



CERULLI
ASSOCIATES

Advisors and UMAs
Issue

THE CERULLI EDGE®

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MANAGED ACCOUNTS

EDITION

Advisors and the
Managed Accounts
of Tomorrow

Summary

Today's UMAs don't completely align capabilities with advisor needs, but these programs can evolve to better fit with advisor practices.

Clearing Hurdles

Building user-friendly next-generation UMAs

Key Implications

- ◆ **UMA programs typically do not encompass the capabilities that advisors have through the suite of existing managed account programs.** In most cases, the UMA offers less than advisors can get from existing programs, such as access to the same investment products/managers, flexibility of portfolio construction, and pricing.
- ◆ **Advisors that plan on increasing their UMA use have a larger average total book of business—\$148 million versus \$115 million in AUM—compared to advisors who responded that they did not plan to increase their use of UMAs in the near future.**
- ◆ **A way of making UMAs more advisor-friendly is to target those areas that advisors see as their clients' biggest concerns.** Advisors see wealth preservation, retirement solutions, and cash flow as their clients' three biggest concerns.

The goal behind the unified managed account (UMA) concept is the provision of a singular platform through which an advisor can manage a client account utilizing a variety of investment vehicles (and ideally all vehicles that can be made available through fee-based platforms). This is primarily a client account administration, asset allocation, and portfolio construction evolution that should solve for the problem of opening multiple client accounts (and receiving multiple 1099 tax forms) across managed account program types. One of the benefits that comes with the technology to manage multiple vehicle types or strategies within a single account has been systematic tax management or optimization.

Advisors look at UMAs as another product, rather than a process.

Because UMA programs essentially strive to bundle the managed account ca-

pabilities that many advisors already have at their disposal into a single, streamlined process, it seems as though it should be a welcome change for advisors accustomed to using multiple platforms (or picking just one or two with which they are comfortable). However, as UMA programs have been rolled out, they do not typically encompass the capabilities that advisors have through the suite of existing programs. In most cases, the UMA may offer less than advisors can get from existing programs (*e.g.*, access to the same investment products/managers, flexibility of portfolio construction, pricing).

The result is that advisors tend to look at UMAs like another product, rather than a better process. Anecdotally, advisors are using UMAs for investors with account balances that are too large for a mutual fund advisory program, yet too small for a diversified portfolio of separate accounts. This is backed by the average account size



for UMAs, about \$315,000 as of 1Q 2010, and makes sense given the obvious capability of UMAs to blend separate accounts (sourced through model submission), mutual funds, and exchange-traded funds (ETFs). But, for the UMA to be successful across the industry, adoption needs to not only spread across the advisor audience, but also across the scope of client accounts serviced.

Determining advisor interest

To gain a better understanding of why advisors choose UMAs, Cerulli analysts profiled advisors based on their plans for future use of UMAs. Those who plan on increasing their UMA use in the near future have a larger average total book of business (\$148 million in assets under management [AUM]) compared to advisors who do not plan on increasing their use of UMAs (\$115 million). Advisors that plan on increasing their use of UMAs are also slightly younger, have a larger portion of their business in fee-based arrangements, and tend to work as sole practitioners instead of part of a team or ensemble practice. As seen in the exhibit below, these advisors are also likely already using separate account programs (or at least appreciate the benefits of separate accounts and tax management) and they do not favor nondiscretionary relationships. This should

be encouraging to UMA sponsors (and asset managers expecting to increase distribution through UMAs), as the most desirable advisors (more fee-based business and larger books) are planning on using UMAs.

Advisors who do not plan on using UMAs are less likely to give up discretion or control over building portfolios and they find less value in separate accounts and tax optimization. Because all of these qualities are antithetical to UMAs (at this juncture), it is possible that these advisors will never embrace UMA programs.

Building a better UMA

A significant part of the solution to advisor use of UMAs is educational (*i.e.*, process versus product). However, another aspect is that UMAs need to include compelling features that are lacking on other managed account platforms (*e.g.*, retirement income solutions, alternative investment exposure, and tactical asset allocation). For instance, since modern portfolio theory and strategic asset allocation were challenged in the recent market crisis, it is clear that advancements need to be made to portfolios that are constructed on managed account platforms.

One way to identify how UMAs can solve advisor needs is to create a gap analysis for existing managed account plat-

