Enabling Financial Advisors to Control UMAs by Eliminating Managed Account Silos

Separating the Provision of Advice from Portfolio Administration and Execution

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Executive summary

U.S. retail wealth management has been and is continuing to shift from commission-based accounts to fee-based managed accounts. Financial advisors (brokers or registered investment advisors [RIA]) either independent or through wealth management distributors such as Banks, Broker-Dealers and Insurers, offer financial advice through a variety of managed accounts programs. Historically these programs, (Rep-as-Portfolio Manager, Rep-as-Advisor, wrap mutual funds and separately managed accounts [SMA]) were sold as siloed individual products for individual investor accounts. The silos largely reside on legacy technology platforms, which in many cases were designed decades ago and generally lack integrated and automated rebalancing, tax optimization and householding capabilities. As the industry has matured, it has attempted to modify the delivery mechanism of managed accounts to offer more complete asset allocation and investment advice delivery, with mixed success. The latest iteration of this modification is the Unified Managed Account (UMA), using a single account to offer investors a full asset allocation and access to multiple SMA and mutual fund sub-asset classes or styles (e.g., large-cap value). UMAs are typically delivered as yet another managed account silo with the asset allocation, product selection and rebalancing controlled by a single 3rd-party investment advisor called an overlay manager.

To date when measured by asset inflows, the success of the UMA has been modest, compared to more established managed account products mentioned above, for the following three major reasons:

1. Financial advisors' desire to retain control of the allocation and product selection function and not pass that function to a single 3rd-party overlay manager.
2. Profitability of the UMA, which is lower than other managed account products largely because the 3rd-party overlay manager, in addition to their primary asset allocation and product selection responsibilities, must provide account services and rebalancing/tax optimization technology.
3. Lack of automated householding capabilities.

The stronger inflow of assets into advisor-controlled managed account products, coupled with a trend toward advisors becoming independent, suggests that for long-term UMA effectiveness, UMAs need to evolve into a more advanced portfolio management delivery mechanism, not another 3rd-party controlled product silo. To do so, it needs to deliver the following characteristics:

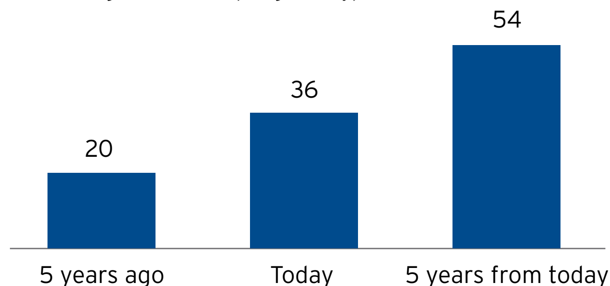
1. Allow for an ***Advisor Controlled UMA/UMH***, where the advisor controls the creation, assembly, implementation and rebalancing of the investor portfolio in an integrated and automated way, including any managed account product.
2. Provide the distributor with advisor guardrails and pre-trade restriction management tools to automate the maintenance and monitoring of investor accounts controlled by the advisor.
3. Provide investor household-level capabilities for rebalancing, tax management and reporting of the entire investor relationship.
4. Support access to multiple 3rd-party tactical/strategic asset allocation firms, properly measured similarly to any other product provider.

In summary, the administrative account servicing and rebalancing functions now provided by UMA overlay managers should be a basic function of any distributor platform and separated from tactical/strategic allocation advice and product selection responsibilities. In this way, the advisor can determine when they will provide the tactical/strategic allocation and product selection advice and when they will hire a 3rd-party to assist them in attracting and managing investor assets. The ***Advisor Controlled UMA/UMH*** is the inevitable next step in the evolution of managed account delivery.

Current trends in wealth management and managed accounts

Fee-based retail managed accounts, usually discretionary, will continue to drive the transformation of the U.S. retail private wealth management marketplace. Retail private wealth management is shifting from transaction-based relationships to relationships based on advice. Increasingly, firms and financial advisors are now embracing managed accounts as the backbone of their support for investment management and the method of choice for delivering investment advice.

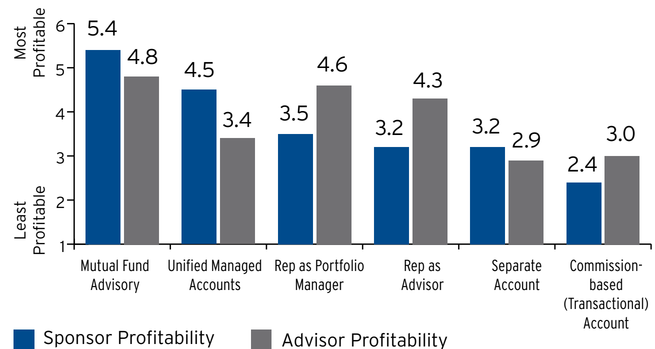
Exhibit 1 — Percentage of Distributors, Total Revenue Sourced From Fee-Based Managed Account Programs (all managed account program types)



Source: Founders Advisory

There is no sign of this slowing with private wealth managers projecting that fee-based advisory programs will be responsible for approximately 55% of total firm revenues in five years (see Exhibit 1), driven by the higher profitability of managed account programs for both the firm and the advisor compared to traditional transaction/ commission based relationships (see Exhibit 2).

