

WM Today: Focus on Wealth Management

Inside: Excerpts from the MMI 2011 Fall Solutions Conference and MMI TechOps from New York City



CONTENTS

PAGE 2

Operational Hurdles of Implementing Business Initiatives in Advisory Solutions

PAGE 3

The Vanishing Tailwind of Economic Growth

Macro Trends in Outsourcing

PAGE 4

Northern Trust Wants Managers With Unique Offerings on Their Platform

PAGE 5

Uncovering Managers in a Crowded Market

PAGE 6

High Growth Solutions – UMA, UMH, RPM

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Keynote Speaker

Ideas That Can Change the Advisory Business

The speaker for this session was [Mark Tibergien](#), Chief Executive Officer of Pershing Advisor Solutions, a BNY Mellon company.

Mark told everyone to step back and think about the advisors that they're servicing and ask what are some things that will truly change the way we think about our business?

1. Managing Growth

What is the rate of growth that we're seeing in the advisory industry today, Mark asked? After 2008, the rate of organic asset growth was reduced for most advisory firms, he noted, so they have to attract new clients in order to grow. Attracting new clients creates new layers of complexity that make it difficult to manage growth.

Managing growth is not only about growth of assets but also about growth of the firm itself. Growth creates opportunities to develop staff, to create succession plans and to generate profits. But it also places strains on advisory firms in the area of span of control, as well as:

- Dilutes the firm's sense of purpose
- Impacts the quality and consistency of service
- Reduces the efficiency of resources

What is the optimal number of client relationships that the average advisor can manage, Mark inquired? Depends on the nature of the model. Pure money managers can handle more while a family office might be lower.

According to a Moss Adams study, the typical advisor has about 1,800 hours of inventory per year, Mark reported. Advisors spend, on average, 20 hours annually on each high value client. This means that the optimal number of clients should be no more than 90. Although that would only be true if all your clients were high value and you spent all of your time on client service, which is never the case. You must take into account time spent prospecting, attending meeting (like MMI) and running the business. The typical advisor winds up spending just 56% of their time on client service, he pointed out.

(continued on page 4)

The Evolving Growth of Advice and Advisory Services

Rep as PM vs Rep as Advisor

The moderator was Marc Zeitoun, Managing Director, Head of Distribution, Rydex/SGL. The panelists were Jay Link, Managing Director, Managed Solutions Group, Merrill Lynch, Peter Malafrente, Executive Director, Managed Accounts, UBS and George Raffa, National Sales Manager, Asset Management, SVP, Raymond James

Which term is more accurate, Rep as PM or Rep as Advisor?

Jay believes that the term Rep as Advisor makes more sense since advisors do quite a bit more than just portfolio management. They act in some ways as

both investment consultants and wealth managers. This is an entrepreneurial community and some RPM advisors consider themselves to be style-specific and market themselves as money managers. Other advisors see RPM as just another level of service that provides a better overall client experience. They use discretion as a tool to deliver more holistic advice.

Peter really doesn't like the RPM title, since advisors are acting in an investment advisory capacity. Rep as PM doesn't adequately capture what the advisor is doing for the client. Planning, liability side of the balance sheet, trusted council. RAA is more accurate.

George feels that RPM works best for teams that are headed by a financial planner

with one person that oversees the portfolios and spends 100% of their time .

What percentage of your RPM program AUM is currently in mutual funds or ETFs?

In the Raymond James RIA program, which includes both discretionary and non-discretionary, the percentage is over 50%, George explained. This has increased since the run rate for last 12-36 months was 60%. The asset base is slowly shifting away from individual securities towards funds and ETFs, he said.

In PMP, there's an even split between mutual funds and ETFs with about 20% of AUM each, George continued. And mutual funds weren't even available on the platform until late 2006. Where they've seen the most growth in mutual funds and ETFs is from the organic increase in advisors moving into discretionary plus advisors coming to Raymond James from other firms, he stressed.

The Merrill Lynch RPM program has approximately 29% of its assets in mutual funds and 20% in ETFs, Jay answered. Mutual fund assets have tripled in last three years at the expense of individual equities. ETFs have been relatively flat, he stated.

ETF market share is small in the UBS RPM program, Peter confirmed. Even in model portfolios they only see around an 11% run rate.

How do you respond to skeptics who doubt the ability of financial advisors to manage money effectively?

George said that advisors can manage money effectively, if they have the necessary support from the home office. The industry trend is towards more RPM due to its flexibility and investor concern over volatile markets. Sponsors can help to make RPM advisors successful by being transparent in their asset allocation models and manager selection process, he stressed.

The team approach seems to work best for RPM, Peter said. The top 25 advisors at UBS that use RPM are all in teams with well-defined roles and responsibilities.

