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The Next Generation of Management: Integrating Privately Managed Accounts into Your Financial Advisory Business

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American wealth is being created at previously unimaginable rates. Guaranteed salaries for professional athletes and other entertainers, executive compensation and corporate equity packages, and intergenerational transfers or liquidations of family-owned businesses and other assets have generated exorbitant sums of investable assets. In addition, the natural appreciation of marketable securities that are a fixture in 401(k) plans, IRAs and taxable portfolios all contribute to the "wealth creation" phenomenon. Real household net worth grew from $20.4 trillion in 1990 to $34 trillion in 2000, a 5.24% annual growth rate compared to a growth rate of only 3.5% during the preceding 30 years.[1] By the end of the 1990s, total investment assets controlled by individuals in the U.S. markets were $11.6 trillion.[2] In addition to this increase in assets, the number of individuals holding at least $1 million in investable assets grew to 7.2 million worldwide in 2000. Today, over 2.54 million individuals hold more than $1 million in assets in the U.S.,[3] and the U.S. economy is expected to continue its expansion, with real wealth explosion continuing into the foreseeable future.

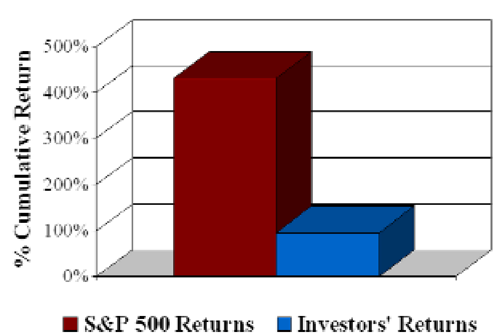
The Market for Private Accounts

So what are all these high net worth individuals and millionaires doing with their money? According to a study conducted by Dalbar in 1999, they are turning to their financial advisors to help them manage their wealth. In fact, 89% of high net worth individuals claim to use the services of an advisor to help them manage their money. Roughly $10.3 trillion in assets were influenced by advisors in 2000.[4] Why are these investors turning to professionals for advice? Due to feeble attempts at market timing and inadequate investment disciplines, most investors do not realize the same returns on their investments as the equity funds that they own. From 1990 to 1999, individual investors in U.S. equities generated cumulative returns of only 96% versus the S&P 500 benchmark, which delivered cumulative returns of 431% over that same time period (Figure 1).[5] Too often, individual investors, when left to their own devices, succumb to their natural emotions of fear and greed, and allow themselves to be sensationalized by the media. As a result, they often choose investment strategies that typically underperform.

Investment products have evolved over the past 20 years, producing a very different marketplace. Since the early 1980s, consumers' investable assets have more than tripled. As previously referenced, in 1981 investors had $4.1 trillion in investable assets, however by the late 1990s, those assets had grown to over $11.6 trillion.[6] In addition, investors have dramatically shifted their product orientation. In 1981, only 25% of total investable assets were held in equities, and 40% of those assets were invested in interest-bearing savings accounts. Conversely by 1997, over 40% of total investable assets were held in equities, whereas investment in savings accounts had decreased to under 20%. Today, over 50% of investable assets are held in equities.[7] During the 1980s and early 1990s, most individuals invested in equities via mutual funds. However, in 1998, over 19% of equity investments were owned outside of mutual funds or retirement accounts. Many investors are now investing in equities directly or through other vehicles beyond mutual fund products. Broad product selections that appeal to different investor preferences have contributed to this change.

In fact, market data indicates that a fundamental product shift has occurred. Investors are now investing in more sophisticated products and are no longer holding money in simple savings vehicles. Likewise, they have more capital available for investment. While mutual funds are still popular with certain segments of

