
# In The News

## Ten Regional Accounting Firms Form Capital Professional Advisors, Inc. to Provide Investment Advice

With the Big Five accounting firms spinning off their management consulting operations into separate businesses which often exceed the capitalization of their accounting services practices, it is not surprising that regional accounting firms would pursue a similar strategy to diversify their accounting revenues while maximizing the value of their enterprise. AllAmerica Financial Corporation, a Worcester, MA insurance and annuity company, is a strategic partner in creating Capital Professional Advisors, a consortium of ten Top 50 accounting firms, creating a broker/dealer to offer investment products and services to their clients. Doug Wright, president of Capital Professional Advisors, Inc., said, “Each firm will be responsible for setting up its own advisory practice. Eventually, we expect all participating firms will coalesce around one common standard of service because of the greater the efficiencies and economies of scale, the bigger the bottom line of each firm, the higher the level of service to the client and the larger the ultimate market capitalization of the company.” These ten accounting firms have 150 offices in 30 states; 160,000 clients, 80,000 of which are businesses; $400 million in accounting revenues; and $40 billion in investable assets. All of the 570 partners in the ten firms have equity ownership stakes in Capital Professional Advisors. AllAmerica has 15% interest in the broker/dealer and will help accountants obtain the necessary licensing.

By virtue of AllAmerica’s involvement, the support platform has the potential to be quite impressive. AllAmerica brings trust powers and a very sophisticated approach to estate planning to the table. AllAmerica could also be a catalyst for creating very powerful technology which is necessary for high level, comprehensive, expert advice. AllAmerica has the capability of creating a virtual real-time balance sheet and income statement which would consolidate all the client’s assets and liabilities into one account. It could create investment processes through which they empower their advisors to add value. AllAmerica can play a significant role in bringing intellectual property and resources to the table.

Doug Wright sees “traditional insurance and investment professionals joining Capital Professional Advisors. As each firm defines how it will serve its clients, some firms will grow by attracting successful financial services professionals with an established client base which would appreciate the dynamics of providing high level advice to businesses, business owners and individuals who now

continued on page 10

## SEI To Assume Responsibility For Account Performance In New MF/MA Platform

Why is the average return in a commission brokerage account just 6% in a market that has generated 15+% returns for 15+ years? The brokerage industry has not yet assumed accountability for account performance. Essentially the work of the commission broker is complete once an investment has been bought and the commission is paid. In executing a series of disjointed, unrelated transactions, it is not possible for the broker to add value. It is only possible to add value when you can look at an investment recommendation in the context of all the client's assets and liabilities. Only then can one determine if the recommendation improved portfolio performance, reduced risk or improved the tax efficiency, liquidity and cost structure of the portfolio as a whole. In the famous Tully Committee report, Dan Tully, then chairman of Merrill Lynch; Warren Buffet, the most successful investor of our time; Chip Mason, the founder of Legg Mason; and representatives of two leading investor groups found "inherent conflicts of interest between commission brokerage, as a means of compensation, and in acting in the client's best interests." The Tully Committee report concluded, in part, that the "role of the registered representative should be in providing professional investment counsel and to compete on the basis of the tangible, quantifiable values one addresses and manages, rather than to simply generate commissions." The unresolved question has been: How does the brokerage industry translate all its support into a methodology which would significantly improve the performance realized in each client account?

SEI, the leading sponsor of mutual fund wrap fee programs not affiliated with major brokerage firms, with $25 billion under advisement, has an answer. In a move that will revolutionize how financial products and services are delivered within the financial services industry, SEI will assume discretion and accountability for the results achieved in each individual client account to include addressing and managing the investment values of risk, return, tax efficiency, liquidity, cost structure and progress relative to long-term goals and objectives. SEI is creating a more funding vehicle neutral consulting platform where high level advice is the focus rather than the investment vehicle. It is expanding its consulting platform to include both managed accounts and mutual funds, and is one of the first financial

continued on page 22




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average just three weeks. According to Steve Galbrath of Sanford Bernstein, "It does look suspiciously like a game of musical chairs, and you do wonder when the music is going to stop, because three-week holding periods is not investing in my view, it is speculating." In addition, New York Stock Exchange statistics reflect shareholder trading has increased by nearly two-thirds in the 1990s.

On-line and nickel-a-share commissions have encouraged more active trading, and television commercials about "taking control of your own investments" has contributed. But in reality, compared to the size of investment, a nickel, dime or quarter is negligible in the whole scheme of things. Sure, you should get the best rate you can, but the commission isn't going to kill you. The "trade" will either make or break you.