Exhibit 2 — Sponsor and Advisor Profitability by Managed Account Program, 2011

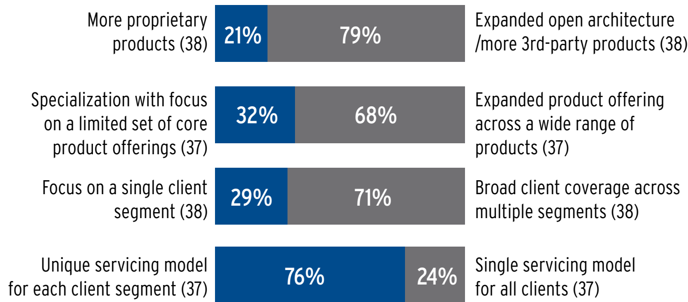


Source: Cerulli Associates

This makes sense as wealth management firms expect individual investors will continue to clamor for customized holistic advice on how to best meet their unfunded liabilities, plan for income in retirement, fund children's education, understand complex financial products, manage taxes, distribute income and integrate different account structures including tax-deferred accounts and trust vehicles, as shown in Exhibit 3.

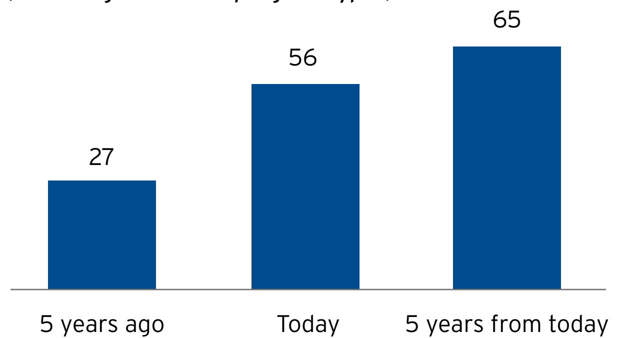
Investment Product Manufacturers (a.k.a. asset managers) are also experiencing a shift to managed accounts as these programs become the predominant source of asset flows. Asset managers project that roughly 65% of their retail asset flows will be sourced from fee-based managed accounts in five years (see Exhibit 4).

Exhibit 3 — Projected Wealth Management Strategic Focus for the Next Two to Five Years



Source: Ernst & Young: Investing in the Future — 2011 U.S. wealth management study: a focus on product and client trends. © 2011 Ernst & Young LLP.

Exhibit 4 — Percentage of Asset Manager Gross Flows Sourced from Fee-Based Managed Account Programs (all managed account program types)



Source: Founders Advisory

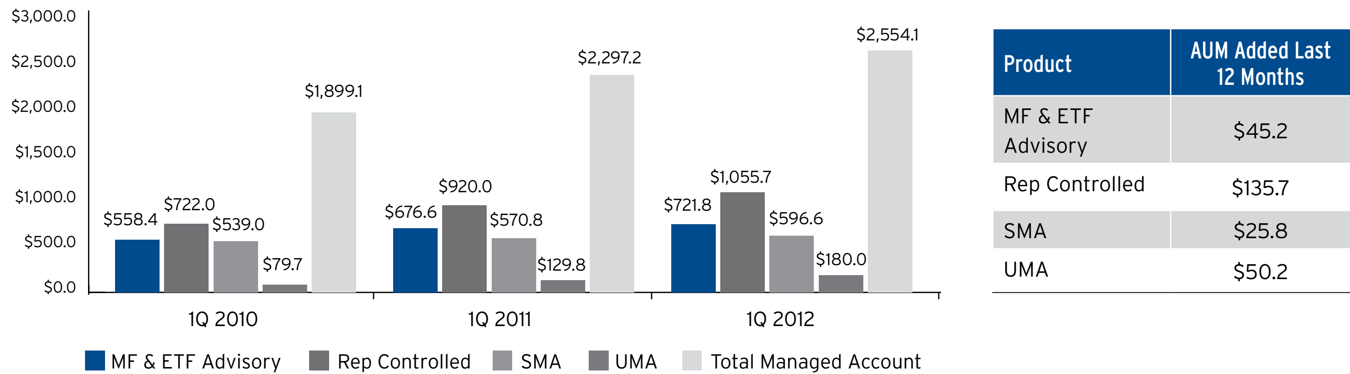
Adopting a unified client-centric approach

While managed accounts are growing, for these advice delivery arrangements to maintain and accelerate their growth, the distributors, be they broker-dealers, banks, insurers or RIAs, need to adopt a unified holistic client-centric approach. Today these firms largely maintain a product silo-driven structure to managed accounts based usually on investment products.

