Unpacking model portfolios
Key considerations for investors

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For Financial Advisors and their Clients

Financial advisers face an array of challenges on a daily basis. Their responsibilities include a wide range of tasks from providing excellent client service, staying abreast of each client's affairs, running a practice, remaining compliant and keeping up with professional development. They also have to be aware of changes on an individual fund level and perform due diligence checks on every single manager and fund available. Consequently, more and more financial advisers are opting to make use of model portfolios when it comes to providing an investment solution for their clients. For this reason, model portfolios have grown substantially over the last couple of years.

Model portfolios enable financial advisers to save a lot of time when it comes to making investment decisions, greatly reduces their administrative burden and frees up time to focus on what they do best – providing holistic financial advice to their clients.

As with any partnership, a careful and considered approach should be taken when deciding what model portfolios to use, or what investment management firm to partner with and, equally important, what platform (LISP) to use.

One size does not fit all

The decision to partner with a firm to provide you with model portfolio solutions for your clients should not be taken lightly. It is imperative for financial advisers to understand that not all model portfolios and/or firms that provide model portfolios solutions are the same. While there are many benefits to reap from model portfolios there are key aspects that must be considered. Model portfolios, when compared to funds, have a great deal of complexity that is often not discussed.

Let's look at some of the key considerations you should keep in mind.

1) Which firm do you want to partner with?

The most important question to answer is what firm you are going to partner with when you are considering model portfolios for your clients. Important aspects to investigate is the firm's history, track record, investment capability, process, philosophy, independence and business longevity.

2) What fees are you paying?

Keeping fees as low as possible is essential. We would advise looking at fees holistically. An investment management firm constructing model portfolios often have the scale to negotiate cheaper fees on your behalf, making the model portfolios' Total Investment Cost (TIC) lower (including the additional investment management fee) than what you would have paid when not using model portfolios.

3) What additional benefits are you getting?

Make sure that you understand the added benefits that the investment management firm can offer you and what they cannot offer. Will they be able to provide additional reporting, commentary, factsheets, market information, research, etc.? What happens if they make changes to the model portfolio? Will you have access to additional technical support or systems that can enhance your financial planning practice?

4) What is the firm’s operational capability and capacity?

Operational support requires a great amount of responsibility, dedication and capability. When choosing model portfolios from a provider, ensure that you ask the right questions when it comes to their operational capacity and capability.

Operational support typically includes (but is not limited to) the following:

- **Owning the complex process of restructuring and rebalancing**. The operational team must make sure that an enormous amount of checks and balances are in place before and after every restructure/rebalance. From ensuring every instruction on every platform are executed at the same time, to monitoring manager flows and liquidity.
- **Reviewing platform reporting** every month to ensure that new restructures have been implemented for all accounts and check for any large drifts.
- **Monitoring model portfolios** to ensure that they are compliant with the mandate.
- Generate, review and distribute **snapshots, factsheets and other client reporting**.
- Compile **AUM (assets under management) data** for model portfolios and advisors every month.
- Assisting with monthly **invoicing processes**.
- Assisting with the **onboarding of advisers** to the selected models on various platforms.
- Complete **TIC calculations** for portfolios.
- Attending to **client queries** and **liaise with service providers**.

5) Which platform do you want to use model portfolios on?

Last, but not least, the financial adviser must decide which platform(s) he or she wants to utilize to list the model portfolios. Just as different investment management firms running model portfolios have different capabilities, platforms range widely in terms of functionality when it comes to model portfolios.

Before deciding what platform to use model portfolios on, the adviser must ensure that a thorough due diligence check is done on the various platforms to assess their respective functionality and capability.

Morningstar has put together a high-level due diligence questionnaire that advisers can use when deciding what platforms to partner with.

When performing due diligence on a platform, here are some key questions to ask:

- Can you accommodate model portfolios?
- Are you willing to work with a DFM and load funds for them?
- Do you have the functionality to accommodate a model portfolio and a fund in one contract?
- Do you have the functionality to accommodate two model portfolios in one contract?
- In which products can model portfolios be accommodated?
- In a living annuity, do you have the functionality to withdraw income from one underlying fund within the model portfolio?
- Do you have specific trading days in a month?
- Do you have the ability to split fees?
- Are you paid fees while transactions are in progress?
- What is your online capability?
- How does your team deal with operational issues and errors?

In conclusion

Model portfolios are a fantastic way to ensure you take your financial advisory practice to the next level by outsourcing the investment capability and some of the operational complexities that come with running an advice practice. Make sure that you choose the right investment managing partner to construct these model portfolios for you and ensure that you understand the functionality and capability of the platforms you are planning to use these model portfolios on.

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