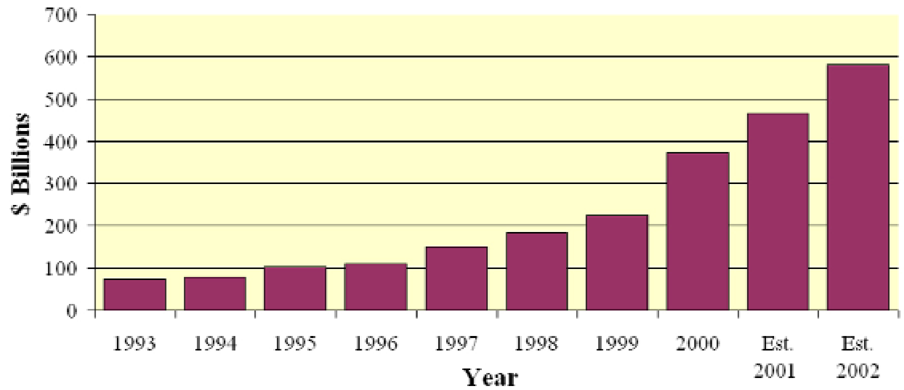
Figure 1.
Why Investors Need Professional Advice



Source: Dalbar's Quantitative Analysis of Investor Behavior Study

today's investor community, private accounts are gaining in popularity as the pooled investment product of choice for the high net worth individual. Private accounts have experienced staggering growth in excess of 25% per year since 1996 (Figure 2). Assets invested in private accounts increased from $225 billion in 1999 to $372 billion in 2000, and are expected to reach just under $500 billion by the end of 2001.[8]

Figure 2.
Growth of Private Accounts



Source: Tiburon Strategic Advisors, The Future of the Brokerage and Investments Industry, March 2000.
Cerulli Associates, 4th Quarter Summary, February 2001.
The Money Management Institute, 1999.
Cerulli Associates, October 1997.

Benefits to Investors

Private accounts have emerged as the most popular product of choice for both the discriminating and wealthy investor as well as for the financial advisor who specializes in serving the needs of high net worth individuals. More than cachet and country club appeal differentiate private accounts in the marketplace today. It is the simple fact that the investor owns the cost basis of the individual securities in the managed portfolio that stimulates the demand. In 2000, many investors were hit with large capital gains taxes, despite the fact that their mutual fund portfolios had actually decreased in value due to the downturn in the U.S. equities markets. With privately managed accounts, investors reap the benefits of having their money managed by a professional money manager without the potentially devastating tax implications inherent with other pooled products such as mutual funds.

Unfortunately, with a mutual fund product, the investor does not own the cost basis of the individual securities in the fund. Instead, they invest in the fund at the per-share-price of the net asset value of the fund, and therefore own a share of the pooled assets, not the actual securities in the portfolio. This means that the investor has to pay his/her proportionate "share" of any and all capital gains taxes that the portfolio manager incurs when the securities held in the portfolio are traded. If an investor buys into a fund when a particular stock is trading at a high and the manager subsequently sells the security, the investor will be hit with the total capital gains taxes associated with the sale, regardless of the stock's trading price at the time of the mutual fund investment. In fact, the average actively managed U.S. equity mutual fund has a 20% imbedded, unrealized capital gains tax.[9] In contrast, with private accounts, the cost basis is established for each security at the time of purchase. Many investors are not aware of the tax implications associated with mutual funds, and they often invest in a fund based purely on the published historical absolute returns. Most mutual funds are managed for pre-tax return objectives with only performance, not tax minimization, in mind. Performance alone may be important in a tax-deferred account, but these high turnover funds with unpredictable taxable gains may not be appropriate for all investors. This is especially true for those high net worth individuals who are subject to high ordinary income tax rates and may wish to harvest losses to minimize their overall taxes.

The investor, working with his/her advisor and portfolio manager, can selectively harvest losses in the private account in order to shelter gains and further minimize their total tax liability. The private account manager can also optimize portfolios around large low-cost basis stock positions and utilize certain derivative instruments and strategies to better manage single company stock risk. In addition, the advisory team can coordinate tax-advantaged gifting and estate transfers of appreciated securities, depending on a client's unique situation and financial objectives. With mutual funds, the specific tax liability cannot be managed for the individual investor. All gains must be distributed to all shareholders, losses cannot be distributed from the fund, and portfolio customization is simply not available.

