# How to select a Managed Portfolio Service (MPS)

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### Introduction

> “Due diligence, or at least inadequate due diligence, underpins a lot of the incidents of crystallised risk we have seen….
> You can rely on third party providers for factual information but not for opinion…; you have to come to your own view…
>
> Rory Percival, FCA Technical Specialist - 30 September 2014”

And so, as we see more and more intermediaries outsource investment management to discretionary fund managers (DFMs), we see a need, according to Rory Percival, not only for good due diligence to be readily available, but for intermediaries to come to their own opinion as to which DFMs they should embrace and work with.

According to Defaqto, the 2015 forecasted advisers, use of DFM managed portfolio services (MPS) was £3.3 billion of new money - a growth rate of an impressive 25.9%.

With over 75 providers of MPS available, how do you begin to go about selecting the right ones for your clients? Most adviser firms will construct a small panel of DFMs typically consisting of somewhere from three to six. In my opinion, it is important that these providers complement each other, rather than replicate what they do, so at least there is a chance they will not all perform in a similar fashion when the markets go up, or importantly - as is currently the case - when they go down!

There are some excellent papers produced on the subject from various platforms, such as Nucleus, to research companies such as Defaqto, so there is no shortage of information and advice available, which should be the starting point for any adviser looking to outsource their investment requirements to a DFM offering an MPS.

From the perspective of a discretionary fund manager offering an MPS, I believe there are a number of important factors to consider, which are by no means exhaustive, but might at least be of assistance when starting out.

### The initial stage

First produce a long list of DFMs, somewhere in the order of 12-15 should do, that offer an MPS from which to begin your search. A simple ratings agency filter could help at this stage. A good starting point then is to request an up to date due diligence questionnaire (DDQ) from those companies that you believe have committed the time and, importantly, resource, behind their MPS resulting in an emphasis being placed on this side of their business by the management of the DFMs in question. Once you have reviewed the DDQs, the heavy lifting really begins.

### DFM providers

In my view, one of the most important considerations to have concerns the culture and management of the business you are researching. All too often this is over looked, but if you are effectively going to work with a DFM you should understand all there is about the background of the provider. How strong is the business and how well resourced are they? Do they have a reputable brand in the industry? Size is not everything, but it does give some comfort in an uncertain and volatile world; it demonstrates the ability of the management running the business and how it has performed during different economic cycles. There are many questions to be asked of the DFM before moving to the next stage, but once you are satisfied with the answers you receive you can then progress with more practical issues.

## Investment process

The investment process of a DFM can be a pretty dry subject, nevertheless, it is important to have a clear understanding of what it is and how it has evolved; after all, you may one day be required to explain it to clients.

Most important of all is that it has to be logical, simple to understand and easy to explain. Who is involved in the investment process? Does it rely upon one individual or is there a team approach? What resource is behind the process? If the MPS is actively managed, is there an asset allocation committee in place? Who provides the research behind the investments, is it internal, external or both? Again, there are plenty of questions to be asked, many of which can be sourced from various providers of research, but the answers need to come from the respective DFMs. Once you are happy with the investment process behind the DFM, you can move on and take a detailed look at the MPS on offer.

## The Managed Portfolio Service

When drawing up a (select) panel of MPSs consider, as mentioned earlier, how they might complement each other. For example, how many models are available from each provider and if they are mapped to a risk profile tool, such as Distribution Technology or Finametrica. Also, do they have different objectives? Some may be designed for capital growth whilst others for income. Are they actively managed? Perhaps a passive MPS would be useful to offer clients. Consider the experience and skill of the team managing the models and if they are fully resourced and of the highest calibre. Does the team apply the firm's asset allocation and investment process with rigour and are they committed to supporting the intermediary market? In my view, the team should reflect the emphasis the business is placing on intermediaries and the growth in the industry of outsourcing investment business to DFMs.

An imaginative and skilful team will wish to invest in open-ended and closed-ended funds as well as ETFs, blending these together to produce the best possible returns for advisers and clients alike. In addition, they may wish to invest in funds that hedge currencies, as we have chosen to do in the Japanese market during the past couple of years. Also, a number of very talented investment managers work for 'boutique' asset management companies and often their funds are not available to the wider market. A team with the necessary resource can uncover such opportunities and has the time to carry out the research in order to decide whether or not to invest in them.

Finally they should be accessible and capable of articulating their view on the markets and the models they manage to IFAs, both in individual meetings and at regional conferences and seminars.

## Access to the MPS

Having decided upon those DFM providers that you may wish to support, one very important factor to consider is how to access the relevant MPS? You will no doubt have carried out separate due diligence on the platform market, but it is worth remembering that not all MPSs are available on all platforms. For example, at Smith & Williamson we have chosen to include investment companies in our models to add to the performance we generate; however, a number of platforms simply cannot administer an MPS which includes investment companies. A clear understanding of what the platform can provide, and of course the costs of the platform, need to be taken into account before progressing further. It might be harder than you think to have a short list of MPS providers who are all accessible on the same platforms and this could ultimately affect your decision to select a particular MPS.

## Service and support

When considering the selected MPSs you should also consider the levels of support you can expect from the DFM. What is the quality of their literature like and what is their reporting like? How frequently will you be informed of changes that have been made to the models and how have they performed? Does the DFM provide market commentary that will prove helpful to you and your clients? Will they support you when markets are challenging? A regular flow of information is essential and will assist you and save valuable time when meeting clients. In addition, occasional seminars, conferences and support through organisations such as Asset TV can also add value, as this gives advisers the confidence they need not only in the DFM they are using, but importantly when they are reporting to clients.

## Fees

Finally, you need to consider the levels of fees and ultimately costs in investing in different MPSs. Many are very similar in amount with a charge of 0.3% + VAT not being uncommon. The OCF can vary depending upon the use of passive investments, which often bring down the costs. But at the end of the day a well thought out and constructed MPS, which delivers risk-adjusted performance for advisers, will result in happy clients. Those DFMs who fail to deliver performance will find that advisers will switch their clients to one of the alternative MPSs on their panel through the platform they have selected.

## Summary

In summary, there is plenty of independent help and research available for advisers. In addition, DFMs should be able to provide comprehensive DDQs which together with the former will be more than enough information to produce a short list of MPSs to consider. All that is required then is for a meeting with the relevant DFMs to complete the process. It's as simple as that!

## For more information, please contact:

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