For example, a typical distributor or sponsor of managed accounts might have upwards of five or more different product programs (Wrap Funds, Wrap ETFs, Rep-as-PM, Rep-as-Advisor, model-only SMA, traditional SMA, UMA) that are not linked together. This silo-based approach is difficult for financial advisors, confusing to investors and causes a plethora of extra accounts and processes beyond what investors would otherwise require. This approach is also insufficiently transparent and creates administrative stumbling blocks to growth and adoption by both financial advisors and their investors. Lastly, this siloed approach is expensive as it results in duplication of platforms, staff, management oversight and investor and management reporting. As a result, current managed account growth continues to gravitate toward long-established, simpler and better-understood products controlled by the advisor. Accordingly, traditional advisor-controlled managed account products (Wrap Funds, Rep-as-PM, Rep-as-Advisor and SMA) continue to deliver the largest asset flows into managed accounts (see Exhibit 5).

Distributors or sponsors of managed account programs should look to simplify and streamline the delivery of complex offerings, while enabling a highlevel of simplicity, flexibility and product access for advisors and investors. Additionally, wealth management firms should seek to move away from a focus on particular managed account program designations or product types to a focus on delivering holistic investor-oriented advice. Put another way, firms ought to strive to deliver to investors' household needs using all products simultaneously across an investor's accounts, rather than selling individual products into individual accounts. By implementing a unified managed household (UMH) framework, the focus shifts from selling disparate investment vehicles to advising on and constructing holistic client-centric portfolios.

Exhibit 5 — Annual Growth in Managed Accounts by Program Q1 2010 to Q1 2012

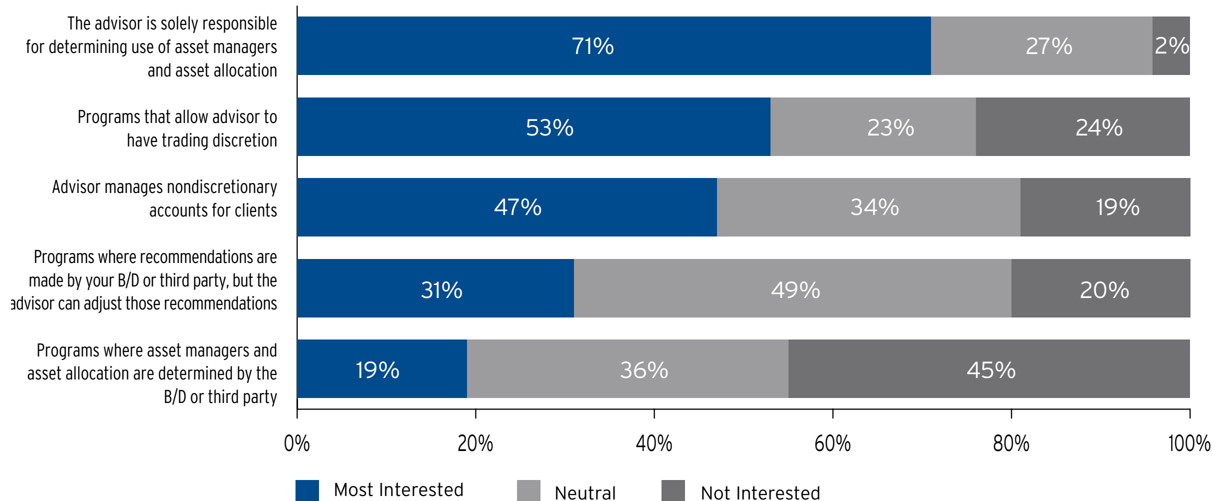


Product	AUM Added Last 12 Months
MF & ETF Advisory	$45.2
Rep Controlled	$135.7
SMA	$25.8
UMA	$50.2

Source: Cerulli Associates

As managed accounts have evolved, attempts have been made to reduce silos, first with Multiple Style Portfolios (MSPs) and most recently Unified Managed Accounts (UMA) where asset allocation advisory and product selection is usually provided across a single investor's account by a 3rd-party overlay manager. Yet, as shown in Exhibit 5, inflows to the traditional legacy managed account products outpace UMA inflows by approximately 4 to 1, and advisor-controlled product (Rep-as-PM and Rep-as-Advisor) outpace UMA by 3 to 1. Advisor acceptance of UMA and other 3rd-party advised products is weak and advisors indicate a strong preference for products where they maintain greater responsibility and control (see Exhibit 6).