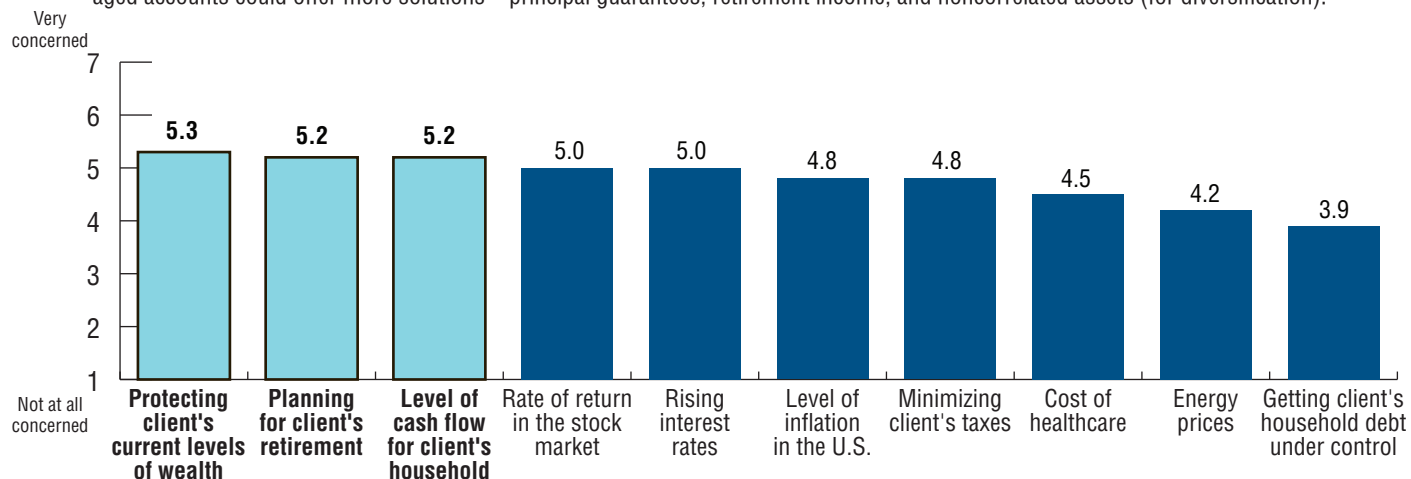
Advisor Opinion of Managed Account Attributes Segmented by UMA Use, 1Q 2010		
Advisors currently adopting UMAs are already inclined to use separate accounts and have a greater acceptance of investment recommendations.		
Advisor Opinion	Increase in UMA Use Planned	No Plan to Increase UMA Use
Those that allow the advisor to utilize a wide range of vehicles (<i>e.g.</i> , separate accounts, mutual funds, ETFs)	6.1	5.0
Those that utilize separate accounts	6.1	4.2
Those that utilize institutionally priced share classes (no 12b-1 fees)	5.7	4.7
The advisor is solely responsible for determining usage of asset managers and asset allocation	5.4	4.7
Those with overlay management that provides automatic tax optimization	5.3	4.4
Those where recommendations are made by your broker/dealer or third party, but the advisor can adjust those recommendations	4.9	4.0
Those that utilize mutual funds	4.6	4.6
Those programs that allow advisor to have discretion	4.3	4.8
Those where asset managers and asset allocation are determined by the broker/dealer or third party	3.4	3.7
Programs where the client must agree to all decisions (nondiscretionary)	2.7	3.5

Note: 7=most desirable, 1=least desirable

Sources: Cerulli Associates, in partnerships with the Investment Management Consultants Association and Morningstar

Advisor Perception of Most Pressing Investor Concerns, 1Q 2010

Although there is not a great deviation in advisor perspective on investor concerns, the three top responses each correspond with areas where managed accounts could offer more solutions—principal guarantees, retirement income, and noncorrelated assets (for diversification).



Sources: Cerulli Associates, in partnership with the Investment Management Consultants Association

forms. This ties back to the exhibit on page five and the reasons that advisors would relinquish discretion to the sponsor firm—particularly alternative investment exposure (even if only through mutual funds and ETFs), principal guarantees, and tactical allocation components.

Currently, UMA sponsor firms report that 43% of programs have asset allocation models that include a recommendation for the allotment of assets to alternative or unconstrained strategies. In those that do have recommendations (or firm-discretionary models) that include these strategies, the average size of the allocation is 13%. This is a strong start (although the 43% figure seems higher than anecdotal evidence suggests). However, Cerulli contends that sponsors would do well to make the access to these asset classes and strategies more of a differentiator from other managed account programs in order to encourage advisors to use UMA programs.

“Best ideas” is a trend that has taken form as a technique for advisors to pivot away from strategic asset allocation. This has been seen in the aforementioned sponsor discretionary portfolios at Morgan Stanley Smith Barney (MSSB), but also has been put more in the hands of advisors through research dissemination, exemplified by the Research Investment

Committee (RIC) report at Bank of America Merrill Lynch. One gap within managed accounts seen during the market crisis was that investing around “best ideas” was often implemented through transactional arrangements because the vehicles (*e.g.*, treasury inflation-protected securities, real estate investment trusts, and commodities) were often difficult to access on fee-based platforms. The challenge to integrating centralized research is that it often needs to include an element of sponsor discretion even though advisors are reluctant to embrace programs where they do not have control over portfolio construction (except with accounts that they deem “low balance”).

A concern for the development of UMAs is that the programs have become too complicated.