In addition to owning the cost basis of the securities in the account, private accounts offer a number of other advantages. As stated earlier, financial advisors can provide better tax planning and tax minimization services with private accounts. They can also provide better cash flow planning. In a privately managed fixed income account, an advisor can work with a portfolio manager to structure a bond portfolio where the principal matures at a time specified by the client's need to help pay for large planned expenditures, while minimizing principal and interest rate risk. If the investor prefers to receive income on a monthly or quarterly basis, or have all the income reinvested, he/she will have the ability to tailor these distributions in a private account. It is important to note that distributions from a mutual fund can only be received as prescribed by the income investments held in the fund. Mutual fund investors may have to liquidate their funds to receive cash.

Private accounts also allow for a high degree of customization and flexibility at the individual security level. A financial advisor can select certain managers who will tailor the individual's managed portfolio to avoid a particular stock, industry, sector or asset class that the investor may already own in a signifi-

cant amount, or may simply prefer not to own for personal, religious or social reasons.

Finally, private accounts as a product class tend to exhibit less style drift and lower management fees than their actively managed mutual fund counterparts. Style drift occurs when a manager begins to move away from, or change, his or her stated investment objectives. It can occur when a manager wants to take advantage of certain market opportunities or when a fund's assets grow so large that remaining in an asset class or particular market capitalization may be difficult. Style drift can disrupt a well thought out, diversified investment strategy for the individual investor and can create difficulty in accurately assessing the relative performance and risk of a portfolio. Fortunately, private accounts can offer some relief. To help prevent style drift from occurring in a private account, an investor, with assistance from their financial advisor, can draft a Statement of Investment Policy and insert a clause in that agreement requiring that the manager strictly adhere to the stated objectives of the portfolio. An investor in a mutual fund has neither this flexibility, nor the luxury of executing such a policy statement.

Private accounts also tend to be more fully invested, thus adhering more closely to their stated objectives and achieving superior returns over time. Given the shared, commonly held nature of mutual funds, more cash is typically held in reserve for these funds in order to meet redemption requirements, and the portfolio is therefore rarely fully invested. With private accounts, there is no need to plan for mass share redemptions that require cash buffers to be held in the portfolio.

Financial Advisors as Private Wealth Managers

Although private accounts have become increasingly popular, the industry currently offers few measures of accountability for private money managers compared to the tools that are available for evaluating mutual fund managers. It seems that just about everyone is in the business of ranking mutual funds today. Most mutual fund companies tout their historical absolute returns, as reported by Morningstar and others, as their key selling point. Private accounts on the other hand, cannot be as easily "ranked" as mutual funds. Absolute performance alone is not enough. A client's unique financial situation, risk tolerance, long-term goals and tax planning strategies are just some of the important factors to be taken into consideration when choosing an appropriate private account product for an individual investor.

While literally thousands of private account products are available, only a limited number of them actually make it into most advisors' opportunity sets. Most private account products are offered to advisors via a "wrap" program. However, these products are not necessarily selected for inclusion in the wrap program based solely upon their portfolio management superiority. In fact, they are often chosen by the wirehouse broker-dealer or wrap program administrator because the firms can provide the sales, marketing and distribution support, as well as the operational and back office structure to service 5,000 to 15,000 brokers investing millions of their client's dollars. Consequently, the firms that offer these private account products typically have at least $3 billion under management in order to fund the requisite wirehouse wrap program infrastructure requirements. That is, these firms primarily serve the needs of larger institutions or manage larger blocks of money. Therefore, their performance returns, investment strategy and investment philosophy may not correlate with an individual investor's needs.

OF THE TOTAL MANAGER UNIVERSES SUITABLE FOR HIGH NET WORTH INDIVIDUALS, 25 FIRMS RECEIVE AN ASTOUNDING 73% OF THE TOTAL ASSETS INVESTED IN PRIVATE ACCOUNTS DUE TO THEIR INCLUSION IN WRAP PROGRAMS

As of year-end 2000, the entire private manager universe of approximately 1,100 firms offered roughly 5,000 products. Private account management firms invest in various asset classes and styles in the portfolios they manage, each of which must be reported as a separate composite, or "product," in order to be in compliance with Performance Presentation Standards established by the Association for Investment Management and Research (AIMR). The bulk of these 5,000 managed products are institutional in nature and are available with minimum account requirements in excess of $10 million. By applying some basic screening guidelines and business rules to this universe, an advisor can identify those managers who have verifiable track records, are viable businesses, and who specifically manage capital for high net worth investors. Looking solely at those private account firms with at least $250 million in firm assets and $50 million in each product and those who manage portfolios for at least 25 different clients, we can narrow the applicable universe to approximately 400 firms running approximately 1,000 different products. If we narrow the universe further by including only those firms with a minimum investment requirement of $1 million or less (that is, non-institutional managers suitable for wealthy individual investors), the resultant universe is roughly 250 firms with approximately 450 products.