### Value Investing Is Dead

Looking at the Callan table, which index has had the least amount of representation in the bottom four slots over the last 20 years? Large Cap Value. While seldom the top performing sub-asset class, value stocks have been successful through more consistent performance. But as mentioned earlier, the S&P 500 is the benchmark of choice, and with growth stocks dominating value, it’s taking a verbal beating. As for Small Cap Value – the heartbeat stopped long ago. Never have we seen the huge disparity between Small Cap Value and Growth. In 1999, the Russell 2000 Growth beat the Russell 2000 Value by almost 45%! Who needs value!

I've seen more articles critical of Warren Buffett than ever. No surprise though. The cheaper a stock in terms of valuation, the worse the performance. Since when are earnings a negative? Whether a company is delivering sales via the internet or stores, companies growing real earnings will be more reliable than those growing revenues at any cost.

### Conclusion

I've only been in this business for 14 years, but when a very dear client of mine, a family friend who knows very, very little about investments, asked me about Qualcomm, I knew that investor expectations were ridiculous. Is it that common for investors to pay absurd prices for stocks that they can't explain? What they know is that it's tripled, quadrupled or more.

I don't think this way of thinking is only with the inexperienced. Most of my clients are institutions – fiduciaries and trustees. Believe me, it runs rampant with them, too. Maybe the world has changed. ■

## SEI To Assume Responsibility For Account Performance In New MF/MA Platform

*Continued from page 2*

services firms to move from a product management to a process management organizational structure which is geared to adding value rather than distributing a wrap fee program product. The difference in the results actually achieved in the client's account is most significant. This makes SEI's new consulting platform a major innovation in how financial products and services are delivered.

The implications of SEI's new consulting platform are also most significant for financial consultants. It frees the independent financial advisor from the burden of portfolio construction, hiring extensive staff and buying and developing the technology necessary for high level advice. The independent advisor, in essence, uses SEI as a proxy for high level, comprehensive, expert advice, which allows the consultant to redeploy a large block of their time and resources (normally expended on portfolio construction, monitoring and management) to winning new client relationships.

Carmen Romeo, president of SEI's Investment Advisor Group which supports SEI's 5,000 independent advisor distribution channel said, "We are positioning ourselves differently from wrap fee program sponsors. Wrap fee programs are built around single investment vehicles, like mutual funds or managed accounts which limit the degree our independent advisors can be of assistance to their clients. We also found our independent advisors didn't just want access to investment vehicles where they had to pick the managers, but they wanted us to do it. So we are assuming the accountability for portfolio construction and account performance." The resulting new SEI platform (1) substantially elevates the competitive bar in the sophistication of portfolio construction brought to bear by the financial consultant, (2) fully integrates the firm as a collaborative partner in the consultant's practice by virtue of SEI assuming accountability for performance in each client account, (3) reconfigures and reprices the support services that firms provide, and (4) shows the financial services mainstream the efficiencies of a process management organization structure and how process management can enhance the earning margins and multiple of the traditional brokerage business.

SEI's much storied evolution from the largest institutional consulting firm in the U.S. to one of the fastest growing mutual fund asset management companies in the U.S. has been baffling the mutual fund industry. In little over eight years, SEI has gone from having virtually nothing under management to $70 billion today. By 2002, they plan to break $100 billion which would take them in the upper echelon of asset management. (SEI also has an additional $180 billion of bank assets under administration, where it acts as back office and distributor of bank mutual funds.)

SEI's extraordinary growth into the upper echelons of asset management over such a short period of time has been baffling to the mutual fund mainstream because the mutual fund industry has a significant blind spot. By definition, mutual funds cannot be investor-specific in managing investment portfolios. SEI has developed an investment process through which it can be investor-specific in constructing client portfolios using 38 very sophisticated, low cost, proprietary mutual fund portfolios which were created primarily for portfolio construction. By offering portfolio management and a process (investment policy, investment strategy and performance monitor) at a cost of 85-90 basis points that results in client-specific advice, SEI has created an investment methodology that allows independent advisors to manage




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investment information in terms specifically meaningful to each client. An independent financial advisor using SEI can provide a mutual fund investment vehicle plus add value with their advice (charging an additional 70-75 basis points) cheaper than the average mutual fund at 160 basis points, not including its trading cost. Essentially, if clients want their independent financial advisors to add value, SEI has developed a superior technology to simply buying a mutual fund. It has created as faster, better and cheaper way to buy mutual funds that allows the independent advisor to manage investment values like risk, return, tax efficiency, liquidity, cost structure as well as progress relative to goals and objectives. Though it is difficult for the mutual fund industry to accept, it is process, or what you do with the investment vehicles, that adds value, not the investment vehicle itself, and thus the mutual fund industry's blind spot. So, it is SEI's investment process through which they empower their advisors to add value, which has made them so successful. This is, in part, because value is actually being added in terms specifically meaningful for each client and, in part, because consultants find they can charge more than a mutual fund because of their added value.

