

The recent entry into voluntary administration by van Eyk Research presents both challenges and opportunities for advisers and competitors, but the show will not only go on, it will evolve and get better.

SIMON HOYLE REPORTS.

In the late 1980s Estate Mortgage was virtually the only game in town for media covering the retail managed funds industry. The company, which promoted itself as being “just like a bank or a building society, but even better”, eventually collapsed in 1990, owing investors about \$600 million.

Leading the scrutiny of Estate Mortgage was a research house that identified what it believed were severe shortcomings in the structure and the management of the funds. That research house was a business that later became known as van Eyk Research, and its work on Estate Mortgage was its making.

In September this year, van Eyk Research entered voluntary administration. While the full details of how, and why, have yet to emerge, it's clear that a decision to diversify into the managed funds business, with its Blueprint funds, played a part.

Research businesses have to evolve to remain relevant – a roll-call of research organisations that have come and gone from the Australian market in recent memory includes FPI, 5Di, Assirt, IWL and Financial Facts, to name but five – and they need secure and robust revenue streams to fund what they do.

Van Eyk placed great store in the fact that it was paid by subscribers to its research, not by the fund managers whose products it reviewed. It moved to secure additional revenue streams from its research activities by using them to underpin a funds management business. But it seems to have run foul of a corporate structure

and corporate governance that wasn't up to the task – a lesson for all research houses, and for the advisers who depend on them.

The impact of van Eyk's predicament is difficult to gauge at this early point, but it is not expected to diminish competition in what is already a competitive space. And it is not expected to halt the evolution of research from “straight” fund ratings to implemented solutions – and beyond.

“If they do exit the industry, from a research and asset consulting perspective you may be taking one player out of the market, but then you may be creating an opportunity for someone already in the market, or potentially a new entrant altogether,” says Piers Bolger, head of research and strategy, advice and private banks, at BT Financial Group.

“The loss of van Eyk in terms of their research and asset consulting capabilities, will that be detrimental to the market long term? You don't know. It's too early to say, because you don't know how industry will evolve and what participants in terms of research will come into the market.”

Even if the circumstances this time are different, the closure of a research business isn't new.

David Wright, a director of Zenith Investment Partners, says competition in the Australian market has always been intense, and will remain that way.

“I don't think it's going to get any less,” Wright says.

It does make it difficult, or virtually impossible in a market the size of Australia's, to offer a purist model where it really is a user-pays approach

"Given the nature of the Australian market, the compulsory growth in superannuation, you see a lot of global managers coming to the Australian market because they see the pool of money. Equally, there will be new [research] players.

"It would be naïve of us and for the existing research players to think that there won't be new players emerging. And you've got the ex-van Eyk guys being a case in point. That might not be a pure research firm; they're seeking to offer part of what the incumbents are offering from the model portfolio and the advice perspective."

Wright says it is undoubtedly a positive thing for financial planners to have a choice of high-quality research providers. But that competition has some consequences for how research businesses are structured, and how research is funded.

"It does make it difficult, or virtually impossible in a market the size of Australia's, to offer a purist model where it really is a user-pays approach," Wright says.

"The advice community realises that there's no perfect model, but it appears at this stage that perhaps having an associated funds management business may not be the best model. I think that's just been a reminder."

But it's not impossible to operate a funds management – or "implemented consulting" – business alongside a research business, says Anthony Serhan, managing director of Morningstar's Asia-Pacific research strategy, as long as corporate governance is adequate.

"In 2009 we acquired a business called InTech, which had an implemented consulting capability – it's now branded Ibbotson," Serhan says.

"Running a funds management business is a very specialised activity, and one that you can't just grow into overnight. It does require stronger corporate governance to run it, because you are taking people's money on board, as opposed to just giving advice on what to do with it.

"That's one of the things that our business is very strong on; and when we look at the way we operate that, the separation of responsibilities is an important element of that. It doesn't mean the two parties can't talk, but it's a stand-alone business with a separate reporting line."