Exhibit 6 — Advisor Opinion of Managed Account Types



Source: Cerulli Associates, in partnerships with the Financial Planning Association, the Investment Management Consultants Association, Advisor Perspectives, and Morningstar

To understand this apparent dichotomy, it's important to take a step back and examine the industry value chain starting with advisor role as investor relationship manager, through to the creation of the investment product and the custodian of the assets (see Exhibit 7).

Exhibit 7 — Wealth Management Industry Value Chain

- Relationship management
- Advice and guidance
- Investment recommendations
- Planning and suitability review
- Access to products
- Customer service
- Performance review
- Client service

- Design and implementation of portfolio solutions
- Provider of the financial advisor
- Investment product provider
- Packaged solutions and advisory programs
- Portfolio books and records
- Trade processing
- Performance reporting
- Regulatory compliance

- Vetting and monitoring of professional product providers
- Product research and due diligence
- Tactical and strategic asset allocation
- Product recommendations
- Maintain product select lists and/or buy lists

- Investment management, trading and reporting systems
- Account aggregation across custodians
- Order management and rebalancing systems
- Performance calculation
- Account workflow
- Integrates with official books and records system such as brokerage or bank trust
- Product management and development

- Professional manufacturing of investment products such as mutual funds, ETFs, SMAs and insurance products
- Securities research and selection
- Risk and correlation assessment
- New investment products
- Client services and sales

- Official repository of investor assets for distributor
- KYC & AML regulatory requirements
- Account servicing
- Securities settlement

Roles within the wealth management value chain

Without question, the retail and high net worth investor and wealth management value chain is growing in complexity. Due to increasingly open architecture, industry influence continues to flow from advisors and their distributors to product and assembly-centric services driving asset managers to deliver innovative products.

Advisor: No longer simply the purveyor of mutual funds, stocks and bonds, today's advisors need to guide their investors through a supermarket of not only traditional products but increasingly complex vehicles for trusts and estate planning (tax-advantaged retirement/expense management accounts, target date funds, education savings accounts) and complex new and rapidly growing investment products (private equity, hedge funds, alternative investments, long/short strategies, ETFs), which have shown significant recent growth.[1] The growing ranks of advisors becoming independent from traditional brokerage firms[1] need flexibility and access to deliver the breath and diversity of product and advisory services their investors seek.

Distribution: Following the financial crisis, investors have expressed concern about the integrity of traditional financial advisors and their institutions. More than three out of four consumers believe that recently reported scandals that have plagued the financial services industry are common among financial advisors and financial institutions.[1] This has enhanced a trend toward financial advisor independence.

[1]Source: Tiburon Strategic Advisors LLC, Tiburon CEO Summit XXII — presentation materials

Firms supporting independent advisors such as Schwab and LPL have been growing significantly, but the number of independent advisor firms has also expanded to include RIA aggregators such as Hightower, Focus Financial and others. These firms compete with the traditional wire-house and bank brokerage firms (e.g., Merrill Lynch, Wells Fargo) to attract advisors to their ranks. They can do this through a number of mechanisms such as higher payout, more expansive access to product and more efficient processing support.

Investment Product Research: The professional vetting of asset managers and other manufactured product providers along with tactical/strategic asset allocation will continue to be a significant component in the overall delivery of wealth management to both individuals and institutions Many wealth management firms and/or advisors do this in-house, but 3rd-party firms are expanding their research capabilities to include ETFs and alternatives as well as provide more assembly services and advisory services including CIO outsourcing and tactical/strategic asset allocation.

Portfolio Assembly Through the Wealth Management System: Investors want solutions, not merely product access. This is evidenced in the growth of new products mentioned above and continued expected movement toward fee-based advisory account programs (see Exhibits 8A and B).

Exhibit 8A – Proportion of AUM in Advisory vs. Commission-Based Accounts

Segment	Base	Advisory Accounts	Commission Accounts
High Net Worth	(19)	69%	31%
Mass Market	(16)	57%	43%

Source: Ernst & Young: Investing in the Future – 2011 U.S. wealth management study: a focus on product and client trends.
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Exhibit 8B – Projected Change of AUM Acquisition

Segment	Base	No Change	Increase – Commission-Based	Increase – Advisory Accounts
High Net Worth	(20)	55%	0%	45%
Mass Market	(15)	40%	0%	60%