Interestingly, of this manager universe suitable for high net worth individuals, 25 firms receive an astounding 73% of the total assets invested in private accounts. What is influencing this commanding marketshare? Primarily this clout is due to these managers' designations as "select" firms by the wirehouse and independent wrap programs.[10] What about the other 225 firms? Might there be other private account products that are actually better suited for high net worth clients? The answer is undoubtedly "yes." But then, how does a financial advisor screen the remaining, non-wrap products to find those that are appropriate for their high net worth clientele?

As already stated, choosing private account products is a much more detailed process than simply choosing the manager with the best historical performance. The financial advisor needs to take into account the unique needs of his/her client and conduct thorough research

and due diligence to determine whether the manager's reported historical performance is repeatable and sustainable. Any investment in a private account should be viewed as a long-term commitment. Changing managers and moving money around can be fairly complex and expensive. Therefore, it is in the financial advisor's best interest to choose wisely when initially screening for suitable private account products.

When selecting private account products, the advisor should first develop an asset allocation strategy for the client and then look for those products that meet the investor's specific asset class needs. Once the advisor has selected the appropriate asset class, he/she should select managers that outperform the designated asset class benchmark on a risk adjusted basis.

Importantly, the advisor should pay close attention to the construction of the composite used by the manager to report their performance in comparison to the applicable benchmark. Most managers typically report their institutional composites' performance to the Mobius, Nelson or Effron databases. Given the sheer magnitude of these institutional portfolios, the process that generated that performance may not be repeatable in a $100,000 or even a $1 million account for a high net worth individual. Therefore, the advisor should examine the percentages of the different types of accounts and the assets in the composite. He/she should assess what types of assets contributed to the composite performance – including whether the composite is made up of institutional dollars, money from wrap products or money from high net worth individuals. Institutional or wrap investments may not mirror investments that an individual investor will be able to make. Additionally, the advisor should evaluate the dispersion of the accounts within the composite and note whether or not the composite has been audited. Analysis of the composite is important in assessing whether the historical returns are, in fact, a reasonable depiction of the performance a client could have expected and whether this composite is representative of the needs of the advisor's clients. It is strongly suggested that the advisor request information directly from the manager in order to obtain appropriate and accurate data for analysis.

Further, the advisor should pay particular attention to the tax performance and efficiency of each manager. If the advisor is managing investments in a tax-exempt account, tax minimization may not be an important factor. However, for taxable accounts, it is very important that the advisor look closely at the manager's overall tax performance and aim to understand how that manager mitigates the effects of taxation on portfolio performance. Performance alone is not enough and can often be misleading. For example, a manager that outperforms a passive benchmark on a pre-tax basis may actually underperform, once the tax bill has been paid.

FOR TAXABLE ACCOUNTS, IT IS VERY IMPORTANT THAT THE ADVISOR LOOK CLOSELY AT THE PRIVATE ACCOUNT MANAGER'S OVERALL TAX PERFORMANCE AND AIM TO UNDERSTAND HOW THAT MANAGER MITIGATES THE EFFECTS OF TAXATION ON PORTFOLIO PERFORMANCE

With the increasing wealth of today's consumers, many pundits and strategists believe that traditional financial planners and investment professionals will need to become "private wealth managers" in order to effectively compete and meet the demands of their clientele. As such, successful investment professionals will need to offer comprehensive services, including sophisticated products, detailed and integrated advice, advanced research capabilities and comprehensive reporting systems. Not all financial advisors can or should become "private wealth managers." Investing in more sophisticated products requires an internal infrastructure and a client base that will be able to support a "private wealth management" practice. However, if an advisor has significant assets under management or has a client who recently came into a large amount of money, private accounts can prove to be a very lucrative focus for their business.