Another way of looking at making UMAs more advisor-friendly is to target those areas that advisors see as their clients’ biggest concerns. In the exhibit above, we see a reiteration of some of the same themes from the gap analysis. Advisors see wealth preservation, retirement solutions, and cash flow as their clients’ three biggest concerns, which correspond to principal guarantees and alternatives exposure (noncorrelated assets). While tax

Consolidation Preference by Investable Asset Range, June 2009

The UMH (and maybe a more effective UMA) depends largely on the willingness of investors to entrust their total financial relationship with a single advice provider, so data collected on investor consolidation preferences is promising to that investors are not reluctant to consolidate their business with one firm.

Prefer to Consolidate Financial Business at One Institution	Investable Assets Including 401(k)						All Households
	<\$100K	\$100K-\$500K	>\$500K-\$2m	>\$2m-\$5m	>\$5m-\$10m	>\$10m	
Strongly agree	10%	6%	9%	11%	13%	19%	8%
Agree	37%	42%	33%	36%	37%	30%	39%
Neutral	40%	31%	31%	27%	26%	30%	33%
Disagree	9%	19%	22%	19%	20%	19%	17%
Strongly disagree	3%	2%	4%	7%	3%	2%	3%

Sources: Cerulli Associates, Phoenix Marketing International

management doesn't rank near the top, it can be implied that managing taxes is critical in protecting existing client wealth.

It is possible that a simple solution of providing additional education around how UMAs more closely align with these investor concerns could benefit advisor adoption of these programs. In fact, a concern for the development of UMAs is that the programs have become too complicated. The industry may be at an inflection point where the decision must be made as to whether UMAs should be resigned to filling the managed account solution for a \$250,000 to \$1,000,000 client account, or whether they should continue to evolve to provide an adaptable solution suitable for all advisory clients.

Unified managed household (UMH)

In the search for a compelling argument to help advisors adopt UMA programs, it is possible that what is necessary is not only the addition of some of the aforementioned features, but also the deployment of those features across differently registered, but related, accounts. The biggest advantage of this type of platform is that asset allocation can be systematically conducted across taxable and tax-exempt accounts, allowing for asset location in the type of account where it makes the most sense from a taxation standpoint (*e.g.*, municipal bond strategies located in a taxable account because the securities are tax-exempt, whereas tax inefficient investments would be allocated to a tax-exempt account). This

concept is often referred to as the unified managed household (UMH).

The vision of managing a client's total financial situation is powerful in that it gives an advisor more information on which to base advice, as well as more options (and opportunities) in terms of tax management and asset allocation. However, even though technology and operational solutions are in place for such an environment, a common counter argument is that clients like to diversify business across institutions and advisors. This can be a reason cited in the failure of national banks in the "supermarket" model of delivering bundled services across deposit, credit, and investment products.

However, nearly half of investor households prefer to consolidate their financial management at one institution, while only 20% oppose concentrating their business. This bodes well for the UMH concept as, even if not all assets are held at a single institution, a single institution can provide advice on how these assets should be managed to a strategy at the household level.

There is little room for the UMH to be conceived as a product, as opposed to a process, because the client solutions will be so customized. Therefore, while this is a challenge from the standpoint of operations scalability, it may be the catalyst for advisors to stop treating the UMA as a product and begin looking at next-generation platforms as a process that complements their existing managed account programs.

Case Study:
Citi Investment
Administration Services

UMH: OpenWealth Platform

The challenges to a unified managed household (UMH) arrangement not only include those facing the unified managed account (UMA), but also extend to the technology necessary for data delivery and reporting (particularly for held-away client assets), and for rebalancing and applying tax optimization across different accounts some of which may be either taxable or tax-exempt. Citi Investment Administration

Services' OpenWealth platform put its first UMH in production when the firm rolled out OpenWealth's capabilities with TIAA-CREF in 2009. The Citi and TIAA-CREF relationship is an interesting case study because it offers a tangible example of the UMH process in a single environment.

The platform ties together both the operational functionality to support cross-registration investment management and automated sponsor-controlled overlay, and offers an environment that supports multiple vehicle types and allows the sponsor to provide varying levels of entitlement to advisors with pre-trade compliance capabilities absent in most RPM offerings. Thus, some advisors can use fully packaged (by the sponsor) portfolios, others can use a hybrid portfolio in which the advisor assigns investments to the asset allocation, and other advisors are given control over the client account (similar to a rep-as-portfolio-manager program). This capability alone is an evolution to most UMA and traditional managed account programs.

Citi is in a unique position to deliver on the promises of the UMH because of their experience, and investment, in operational outsourcing. From an infrastructure standpoint, OpenWealth provides the ability to scale that few firms can match. From an organizational perspective, Citi is also experienced in managing projects and third-party vendors in building systems spanning front-office to back-office.

A challenge with even thinking about UMH capabilities is the belief that the environment will work as promised. As UMA programs have largely underwhelmed expectations, advisor adoption has been slow, while sponsors often balk at third-party overlay fees, both of which may have resulted in skepticism from sponsors about more grandiose projects.

TIAA-CREF currently has \$643 million in its UMA/UMH program as of 1Q 2010, but has more than \$400 billion in total client assets. Thus, it may be an understatement to say that it is still early in the process.