Source: Ernst & Young: Investing in the Future – 2011 U.S. wealth management study: a focus on product and client trends.
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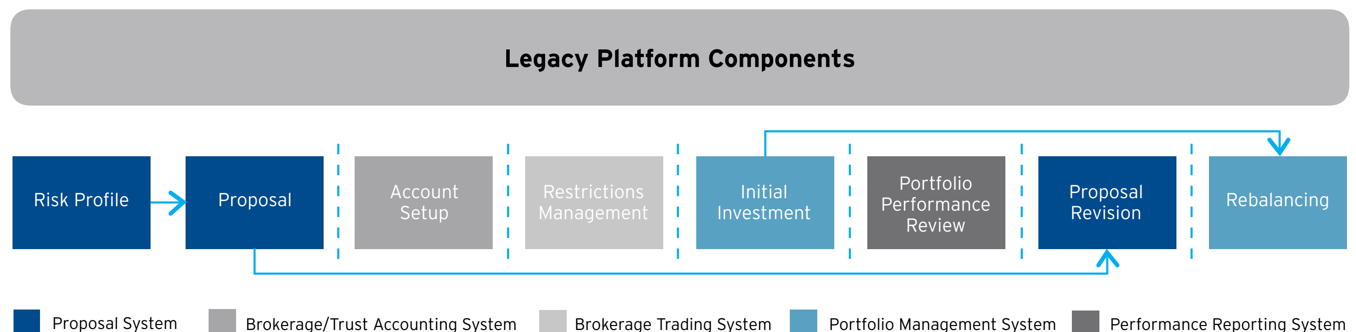
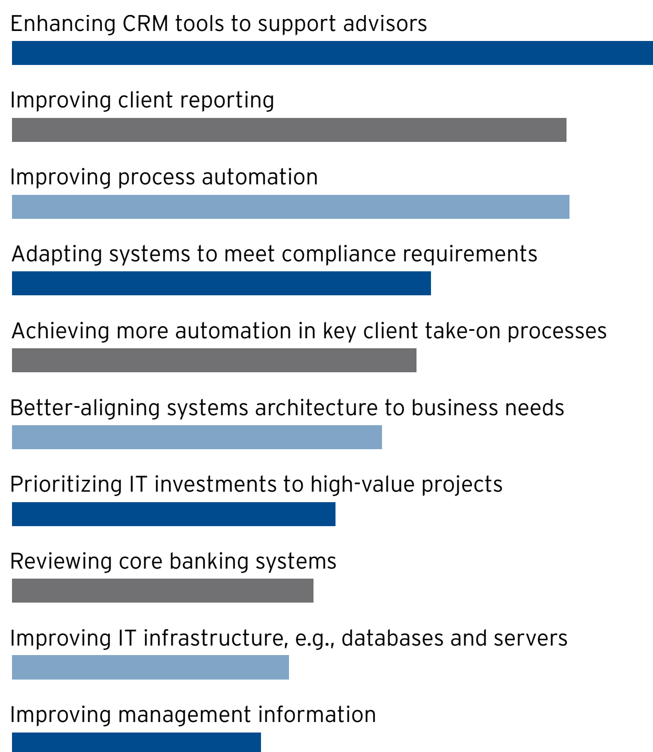
Exhibit 9 – Non-integrated legacy Systems Set Supporting Wealth Management



Historically, managed account programs have consisted of disparate components that are not integrated requiring multiple data entry points, with little automation of the investment process (see Exhibit 9). However, with the industry anticipation of increasing regulatory requirements,[4] distributors are focused on and expect to spend their resources on replacement systems to meet these requirements and to reinvigorate growth.

Figure 10A — Wealth Management Survey Top Three Technology Budget Requirements



Source: PwC Global Private Banking and Wealth Management Survey Report, *Anticipating a new age in wealth management* (June 2011) p. 36

As shown in Exhibits 10A and B, consulting firms focused on the wealth management industry, such as Ernst & Young and PricewaterhouseCoopers, report that growth and the need to meet certain regulatory requirements are compelling technology replatforming largely focused on a few key areas: enhanced front office/advisor tools, investor reporting and process automation as the three most important technology needs identified in 2011. Now the platform can truly distinguish firms who are willing to make the necessary investments.