The new SEI consulting platform is significantly different from a wrap fee program where independent advisors pick mutual funds or managed accounts to construct portfolios. Unlike those programs, SEI is responsible for directing the investment process. SEI will charge the same 85-90 basis points it does in their mutual fund wrap program but assumes responsibility for portfolio construction and account performance. Assuming a 50 basis point cost for the separate account managers, with a 85-90 basis point cost for SEI's services, SEI is charging 35-40 basis points for their investment process, including reporting and is accountable for the performance of each custom-built client portfolio. This changes both the pricing and the level of service and consulting support consultants can now obtain from third party vendors.

Conventional retail mutual fund wrap fee programs start at a 3% fee for small retail accounts. Mutual fund companies are engaged for 50-60 basis points as subadvisors to manage a particular portfolio against a specific investment management style or mandate. There is an additional 12b(1) fee of 25 basis points paid by the mutual fund company to the firm sponsoring the wrap fee program to cover trading and administrative costs. Fifteen to twenty basis points of the 12b(1) fee usually covers the administrative cost incurred by the wrap fee program sponsoring firm. Trading cost should not exceed 5-10 basis points. The wrap program sponsoring firm splits the remaining 250 basis point fee (after paying the mutual fund 50 basis points for asset management), with the firm getting 150 basis points (60% x 250 basis points) and the broker getting 100 basis points (40% x 250 basis points). Using this cost structure as a point of reference, SEI is providing a higher quality and more sophisticated service in portfolio construction by being accountable for the performance of each individual account and at 40 basis points is one quarter as expensive as the pricing structure (150 basis points) of major firm wrap fee programs. The major firms are four times as expensive because SEI doesn't have to provide office space, pay telephone bills or hire office support staff, but SEI, unlike the major firms, assumes accountability for account performance. Thus, the difference in pricing of a wirehouse wrap fee program and SEI is the pay-out structure or the 150 basis points the firm retains which is required for facilities management and support services. Yet, because SEI is providing a higher level of service by assuming accountability for account performance, most of the difference in cost must be attributable to facilities management and the cost structure of the firm. The cost structure of firms and the support provided will continue to be a major issue as the new advice business model unfolds.

**Firms like SEI are inexpensive and assume accountability for the investment results achieved in client accounts**

SEI's new consulting platform points out a dichotomy in the services offered, the value added and in the pricing of those services between the financial services mainstream and a new generation of organizations built to support high level advice. From the client's perspective, major financial services firms are expensive and assume no accountability for performance realized in the client's account. Firms like SEI are inexpensive and assume accountability for the investment results achieved in client accounts. Major financial services firms which are defined by commission brokerage and a product management organizational structure have become high cost, low service providers and have much to learn from SEI as they evolve their pricing, support services and investment sophistication around high level institutional quality advice. In simply offering access to mutual funds without process, the financial services mainstream has built a very expensive product management infrastructure that does not add value for the client. In SEI's process management organization structure (primarily geared to individual investors and 401(k) plan clients of their independent advisors), they have a team of four dozen analysts scrutinizing data on more than 10,000 managers, putting together teams of fund managers from across the world to construct portfolios that are proxies for the broad range of investment management styles (large cap, mid cap, small cap value and growth; domestic/international; equity/fixed income). For example, their $3 billion institutional large cap growth fund combines Alliance Capital, Provident Investment Counsel and AON Funds Management. SEI has 38 such custom investment portfolios which they monitor continuously to make sure the managers are on track relative to their performance benchmark. This is a serious institutional quality investment discipline as opposed to having selling agreements with every major fund company in the country. The sales-driven product management organizational structure of the financial services mainstream that is driven by maximizing sales volume and commissions by limiting shelf space and product offerings so the firm can hit all the institutional breakpoints in compensation, is becoming outdated and out of sync with the thesis of offering high level advice. SEI can provide a far higher level of support service and value at a far lower price than a conventional product management structure for mutual funds or managed accounts. At some point, it will become clear that all product areas of the financial services mainstream have to be subordinated to an objective funding vehicle neutral investment process designed to add value. When the major product areas subordinate their self-interest to an objective investment process, it will also become clear that the investment discipline, process and methodology of investment management consulting and high level advice will define the industry.