Does your firm's RPM program allow hedging?

The concept of hedging in RPM programs is immature, Jay believes. Shorting or margin usually aren't allowed, although, some options or inverse ETFs are permitted. Diversification parameters in their programs encourage portfolios to be long-only and fully invested, especially for entry-level and middle-tier advisors. There has been an increase recently in the use of non-correlated investment types, such as alternative investment mutual funds, he continued.

How does a manager get an appointment with your team?

To get an appointment a manager should start with a solution-based approach, George responded, since the markets are difficult and the numbers aren't coming in. Standard asset allocation models are underperforming the indices. The slices of the pie that advisors control aren't performing well and they want data about why they're not working or why they should be working or if they should move it, he said.

For example, managers could provide new ideas in the fixed income or alternatives space, George suggested. Be pro-active and have ideas that you can talk about with conviction that compliment advisors current strategies. The solution-based appointment is more powerful today than ever before, he emphasized, and it would be extremely effective with Raymond James advisors as well as their home office research team.

Jay concurred and added that managers should think about the leverage points. The people that know Merrill's advisors and team structures the best are their Wealth Management specialists, he noted.

Managers should be knowledgeable about a firm's advisor segments — the high end are the rain makers, portfolio managers, and research analysts who are responsible for equity, fixed income and AI rosters and matrices that they use in their RPM portfolios, Jay concluded. ♦

Break-Out Session

Operational Hurdles of Implementing Business Initiatives in Advisory Solutions

The moderator was Heeren Pathak, CTO, Vestmark, Inc. The panelists were John Ashefski, Managing Director, Investment Management Services, SEI Investments, Cheryl Nash, President, Investment Services, Fiserv, Chandresh Iyer, Managing Director, Head of Global Custody & Investment, Citi Global Transaction Services and Roger Paradiso, President and Chief Investment Officer, Private Portfolio Group, Morgan Stanley Smith Barney.

What can firms do now to prepare for upcoming regulation changes, even though they haven't been finalized?

Cheryl was at the Tiburon conference last week and told us that there was lots of discussion around the SEC ruling. The consensus was that the Uniform Fiduciary Standards won't be implemented until after the election. From Fiserv's perspective, a lot has to do with transparency, understanding what's in your investment models and how visible it is to the end investor.

"We're working to provide clients with an integrated end-to-end solution that ties everything together."
-- Cheryl Nash, President, Fiserv Investment Services

Fiserv has invested a lot to ensure transparency in their solutions, Cheryl noted. Starting with important front office functions such as planning and investment policy statements and making sure they translate through to trading and reporting to support execution of an investor's household plan.

Citi's view is that it's better to build the necessary capabilities into the system design now rather than waiting for the regulations to be finalized, according to Chandresh. In order to support this, they created the concept of "Continuous Compliance". This means that at any

point in the life cycle of a product or service, enough flexibility should be built in to enable the delivery of data or reporting or analytics to ensure they can be in compliance with new regulations. As long as you understand the key parameters of the issues the regulations were intended to address, you can start building them in as early as possible in your life cycle, he added.

How do you balance compliance control against the needs of the product development and customer service teams?

Citi is continuously working to create a balance between product innovation and risk control, Chandresh reported. But there isn't one answer that fits every firm.

A major dilemma that Chandresh has to address is how much of his \$150mm annual technology budget should be spent on compliance versus building out new client capabilities?

To better address this concern, he explained that Citi fundamentally changed the way they develop products and services. They factor risk and control issues very early in the development cycle, he said.

Chandresh identified three key trends that are affecting the investment industry: 1) globalization 2) regulation and 3) risk management. It's a tough balancing act between time to market and regulatory requirements, he said.

What are some of the lessons learned about maintaining support for compliance during large systems integration efforts?

One such integration effort took place at Morgan Stanley and they learned a lot about how to deal with compliance and oversight because you can stretch things much further than you thought when working on simultaneous projects. Roger recommended that firms should build the right foundation early and skip the bells and whistles. For large organizations, regulatory support must be built right initially since high volumes make it difficult to backtrack. It might be easier for smaller organizations to go back and retrofit systems later, he added. ♦

Keynote Address

The Vanishing Tailwind of Economic Growth

The tailwind of economic growth that drove our economy to new heights for the past thirty years has disappeared, according to Curtis Arledge. The source of the tailwind was the extraordinary amounts of debt taken on by the government, corporations and individuals, which reached levels not seen since the Great Depression, he said.

Curtis, who is Vice Chairman and Chief Executive Officer, Investment Management at BNY Mellon, explained that the ratio of our total debt to GDP is at a higher level now than it was in 1929. At that time, the debt to GDP ratio reached a peak of 2.3x (in other words, \$2.30 of debt for every \$1.00 of GDP). After the market crashed, he added, it took almost 50 years for the economy to de-leverage down to 1.5x.