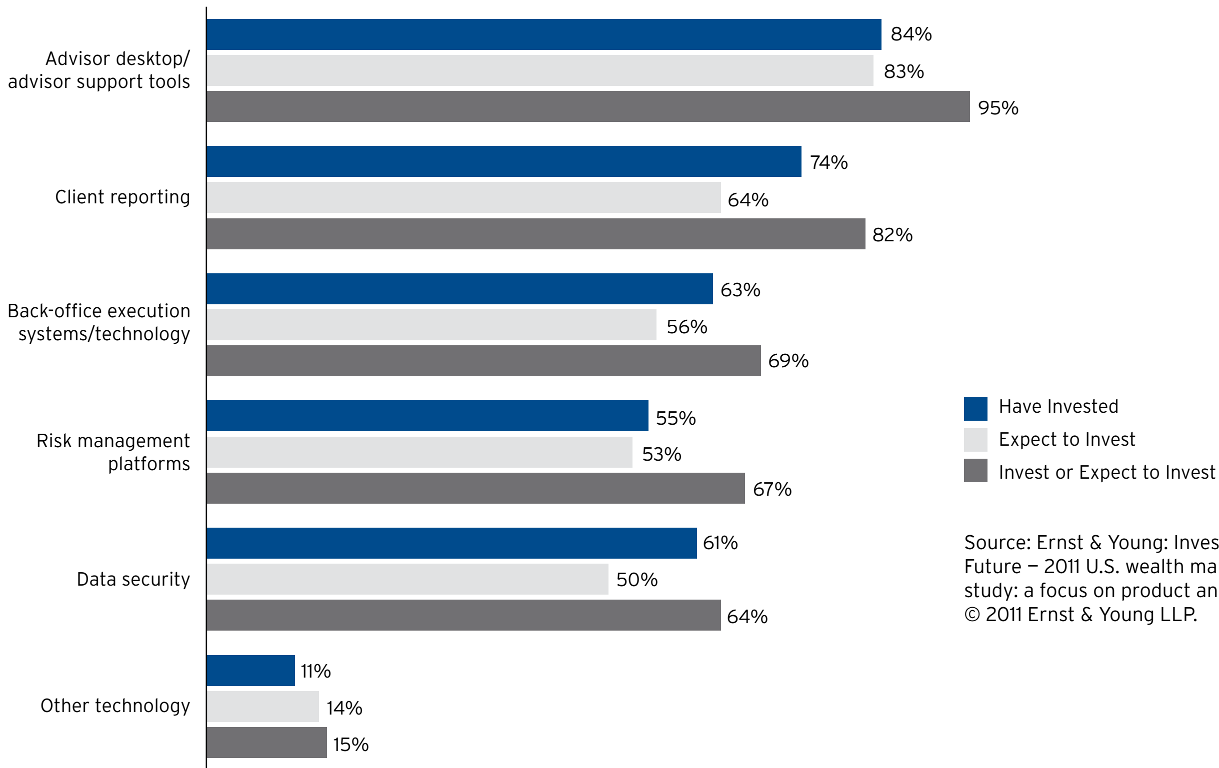
Manufacturing: Investment product manufacturing has been largely unbundled over the last several years. This is due to a number of factors including: the advent of new products (e.g., ETFs), wider availability of new products through distributors' open-architecture programs, increased media exposure (e.g., Jim Cramer's *Mad Money*) and technology advancements in social media such as Facebook and LinkedIn. These factors have contributed to a transformation of asset managers to a more specialized class of product designers serving advisors/distributors and platform providers who have more control over the investor relationship and decision-making.

Isolating advice from portfolio administration

A critical step to transforming the delivery of wealth management and managed accounts to a unified holistic solution is distinguishing decision-making components of the value chain from administrative processing components. Today, in many cases, investment advice and portfolio administration are intertwined. One example is traditional SMAs where the investor account for a particular sub-asset

[4]Source: *Broker-Dealers as Fiduciaries? How the SEC Staff's Study Could Raise the Bar for Investment Advice*

Exhibit 10B — Wealth Management Current and Projected Technology Investment



Source: Ernst & Young: Investing in the Future — 2011 U.S. wealth management study: a focus on product and client trends. © 2011 Ernst & Young LLP.

class or style (e.g., large-cap value) is controlled by the chosen investment manager held in a silo away from the other investor accounts. This creates obvious limitations in how the decisions on that SMA model interact with investor's larger household portfolio assets, creating issues around asset concentration/overlap and tax management. Historically, advisors have tried to address this limitation by giving investors broad access to multiple SMA style managers and reallocating or rebalancing assets between account silos. But this process was often manual and difficult. As managed accounts have evolved, additional attempts have been made by distributors to enhance the automation within silos, first with Multiple Style Portfolios (MSPs) and currently with UMAs. However, UMA providers typically bundle the delivery of overlay advisory services (tactical/strategic asset allocation and product selection), with the administration of accounts (e.g., rebalancing, deposits and withdrawals). Granted, these accounts encompass a broader asset allocation across styles, thereby solving the problems of a single SMA in one account silo, but they fail to solve three additional limitations.

First, UMAs are still limited to a single investor account and do not encompass the multiple legal account types in a typical family (e.g., trusts, IRAs, joint accounts), therefore overlap or overweight positions/asset classes and tax management across the household is not addressed.