Serhan says there is still strong demand from clients for an implemented consulting service. But the trick to longevity in the research game, he says, is to offer a range of services and to be adaptable.

He says Morningstar "strongly agrees" that research should be funded by subscriptions from clients, not by fund managers.

"We support a subscriber-pays research model, as opposed to an issuer-pays research model," he says.

"Where we get some benefit as a business...is that we do research and we sell it into multiple segments. We sell it to financial planners; we have individuals who subscribe to it; and we have institutions that subscribe to it.

"If you took all the research that's being conducted in the market today and you said we want people to pay for it now...that is going to result

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in a much more competitive research environment, where the consumers of research are allocating the dollars to the research provider who best meets their needs. We think that is a better operating model for the industry.

"We're a long way from that, in terms of if you look at the way research is funded in the market.

"When I think about the research business of Morningstar, it is funded by subscribers paying for research. That's also one of the things that has made us successful over the past five years – the fact that we have to compete on what we're doing at a research level; we have to listen to what the people paying us for that research are doing; and importantly, we have to allocate what research resources we have to what we think are the products that we need to research.

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First, work out the spending needs

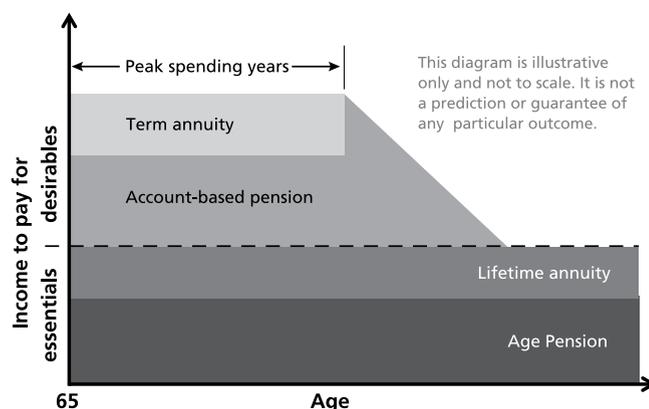
You can use Challenger's online tools to help clients assess their spending and forecast the income they'll need in retirement. Explain how their spending can be grouped into 'essentials', to cover the cost of living (things like food, clothing and electricity), and 'desirables', to cover holidays, entertainment and so on. Then they're ready to learn about layering.

Income layer 1: The Age Pension

The first step is to employ all available strategies to get the most from the Age Pension. These predictable payments may provide some inflation protection and last the life of an eligible pensioner. They will help pay for day-to-day essentials. However, the Age Pension alone is unlikely to cover everything. To help prevent the cost of essentials from becoming a worry, it's time to add an important layer.

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“So the incremental decision is not one of will we get paid to write this research report? The incremental decision is: are we serving the needs of our clients by conducting this research?”

David Wappett, head of ThreeSixty Research at MLC, says advisers are increasingly thinking less about just individual funds and stocks, and more about portfolio solutions. This means the way ThreeSixty conducts its research and communicates its findings to advisers is changing.

“We’re being asked more and more portfolio construction questions, rather than just yes or no, is this fund on the APL [approved product list] or not on the APL, or can I get another fund on the APL?” Wappett says.

“There’s a lot more focus on how do I use these funds when I put together a portfolio? That leads us to our model portfolios, and we’ve put in a lot of time and effort to try to explain the client needs and the client profiles that we’re building these portfolios for.

“There’s a lot of interest in that discussion and we’re trying to spend more of our time in that part of the market, because that’s where the conversation with us has gone.”

Wappett says that as the demands from advisers evolve, and research firms evolve to match, the skills required of the research professional are evolving to match.

“There’s a very technical element to the role, but there’s also an important customer-focused element to the role as well,” he says.

“We do look for a combination of people who are able to research fund managers and understand the process, but also things like portfolio construction and being able to take those insights and flip them around into, well what does it mean for portfolio construction for a client?