Starting in the late 1970's the ratio started growing again until it reached another peak of over 3.5x in advance of the recent financial crisis in 2008. More than three years later, we've only managed to reduce the debt-to-GDP ratio to 3.3x, Curtis observed. At this rate it's going to take a long time to get back to a safer level.

Every time we had a problem in our economy, from the 1980's until 2007, the solution was to create some new form of leverage. This acted like a tailwind to our economic growth. The events of 2008 demonstrated that new leverage solutions aren't the answer anymore, Curtis emphasized.

The rest of the developed world has similar debt problems and they're also trying to reduce their debt-to-GDP ratios. This global de-leveraging will dampen future growth, Curtis noted. Risk-based capital fared especially poorly in Britain, where banking assets went from 1x in the early 1800's to 6x the size of the entire UK economy by 2007.

Curtis noted that the process of reducing our debt load won't be as bad for us as it was for Japan after the 80's boom, since our economy is more multinational. Our economy benefits from being able to move assets around the globe as needed. This will shorten the de-leveraging cycle, he predicted. ♦

Break-Out Session

Macro Trends in Outsourcing

The speaker was Steve Dunlap, President, Pershing Managed Account Solutions.

This is a summary of a session from the MMI TechOps 2011 Conference.

Steve started out by explaining that outsourcing makes good business sense since it centralizes functions and contributes to scale.

Almost on a daily basis, a regulator is imposing new rules and these rules consume management bandwidth, Steve noted. Outsourcing can help firms react to regulatory changes without impacting their management bandwidth and allows better management of the core business functions, he explained.

As Curtis Arledge mentioned in his session (see column to the left), the last 10 years were spent on asset gathering but the next 10 years will be focused on portfolio construction, Steve said. In order to focus on portfolio construction, firms should identify commodity components of their business and figure out how to centralize support internally or outsource, Steve advised.

Outsourcing provides significant benefits in business continuity and disaster recovery as well system consolidation to lower operating costs, Steve said. He confirmed that Pershing is in the process of consolidating four internally developed billing systems onto a single billing platform provided by Redi2.

When planning to outsource, an incremental approach work better than a big bang, Steve stressed. It's better to avoid too much change, he warned, especially if it involves cultural shifts.

Firms should think about outsourcing for technology and operational support and should have clearly defined goals, he said.

For outsourcing overseas, Pershing decided to build their own development center in Chennai, India. Steve explained that since they hired all their own employees, it gave them the ability to quickly respond to DR/BC issues. The time difference between local operations is another benefit since they can essentially work around the clock. ♦

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Northern Trust Wants Managers With Unique Offerings on Their Platform

By Tom Stabile, www.fundfire.com

Katie Nixon, the new CIO of Northern Trust, said that the firm prides itself on maintaining a platform of external managers next to its own products, with a particular focus on separately managed accounts for its high-net-worth and ultra-wealthy clients. “SMAs are very important for most of our clients because of the tax ramifications,” she adds.

The firm tends to seek external managers that have “unique and differentiated offerings” and wants a focus on alpha-generating strategies, not more passive, index-hoarding approaches. It then fits those products into a broader “risk management context” for clients. With that strategy, Northern Trust has been able to access numerous unique strategies that its competitors can’t offer to clients, she adds.

Northern Trust’s investment team regularly adds new strategies and culls its roster to excise products that no longer are contributing, aiming to adjust its investment lineup in order to meet its evolving market outlooks, Nixon says. It doesn’t aim to grow the platform’s size in relative terms, however.

“We’re never going to be a supermarket... with hundreds and hundreds [of products],” she says. “There is an optimal size.” The firm currently utilizes 36 third-party SMA managers.

While getting on Northern Trust’s selective SMA menu is probably a tough bid, it’s likely a lot of managers are already trying to adjust to the asset management market’s heightened competitiveness, says **Craig Iskowitz**, principal of **Ezra Group**, a wealth management consultancy. And even as managers scramble to respond with products needed in the changing market environment, there is also a trend of sponsors trimming their SMA rosters.

“Managers are feeling a lot of pressure to get on platforms,” he says. “You’re seeing managers develop strategy niches to differentiate themselves in the market.”

Advisory Ideas from Mark Tibergien

(continued from Page 1)

2. Achieving Operational Efficiency

Advisory firms have to keep increasing efficiency as they grow. Otherwise, margins will evaporate as their internal processes are overwhelmed, Mark commented. How can they design a workflow that is both scalable and efficient?