Private accounts offer flexibility, personalized functionality, a focus on tax sensitivity and a capacity to add true, measurable value to the wealthy taxable client. Private accounts can help the financial advisor differentiate himself or herself in a very competitive marketplace. Advisors who incorporate separate accounts into their practices report that such accounts can be especially useful in attracting clients they would not otherwise be able to serve, as well as for helping them retain clients whose needs have increased sophistication. In fact, private account clients typically make up a disproportionately large share of a private wealth manager's total assets under management.

Managing money for high net worth individuals can prove to be a highly profitable business model for the private wealth manager. Rather than managing 100 accounts (representing 30-40 client relationships) worth $250,000 each, a private wealth manager could alternatively manage 10 accounts (five client relationships) worth $2.5 million each, subsequently making more money with the same assets under management and working smarter, rather than harder. By managing a smaller group of clients with more substantial assets, the advisor can decrease his/her total number of client meetings quarterly and annually, conduct fewer total financial planning sessions and focus on providing more substantial advice and services to a smaller, more lucrative group of clients while simultaneously increasing total profits. As John Bowen Jr., president of CEG Worldwide LLC, stated in a recent article: "Fewer [high net worth] clients allow the advisor the time to provide a consistent, high quality experience, resulting in better client retention and referrals."[11] With this emphasis on private wealth management services, advisors will be able to extend their reach into the wealthy investor community and grow their client base within this profitable niche.

Private Accounts: Client Management Needs and Changing Business Models

In order to add private accounts to an existing business, advisors will need to have a back office structure that can support trade execution, reporting and custody of the assets in the private accounts. If these needs cannot be supported internally, they may need to be accessed through a larger institution. The advisor will also need to provide portfolio accounting, reconciliation, performance measurement and client reporting on private accounts. The addition of private accounts may require some internal reorganization of an advisor's office. While the required restructuring may seem daunting at first, the benefits to the advisor's business can be substantial.

For advisors who have made the decision to offer private accounts to their clients or who have clients demanding more sophisticated products, business management needs associated with private accounts can be approached in several ways. Turnkey Asset Management Providers (TAMPs) or independent wrap programs may offer a means to rapidly enter the private account market. These programs offer full service tools including asset allocation, proposal generation, manager research and due diligence, back office processing and performance reporting, which help the novice financial advisor build a private account program. By offering a soup-to-nuts solution, TAMPs can be a quick means for advisors to ramp up their business and offer private accounts to their high net worth clients. However, in order to access all of these services, the advisor, and subsequently their clients, will ultimately pay the TAMP or wrap program administrator a hefty fee based on a percentage of assets under management for services which they may not be fully utilizing. For example, the traditional TAMP may charge anywhere from 25-100 basis points on the total assets under management for their services (depending on the total assets under management). This does not include additional fees that the advisor/client will have to pay to the manager (averaging 50 bps for equity accounts and 35 bps for fixed income accounts) or the fees that they will have to pay for custody and trading of the assets (ranging from 10-45 bps). With most TAMPs, the financial advisor will then set up his/her own fee structure on top of the other associated fees (although some TAMPs will pay the advisor a percentage of their fees). The end result is that the client may end up paying anywhere from 125-300 basis points to invest in private accounts through his/her advisor.

As long as the Standard & Poor's 500 index is posting 25% annual returns, these fees may be fairly easy to pass through to the client. However, if the market's returns regress to their long-term averages (which they already appear to be doing), many individual investors may start asking advisors to justify their fees, their value added propositions and their service models. As Mark Hurley and Tom Fuller stated in an article in *Financial Advisor* magazine in July 2001: "The same 1% fee that appeared fairly reasonable in a 6% to 8% equity premium environment now is going to look very expensive to many clients …. Advisors may suddenly find that their clients view their services as both overpriced and incapable of solving their problems."[12] Advisors will need to come up with a new model to offer their clients value added services for reasonable fees.