“And the third thing is a bit of an

understanding about the advice process, because we’re finding that more and more that’s becoming intertwined – things like limits that you might put on products’ risk assessments, accreditation – all of those things have become part of the broader advice framework, rather than just reviewing the fund and giving it a ‘good’ or a ‘bad’, a tick or a cross.

“In terms of the aspiration, they’re the kinds of people you’re targeting. They can be in other internal firms, or they can come from external firms like the Lonsecs and the Zeniths. The ones that we’ve recently [hired] have come from internal firms. It’s not necessarily been [us] targeting that, but one of the benefits is that often they do have a perspective of the advice process. I wouldn’t say it’s targeting that intentionally – it’s been a bit that it turns out that’s what we’ve got as well, and maybe there’s that internal bias, so when we see people we like that element – that they can talk about the next stage, which is about how that fund would be used in a portfolio, or be advised on.”

The way research is used by advisers will continue to change, says Morningstar’s Serhan.

“I don’t think it will become more commoditised,” he says.

“The pools of money are getting bigger – our industry is growing. One of the things we’ve experienced over the past five years is a growing number of firms that have in-house teams that we’re effectively providing a platform to and advising on. Those teams are important today and will become more important as we move one.

“[Advisers] are still going to need good-quality research to underpin what they do. Everyone is going to need a research report or some fact sheet or information on a security; it depends on everything else you can do on top of that to service them.

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However it evolves, Bolger says there will always be an “absolute need for organisations that provide quality research; and/or the need for groups such as ours to ensure it can be done internally”.

“The markets are very complicated; they are very dynamic,” he says.

“Products are very challenging. And you’ve got a regulatory environment that really requires what I would say are specialist skills. Some adviser groups have got that into their practices, but a lot of them don’t.”

Bolger says the work researchers do – whether they’re [an] external research house, inside a financial planning practice or housed within a licensee or dealer group – will always be the foundation on which financial planners build effective investment solutions for clients.

“If you think about the regulatory environment, your APL is actually your first line of defence,” Bolger says.

“It shouldn’t be seen as a handbrake. It’s actually there to help you, because the work’s been done; and if it’s been done well, it allows you to make appropriate recommendations and deliver the right solutions to clients.

“In order to do that, and to do a good job of that, you need to not only do appropriate research on that particular strategy, you need to have research on the relevant elements of that strategy compared to others in the marketplace. Without doing both, it’s very hard to say whether that strategy is good or bad in isolation.”

Implicit in the value proposition of a research business is the ability to educate and inform financial planners about how best

to use the solutions at their disposal, and Zenith’s Wright says that inevitably means an increase in the sophistication of the support received from the researcher.

“Lifting the sophistication of information requires more hand-holding and explanation,” he says.

“One of the things that we do on that front is for clients who take model portfolios, they must – it’s compulsory – take the investment committee service. You need to talk [about] things like portfolio attribution. It’s a pecking order: the adviser explains to the client in client-friendly terms the characteristics of the portfolio; you take it up another level, and it’s the researcher’s role to explain the characteristics and performance and attributes of the portfolio to the adviser in adviser-friendly terms.”

Wright says that shift means a great researcher must not only be technically rock solid, but must also be a great communicator.

“In our business the key client-facing people are the four partners in the business, and they’ve all got extensive experience in researching funds,” Wright says.

“We’re not, and can’t be, full-time on the tools in terms of researching funds – that’s what the analysts do. But you do need to be able to take the work of the analysts, understand it, and communicate it to the advisers.

“You can imagine that the adviser is getting hammered by their clients. A large part of our role during those periods is reassurance that the portfolio remains well structured, the rationale for the different funds and/or allocations in the portfolios – so again, it’s that pecking order thing: the research is encouraging and providing support to the adviser; the adviser is encouraging and supporting the client through that period of stress.” ■