SEI has provided the financial services mainstream an important model on how it may evolve from commission brokerage to high level advice. If the financial services industry were to expand its research function so that it is funding vehicle neutral, incorporating all investment vehicles; and if its firm's assumed responsibility for portfolio construction and individual account performance; and if it were to further move to a process management organizational structure from a product management organizational structure; the competitive character of the financial services mainstream would be greatly enhanced because it could actually compete on the basis of the value it empowers its financial consultants to add in each client account. If this new process management organizational structure were also tied to advanced systems technology, the firm could cuts its cost structure by 50% or more. By moving to ongoing advisory fees associated with high level on-going advice, the firm also expands its earnings multiple to three times that of commission brokerage. By managing all the client's assets and liabilities, rather than executing isolated, disjointed trades, the assets and the earnings of the firm are greatly increased. So, not only is the client well served by providing high level advice, but the firm enjoys higher earnings, margins and multiple. It is the emergence of firms like SEI which trigger an unflattering comparison to mainstream financial services organizations which will cause the mainstream to evolve in a more dynamic way. This is the next generation of financial services firm. ■

## What Is Professional Investment Counsel Worth And Where Does That Take the Industry?

*Continued from page 4*

would require more than 1 2/3 hours of service for the year. Some may reason: "Forget advice; mutual funds are indeed the best option because it implies no personalized advice." Yet, clients with $50,000 have a greater need for advice and are more prone to very costly mistakes than the more seasoned, well-advised investor. The smaller the client assets, the greater the need for advice but the less feasible advice becomes.

This conundrum tells us much about how the financial services industry will evolve its structure; how pricing of support, products and services will evolve; and how consulting practices will evolve. In order for a consultant to provide high level, comprehensive, expert advice, it will require at least 10 hours of their time per client during the course of the year. This means if the consultant works a conventional 40-hour week, or 2,000 hours a year, that they can serve 200 clients. If the consultant has a minimum fee of $1,500 per client (in effect, billing their time at $150 per hour) and requiring a $100,000 account minimum, they would generate a minimum gross revenue of $300,000 a year. From this $300,000, the consultant must pay for services which leverage their time. They pay their firm half or more of their gross revenues for office space; systems; administrative and operations support; fiduciary, philanthropic, trust and investment services support; and an investment process methodology and technology through which they add value. Also from this $300,000, the consultant must pay for a technical analyst who makes all the unintegrated technology function as a system and who helps construct, manage and report on client investment portfolios. Also needed is an operations/administrative person who may or not may not be provided by their firm. If the consultant is to leverage the number of clients that the practice can manage, they will also hire a relationship manager who will work with existing clients. This practice model of successful senior consultants focused on high net worth and ultra high net worth individuals is driven by an average client base of 120 investors and $500 million assets.

**IF WE ARE GOING TO PROVIDE HIGH LEVEL ADVICE IN THE ADVICE BUSINESS MODEL, THE CONSULTANT MUST FIND A MORE EFFICIENT MEANS TO SUPPORT HIGH LEVEL, COMPREHENSIVE, EXPERT ADICE**

The advice business model is much different than commission brokerage, and if we are going to provide high level advice, the consultant and the industry must find a far more efficient means to support high level, comprehensive, expert advice. Today, highly successful consultants have been required to exert an almost Herculean effort to provide high level advice within firms which are not structured for advice but for commission brokerage. Technology breakthroughs are such that at $30 million in assets, it is actually less expensive for consultants to spend $150,000 on hardware and software and to hire a technical analyst at $60,000 and an administrative/operations person at $40,000 than it is to spend 75-90 basis points on using the advice support technology and infrastructure of their firm's wrap fee programs. Importantly, the consultant ends up with a better funding vehicle neutral investment process that empowers them to add far more value than they could using the firm's technology. The 50% of gross revenues that consultants provide their firms for support can and must be far more effectively deployed as today's decline in commission brokerage rates will inevitably make it impossible for firms to sustain their present overhead. Firms must develop a new and more efficient business model that facilitates economies of scale in providing high level, comprehensive advice.

The future is high level advice, not commission brokerage. The consultant must receive commensurate value for the share of gross revenues they provide. Access to financial products, trade execution and facilities management are commodity-like services which can no longer command even a small fraction of the 50% or 60% of gross