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EXECUTIVE SUMMARY

QUARTER III, 2008: MANAGED ACCOUNTS

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Editor's note: This article focuses on survey results relating to managed accounts from registered investment advisors, broker-dealers, and institutional consultants.

Methodology: In February 2008 IMCA distributed a survey link to more than 6,800 U.S. members. The respondents included 496 broker-dealer reps, 84 registered independent advisors, and 99 institutional consultants who completed the survey instrument using Cerulli Associates' online survey engine. Wholesaler representatives and other professionals who did not work with clients were encouraged to NOT complete the survey, making the response rate 12 percent.

Managed accounts have been the engine that has transformed the financial advisory business from a sales- and transaction-oriented business to one that is more relationship-based and consultative in nature. Cerulli Associates estimates that the managed account industry now accounts for more than \$1.8 trillion in assets and has posted double-digit compound-annual-growth rates for multiple years. To meet Cerulli's definition of a managed account, a program must include client profiling, asset allocation, ongoing monitoring of the investments and client situation, a clearly identifiable asset-based fee, and consolidated statements of client holdings. These programs typically are sponsored by a broker-dealer or third-party vendor (e.g., SEI, Lockwood) as the platform for advisors to conduct fee-based business.

The growth of managed account programs initially was driven top-down by broker-dealers. However, this revolution gained steam as all parties realized the benefits of doing fee-based business. Both broker-dealers and financial advisors have reaped the benefits of predictable, recurring revenue. In addition, fees have allowed advisors to shift to a more holistic relationship with clients, which, in turn, has helped them to consolidate assets, target wealthier clients, and position themselves as trusted financial advisors, ultimately fueling the growth of their practices. Clients also have benefited because they no longer must question their advisors' motivations in making recommendations.

Managed accounts carry efficiency advantages for advisors as well. With tools such as client profiling and performance

reporting, these platforms contain features that help advisors more easily manage client relationships. In addition, many programs include research assistance and model portfolios that help advisors allocate and manage client portfolios. Ultimately, the key theme is that managed accounts can help an advisor spend less time on administrative tasks and spend more time with clients.

Research assistance provided by the broker-dealer and sponsor can be a key success factor in advisor adoption of a managed account program. On one hand, giving up control of asset allocation and manager selection can create major time savings for advisors, allowing them to spend more time with clients and prospects. On the other hand, many advisors believe they can add value in asset manager selection-and-packaging and are unwilling to give up control of this process. In addition, many advisors consider investments a key part of their value proposition to clients, meaning they wish to control this process to whatever extent possible.

IMCA members reflect this attitude. When asked about their opinion and usage of different attributes of managed account programs, IMCA members rated those programs where the advisor had full control over asset-manager selection and asset allocation the highest. Given significantly lower scores by IMCA members are programs where the broker-dealer or sponsor fully packages the asset allocation or where the broker-dealer or sponsor makes recommendations and develops a short list from which the advisor can choose. For broker-dealers and sponsors that wish to have advisors

adopt managed account programs with research assistance, establishing the independence of the research is essential. Advisors must believe that a “Chinese Wall”¹ exists between research and distribution and that no other influences exist on recommendations other than the quality and skill of the asset manager being recommended.

Research assistance has played a role in the advisor adoption of unified managed accounts as well. Cerulli defines unified managed accounts (UMAs) as the program environment that can accommodate multiple vehicles and have the ability for overlay management. Overlay management is technology that helps inform client trading decisions based on their preferences, other holdings, and tax situations. The launch of UMAs represents a major evolution for the industry because managed account programs traditionally have been defined by the vehicles they hold (e.g., separate accounts, mutual funds). However, considering the high minimums of separate accounts and the growth of products such as exchange-traded funds (ETFs), the promise of a vehicle-neutral platform could hold significant advantages for diversifying a client account.

However, a number of factors have derailed the early adoption of UMAs. First, as we alluded to earlier, many of these programs were introduced as fully packaged, meaning

the advisor had no control over asset-manager selection and packaging. As we have discussed, IMCA members have expressed a strong interest in those managed account programs where they determine the client’s asset allocation. Second, advisors are satisfied with the state of managed accounts currently. When asked why they chose to do business in managed accounts, IMCA members sang the praises of doing business in a fee-based environment. Advisors historically have been reluctant to be early adopters of any new program, so given their satisfaction with existing platforms, they have not yet seen a reason to transition.

IMCA members are optimistic about the future of UMAs. More than three-quarters (77 percent) of IMCA members cited managed accounts that could utilize multiple vehicles as highly desirable. Likewise, approximately 40 percent of IMCA members considered UMAs a way to simplify client interactions and a better way of delivering asset management to clients. Sponsors and broker-dealers should be reassured by advisor interest in these platforms. However, they must rethink how to package asset managers within these programs so that advisors who desire full control over their clients’ investments can exercise it, while still reaping the benefits of a product-neutral managed account.

The full results of the Cerulli Associates–IMCA survey on managed accounts are available to IMCA members as an exclusive member benefit. IMCA members receive four quarterly research reports and six issues of *Investments & Wealth Monitor* each year. For a \$395 annual membership fee, you can continue to receive cutting-edge investment consulting and wealth management content.

¹The ethical (not physical) barrier between different divisions of a financial (or other) institution to avoid conflict of interest. A Chinese Wall is said to exist, for example, between the corporate-advisory area and the brokering department to separate those giving corporate advice on takeovers from those advising clients about buying shares. The “wall” is thrown up to prevent leaks of corporate inside information, which could influence the advice given to clients making investments and allow staff to take advantage of facts that are not yet known to the general public.