example, some separately managed accounts charge a fee to allow securities to be transferred directly (*in-specie*) into a separately managed account. Others may not allow the transfer of securities *in-specie*, which means selling current holdings (triggering a CGT event) and then purchasing stock to match the models being invested in.

The transparency, flexibility and tax advantages of separately managed accounts are making them very popular – and the market is already seeing a number on offer. However, like any class of investment product, separately managed accounts can vary significantly in the features they offer. Some important features do not come embedded automatically with these accounts and should be considered before making a decision whether to invest. Some critical features include:

- Blending – the name given to the way the holdings of an investor across a number of models are 'merged' after balancing so that they behave like a single portfolio. Not all separately managed accounts are blended. Those that do, offer two major benefits: firstly, holdings are displayed as a single portfolio no matter how many models are invested in; and secondly, blending ensures that full advantage can be taken of netting come trading time, which may provide brokerage cost savings.
- Reporting – separately managed accounts that offer online services mean that reports can be accessed as required including immediate confirmation of trades. Standard financial industry reporting periods are also met.
- Tax – it is likely that investing in a separately managed account may result in an increased number of tax parcels, and an increase in events that trigger CGT. This can make tax time significantly more complex unless the separately managed account is one that is able to report at tax parcel level directly to your accountant, thereby offering transparency and

optimising tax efficiencies. Independent tax advice should be obtained.

- Responsible entity – an experienced responsible entity provides a stable infrastructure for service provision in the complex financial market. Keep in mind that the greater the administrative capacity of the responsible entity, the greater the number of possible investors and the greater cost savings.
- Fees – vary widely from one separately managed account to another. Check the fee structure and rates before making a decision.

### SUMMARY

In summary, separately managed accounts are an evolution from the managed fund style of investments. They are sometimes referred to as 'managed funds on steroids'. A separately managed account can offer sophisticated investment models as well as a simple index solution tailored to meet specific investment requirements. The investor may have considerable leeway in how the investment is allocated across those models. However, regardless of allocation the portfolio has visibility right through to the share level and often investments can be customized further by prohibiting or substituting particular stock or freezing tax parcels. They offer tax advantages due to inbuilt features such as netting, which reduces the events that would trigger CGT, as well as potentially reducing transaction fees.

Additionally, a separately managed account provides flexibility as to how tax parcels are managed – allowing tax positions to be optimized. As with any type of investment, however, the investor needs to be aware of fees, costs and whether the separately managed account meets their individual investment needs.

As we begin 2007, let me take this opportunity to wish everyone a prosperous year ahead. This is our 10th year providing low cost investment services to members of professional associations and we are proud to have saved those members from paying several million dollars in unnecessary commissions to advisers. 2020 has always worked to empower investors with the tools necessary to research and execute their own investments, and we will continue to represent the interests of members by aggregating your buying power to bring you low cost innovative products and ideas. We are a staunch consumer advocate in this industry and firmly believe in the separation of products and advice.

Thank you for reading my column and for your support. We look forward to your feedback concerning separately managed accounts.

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