As the advisor's total assets under management increase, they will continue to pay a percentage-based fee to the TAMP, in addition to manager, custody and trading fees. An advisor with $10 million in assets under management may pay a total of $125,000 per year in associated fees, including fees to the TAMP, custodian and manager. An advisor with $25 million under management might pay a total of $275,000 in fees. (see Table 1 for details on fees). As assets under management increase, the advisor may receive a negotiated price break from the TAMP, however he/she will still be paying a sizable chunk of money.

Table 1.
Cost of Application Service Providers vs. Turnkey Asset Management Provider[13]

TAMP Solution

Associated Fees	$1 Million AUM	$10 Million AUM	$25 Million AUM	$50 Million AUM	$75 Million AUM
Fees to TAMP	$5,000 (50 bps)	$50,000 (50 bps)	$87,500 (35 bps)	$150,000 (30 bps)	$225,000 (30 bps)
Fees to Manager	$5,000 (50 bps)	$50,000 (50 bps)	$125,000 (50 bps)	$250,000 (50 bps)	$375,000 (50 bps)
Fees To Custodian	$2,500 (25 bps)	$25,000 (25 bps)	$62,500 (25 bps)	$125,000 (25 bps)	$187,500 (25 bps)
Total Fees	**$12,500 (125 bps)**	**$125,000 (125 bps)**	**$275,000 (110 bps)**	**$525,000 (105 bps)**	**$787,500 (105 bps)**

ASP Solution

Associated Fees	$1 Million AUM	$10 Million AUM	$25 Million AUM	$50 Million AUM	$75 Million AUM
Fees to Manager	$5,000 (50 bps)	$50,000 (50 bps)	$125,000 (50 bps)	$250,000 (50 bps)	$375,000 (50 bps)
Fees to Custodian	$2,500 (25 bps)	$25,000 (25 bps)	$62,500 (25 bps)	$125,000 (25 bps)	$187,500 (25 bps)
Asset Allocation	$1,000 to $10,000	$1,000 to $10,000	$1,000 to $10,000	$1,000 to $10,000	$1,000 to $10,000
Performance Reporting	$10,000 to $50,000	$10,000 to $50,000	$10,000 to $50,000	$10,000 to $50,000	$10,000 to $50,000
Portfolio Accounting	$2,000 to $13,000	$2,000 to $13,000	$2,000 to $13,000	$2,000 to $13,000	$2,000 to $13,000
Research and Due Diligence	$5,000 to $5,000 to	$5,000 to $5,000 to	$5,000 to $5,000 to	$5,000 to $5,000 to	$5,000 to $5,000 to
Total Fees	**$25,500 to $105,500**	**$93,000 to $173,000**	**$205,500 to 285,500**	**$393,000 to $473,000**	**$580,500 to $660,500**

Additionally, as the advisor's business matures and he/she begins to internalize some of the back office, reporting, asset allocation and other administrative needs, the fees paid to the TAMP will ultimately include services that are no longer utilized or considered to be of value.

In addition to the high costs associated with TAMPS, most offer a very limited number of private account products. As stated previously, wirehouse firms and TAMPs often choose their "select" private account managers based largely on operational, marketing and purely business considerations. Therefore, their products may not represent the "best" private account products or those most suitable for the wealthy taxable investor. Instead, they represent the "best" products in terms of their ability to cater to the demands of the wirehouse brokerage firm or TAMP. This puts the advisor in an awkward position as the fiduciary for the client, whose ultimate goal is to serve and uphold the best interests of the client. With a limited number of products from which to choose, the financial advisor may actually be compromising his/her clients' investment needs by not offering a choice and access to better, more suitable products for their unique situations.