Second, UMAs are typically held at the single brokerage institution of the advisor and the assets serviced are limited to what has been transferred to the UMA provider. However, assets held away at other institutions

(e.g., bank trusts) are not included; this arrangement fails to address issues such as household overlap and tax considerations. Third, and most important, most UMA providers typically are the sole UMA option for the advisor's organization. Therefore, if an advisor wants a UMA they are required to submit portfolios to that single UMA overlay manager for both the provision of the strategic/tactical allocation, product selection, rebalancing and account administration. This is generally due to limitations outlined in Exhibit 9 and the lack of automated rebalancing and tax management capabilities of most legacy distributor systems. Account data must be passed back and forth with a separate technology platform operated by the overlay manager with these capabilities. This account transfer most often also transfers advisory responsibility from the financial advisor/distributor to the overlay manager, making the investment process opaque to the advisor except for reporting purposes. In fact, most overlay managers require separate advisory agreements directly with the investor.

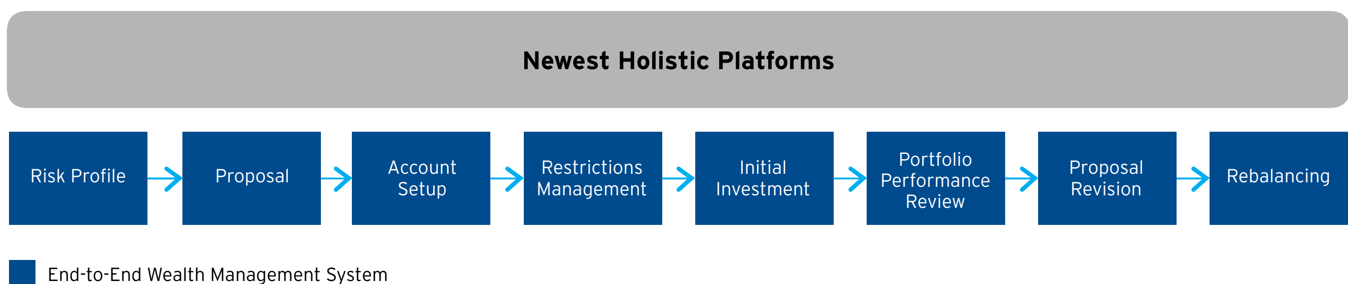
Ideally, platform technology should not be bundled together with the advisory component of overlay management (asset allocation and product selection). The administration of an investor's portfolios (e.g., rebalancing) should be handled holistically within and across investor accounts within the financial advisor platform. Said another way, platform technology that enables the administrative component of overlay management ought to be part of any standard managed account platform within the distributor. While new, these platforms exist today and solve most, if not all, of the limitations for managed accounts previously noted. In addition, these new technology platforms can address any potential requirements related to audit trails of end-to-end processes,[5] linking previously disparate processes and technology, and aggregating, rebalancing and reporting at the investor's household level across multiple institutions and account types (see Exhibit 11).

Separating the technology that enables portfolio administration and rebalancing from the alpha-generating components of overlay management (asset allocation and product selection) will improve the UMA and support its transformation from product silo to an investment management approach, while consolidating other managed account silos into investor-oriented holistic advice.

Impact on costs and product availability

In the separation of advice from administration, UMA costs should significantly decline as overlay managers focus on their advisory service capabilities (asset allocations and product selection) while no longer needing to provide

Exhibit 11 — Integrated Holistic Platform Supporting Wealth Management



[5]Source: *Broker-Dealers as Fiduciaries? How the SEC Staff's Study Could Raise the Bar for Investment Advice*

(or charge for) the infrastructure, technology and staff needed to administer these accounts. This should assist in the attractiveness of UMAs, which are now the least profitable of the managed account products for advisors and distributors who outsource overlay services to 3rd parties (see Exhibit 2). This separation also expands the open-architecture nature of managed accounts, as the overlay manager's role evolves to the role of the investment strategist. This new investment strategist role can be performed by multiple providers including: multiple 3rd-party brands, a distributor's in-house CIO and directly by the financial advisor, depending on the needs of the investor. Finally, this separation of advice from administration sets the stage for investment strategists (a.k.a. overlay managers) to be hired not for the required use of their technology, but purely by their alpha-generating track record, as other investment product manufacturers such as mutual funds, ETFs or SMAs are hired today.