A Better Way: Utilizing Application Service Providers

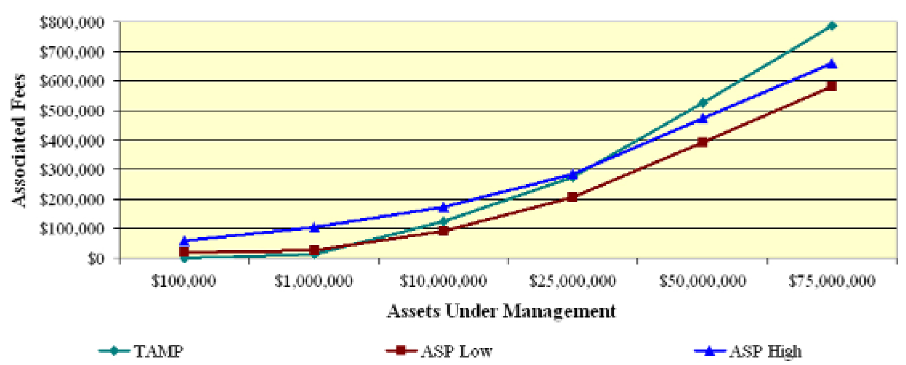
This begs the question, "Isn't there a better way?" Indeed there is. An advisor can internalize many of the services associated with private accounts by building them in-house and/or by utilizing Application Service Providers (ASPs). By transferring the responsibility for non-core business processes to an outsourcing partner, advisors can streamline the process of offering private accounts to their clients, reduce costs, differentiate themselves in the market and better leverage their time to focus on relationship building, client service and referral generation. Some advisors with large practices may wish to build back office, reporting, research and other services internally. However, building internally can prove to be both costly and time-consuming. Advisors who wish to get to market quickly and cost effectively with a private account offering should seriously consider outsourcing some of these services to ASPs rather than building them internally.

TAMPs may offer a good solution as advisors are getting started with private accounts. However, as an advisor builds significant assets under management in excess of $25 million, the cost benefits and effectiveness of using a TAMP begin to disappear (Figure 3). As stated above, an advisor with $25 million under management may end up paying the TAMP, custodian and private account manager an estimated total of $275,000 per year. By outsourcing some of the services provided by the TAMP, he/she would be able to offer his/her clients a more robust solution and potentially realize a significant reduction in associated annual fees. The advisor would need to pay for asset allocation software, about $1,000 to $10,000 per year (the high-end being very sophisticated software); custody and trading, about $25,000 to $112,500 per year (depending on assets and total trades per year); research, due diligence and analyst opinions on a wide range of managers and mutual funds for $5,000 to $25,000 per year. Performance reporting from a service bureau, if purchased, would cost about $100 to $500 per account. Portfolio accounting software would cost about $2,000 to $13,000 per year (the advisor can purchase software or outsource this service). The advisor will still need to pay fees directly to the custodian and the manager. However, most advisors may already have many of these outsourced services in use in their practice. Therefore, there may be fewer incremental costs and greater savings when they bring the private account solution in-house instead of paying for the full-service TAMP solution. In fact, many advisors may begin to see a cost savings by outsourcing to ASPs with as little as $8-$10 million in assets under management, depending on the level of services they demand (Figure 3).

To further build the financial scenario, let's say an advisor has 100 clients with $250,000 of assets in each client account. He/she can expect to pay a flat fee ranging from $205,500 to $285,500 per year, depending on the level of services desired versus $275,000 per year for a TAMP solution. This could represent a savings of $69,500 per year. In a worst-case scenario, the advisor would break even on the associated fees but have more flexibility as well as the foundation for a more robust and customizable solution that would differentiate the advisor's services in the market and add measurable value to his/her clients. Importantly, if an advisor with 100 clients increases his/her total assets under management to $50 million, the fees associated with the ASP modular solution will range from $393,000 to $473,000. However, the TAMP fees will increase to $525,000 and will continue to increase as the assets under management grow. The ASP model will generate a savings – $52,000 to $132,000 per year – while also providing a substantially superior private account solution. (See Table 1 for details.) However, the savings associated with the ASP model will most likely be greater as many advisors already utilize some of these software and outsourcing solutions.

Additionally, as an advisor becomes more versed with private accounts, he/she will quickly realize that the limited products avail-

Figure 3.
ASP Solution vs. TAMP Solution



able to his/her clients via a TAMP are less than optimal. As stated, most TAMPs and independent wrap program providers offer access to a very limited number of products. By offering access to a wider range of managers using an ASP solution and choosing managers based on the client's specific needs, rather than purely based on what is available, an advisor can significantly differentiate himself/herself in the high net worth marketplace.

Most importantly, by building the process internally and partnering with ASPs, the advisor will ultimately be able to offer his/her clients better, more personalized investment options. Today's wealthy clients want their taxable and tax-deferred accounts to have comprehensive asset allocation models that take into account their total financial picture and unique needs. Many wealthy investors hold more than managed portfolios and other traditional investments. In fact, in addition to their portfolios of marketable securities, most have investments in real estate, commodities, art, antiques and other alternative investments. Therefore, they demand that their advisor provide reporting, comprehensive balance sheets with all their assets and financial plans that take into account the totality of their financial situations. Finally, investors need portfolio managers who can consistently beat their benchmarks and also provide managed portfolios customized to meet their client's asset class, taxation and investment needs.

An advisor is simply not able to provide all these services to his/her clients with a TAMP. In today's market, advisors have been hit with a volatile stock market, a rising tide of investor pessimism and a softening economy. As a result, many practices are feeling a decrease in their total revenue. According to research conducted by Prince & Associates, "On average, assets at advisory firms across the country fell 13% during the first four months of the year and are down as much as 30% to 40% at some firms."[14] Advisors need to pay more attention to the bottomline of their investment management business. As John Bowen Jr. states, "The top 15% of advisors are successful because they have reacted to the market and are willing to make structural changes to their business as events unfold. Those top earners employ operating practices that differ significantly from those who earn less … and keep them squarely focused on the bottom line."[15]

Advisors who use an outsourced ASP private account solution with $25 million in assets under management instead of a TAMP, will at least break even on their total costs, while providing their clients with more choice and better services. Additionally, they will build a more efficient and more effective private account solution internally. As the advisor's assets under management increase to over $25 million, the argument to outsource services to ASPs becomes even more compelling, as it maximizes financial savings as well offers better services and more choice to high net worth clients.

In conclusion, by utilizing an ASP solution, the advisor can increase his/her total revenue through cost savings. As a result, advisors can augment their business' financial outlook and enjoy the fruits of better business management internally or pass on the savings to their clients, while offering a broader range of more customized, value added services to their clientele. ■

Notes

[1]American Enterprise Institute (AEI) for Public Policy Research, Feb. 2000. AEI Economic Outlook 2001.

[2]Tiburon Strategic Advisors, Sept. 2000.

[3]Merrill Lynch/Cap Gemini Ernst & Young, World Wealth Report 2001.

[4]Tiburon Strategic Advisors, Sept. 2000.

[5]DALBAR's Quantitative Analysis of Investor Behavior Study.

[6]Tiburon Strategic Advisors, Sept. 2001.

[7]*Business Week,* Feb. 14, 2002 (IRS, Federal Reserve).

[8]Tiburon Strategic Advisors, *The Future of the Brokerage and Investments Industry,* March 2000; Cerulli Associates, 4th Quarter Summary, Feb. 2001.

[9]Morningstar Principia Plus for Windows.

[10]Cerulli Associates, 2000. The Money Management Institute, 2000.

[11]Michael Fritz, Investment News, Sept. 17, 2001, *"Top-$ planners earn more from fewer."*

[12]Mark Hurley and Tom Fuller, *Advisors Must Shift to Value Based Fees,* Financial Advisor, July 2001.

[13]When calculating cost estimates, assumptions made are: (a) Advisors manage 100 accounts for each scenario. Accounts are defined as the total number of accounts, not the total number of client relationships the advisor manages; (b) We are assuming that advisors do NOT already have any of the necessary back office components internalized. Therefore, the savings they will experience may be much greater than represented by the numbers in this table; (c) The costs associated with both the TAMP and the ASP solution are variable and can be negotiated. We did our best to find the average costs; (d) We made the assumption that the manager fees with remain the same after the advisor separates from the TAMP. We believe that most managers will maintain the same fee structure regardless of the platform the advisor uses to access the manager.

[14]Tracy Longo, *Under the Microscope,* Financial Advisor, Aug. 2001.

[15]Michael Fritz, Investment News, Sept. 17, 2001, *"Top-$ planners earn more from fewer."*

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