Aligning platform technology with the advisor

Key to the adoption and delivery of a holistic client-centric approach is having a solution set and tool kit that enhances the financial advisor value proposition with their investors. An important element to this is enabling the control of the new investment strategist role at the financial advisor level, thereby creating the ***Advisor Controlled UMA/UMH***. As shown in Exhibit 5, financial advisors already direct the vast majority of managed account assets into products over which they have control and eschew those over which they do not. Although the current configuration of the UMA — with a single-source 3rd-party overlay manager and embedded technology — has shown a strong recent growth rate, its AUM capture pales in comparison to advisor-controlled products. Given the pricing and profitability disadvantages outlined in Exhibit 2, poor advisor perception of 3rd-party advised product outlined in Exhibit 6 and the trend toward advisor independence lead one to the conclusion that advisors see the investment strategist role (i.e., providing asset allocation and product selection functions to their investors) as a core competency of their investor value proposition. Increasing control over UMAs by the advisor is therefore inevitable.

Adopting a holistic end-to-end wealth management solution

In conclusion, the key to enhanced managed accounts growth will be the ability to deliver an ***Advisor Controlled UMA/UMH*** solution. In other words, the industry needs to enable financial advisors to play what is now known as the role of overlay manager. For distributors, ***Advisor Controlled UMA/UMH*** and current Rep-as-PM and Rep-as-Advisor managed account silos are not programs managed without peril. Many distributors use internal training programs to assure their advisors have the skill level to act with discretion over investor accounts and often have programs to authorize advisors before they are able to take such discretion. However, legacy distributor systems usually lack the automated pretrade compliance-monitoring capability, automated modeling and rebalancing tools and automated restriction tools to efficiently apply these firm-level controls (a.k.a. advisor guardrails) necessary to maintain the integrity of advisor, in-house or 3rd-party model portfolios. Therefore, platforms that offer redesigned Rep-as-Portfolio Manager and Rep-as-Advisor programs that expand the advisors' capabilities to incorporate all the other managed account products, end-to-end workflow (linking the proposal at one end to household rebalancing and performance at the other), household tax optimization, pretrade compliance monitoring and automated advisor

guardrails are going to gather the lion's share of asset flows into managed accounts. Within these new platforms, financial advisors can now be empowered to deliver efficiently and effectively, investor-based portfolio construction and asset allocation decisions, which they already not only promote but have the influence to deliver. While much of the wealth management industry still uses legacy approaches (product silos, disparate systems, single custodian, etc.) new technologies exist to seamlessly enable the role of the advisor as investment strategist with these additional capabilities. Based on the industry trends discussed above, advisor-based technologies are likely to be the most important investment that wealth management firms will make for the growth and profitability of their business.

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Andrew Clipper is North America Head of Product Management and Development for Wealth Management Services. Andy is responsible for OpenWealth, the first Unified Managed Household (UMH) platform supporting distributors of retail wealth management services such as banks, broker-dealers and insurers. OpenWealth is the winner of the 2011 and 2010 MMI Innovation of the Year, 2010 Product of the Year, 2010 ICFA Most Innovative Product and the 2009 Fund Action SMA Player of the Year awards. Andy has over 27 years of financial industry experience. Prior to joining Citi in 2004, Andy was the Director of Separately Managed Accounts for Evergreen Investments division of Wachovia Corporation, Eastern Divisional Sales Manager for separate accounts with Merrill Lynch Asset Management, Director of a subordinated debt lending for Merrill Lynch Business Solutions, Director of health care investment banking for Oppenheimer & Co., Inc., and an Equity Analyst covering the health care industry for Eberstadt Fleming.

Andy has a Master of Business Administration in Finance and Master of Public Health in Health Administration from Columbia University, and a Bachelor of Science from the State University of New York.

Andy was also recently the co-author of the white paper *Broker-Dealers as Fiduciaries? How the SEC Staff's Study Could Raise the Bar for Investment Advice*. For a copy of that white paper, please visit: http://www.transactionservices.citigroup.com/transactionservices/home/securities_svcs/investors/docs/fiduciary_standard.pdf

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Paul Fullerton is the Founder and Managing Principal of Founders Advisory, started in 2008. Founders provides management advisory/consulting to financial services institutions such as asset managers, private wealth management firms, brokerage firms, platform providers and technology firms. Paul has more than 17 years of professional experience within the financial services industry.

Prior to forming Founders Advisory, Paul spent eight years consulting and researching the financial services industry. He was most recently at McKinsey & Company, and previously at Cerulli Associates. Paul has authored numerous reports and worked on several consulting engagements with topics including managed accounts and advisory solutions, institutional asset management, product strategy, private wealth management, advice and planning, the state of multi-boutiques, and retail and institutional asset management distribution.

Prior to joining Cerulli Associates, Paul worked at Invesco, where he focused on strategic planning and building an IRA rollover service. He began his career at an independent boutique investment and wealth management firm, Astrop Advisory Corporation, where he was responsible for research and trading for investment portfolios and new business development.

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For more information, visit Founders Advisory at http://www.foundersadvisory.com

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