Mark discussed the following advisory business models:

- Advisor-centric – Impossible to scale due to unique processes
- Client-centric – Creates more silos that can’t be leveraged
- Process-centric. The optimal solution. Enables you to be systematic in how you manage your business, yet customized in how you deliver advice.

Problems occur at firms with multiple advisors because most advisors have unique approach to how they do business, Mark observed. Advisory firms shouldn’t be client-centric or advisor-centric, but should become process-centric. This doesn’t mean that advice becomes generic for all clients. It means that you create repeatable, scalable internal processes that enable efficient delivery of customized advice for each client, he stressed.

3. Creating Capacity

The advisory business is fundamentally a people business, not a technology business, Mark emphasized. The biggest challenge seen in advisory firms today is how to create capacity. He went on to define capacity as the physical limits of your resources and must be increased in order for your firm to maintain or, preferably, to increase profitability as you grow.

Many advisory firms are at a crossroads, Mark cautioned, and must choose one of the following options if they want to continue to grow:

- increase the capacity of their advisors
- change their customer service model by decreasing the amount of touches required for each client
- “scale down” by culling the least profitable clients so they can focus on the high value ones.

In Mark’s most recent book, *Practice Made (More) Perfect*, he identified a number of signals that should alert you when your firm has reached a point of transformation:

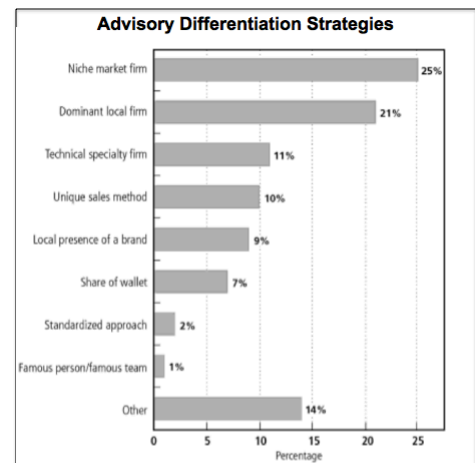
- Client complaints
- Exception reporting
- Staff turnover
- Response time to clients
- Overhead as a percentage of revenue

4. How Can You Differentiate Your Business?

Everyone wants to call themselves a “wealth manager,” Mark observed, and the market tends to blur for clients for the following reasons:

- All financial firms use the same terminology
- Client focus tends to be on asset size, not other characteristics
- Big firms have greater resources to capture top of mind

Mark then enumerated eight strategies that advisory firms claim differentiate themselves from the rest of the market (taken from his book, *Practice Made (More) Perfect*):



Source: Moss Adams

5. Attracting and Keeping People

We hear all the time that people are an asset, Mark noted. But are they diminishing assets or appreciating assets? The RIA segment represents just 15% of the total retail advice population. However, a recent Moss Adams study projected that the industry would need 9,000 more financial professionals over the next five years.

Top performing firms distinguish themselves by focusing on three elements to strengthen their human capital, Mark explained:

- the nature of the work – they understand what the function is and what excellence looks like
- the nature of the worker – do they have not only the aptitude, but also the motivation and interest to stay on the job?
- the nature of the workplace - Can't motivate but can demotivate! Your job is to create an environment where motivated people will flourish.

Top performing firms spend more on their people than average, Mark claimed. They have higher median people costs as a percentage of their expenses. (defined as professional+non-professional compensation expenses) The top quartile allocates 70% of their expenses to people versus 61% for the other quartiles. They spend more on their human capital strategy, but are able to manage their overhead while increasing productivity. Their number of clients per total staff is greater than the average firm, Mark reported.

From the [2011 InvestmentNews/Moss Adams Adviser Compensation and Staffing Study](#):

“Despite working from a larger base (in revenues, AUM, and clients), top human capital firms are able to match the growth of their smaller counterparts – both top human capital and all other firms each grew at a compounded annual rate of about 5% for clients between 2008 and 2010, and both groups show a compounded annual growth rate of about 23% for assets over the same time frame. Top human capital firms are matching the growth rate of their smaller peers by quickly building size and scale, and adding significant numbers of new clients and assets, even though overall industry growth is slowing.” ♦

Accessing the Platform

Uncovering Managers in a Crowded Market

The panelists were Thomas Latta, Global Head of Traditional Due Diligence, Bank of America Merrill Lynch, Barnaby Grist, Head of Wealth Management at Cetera Financial Group and Greg Nordmeyer, General Manager, Managed Accounts, Ameriprise Financial.

How do you formalize your expectations with managers?

In order to set expectations and improve communications, Ameriprise created a guide for managers coming into their firm, Nordmeyer explained. However, since every relationship is different, each manager can't be handled in exactly the same way. They are all unique relationships, from large, established asset managers down to very small boutique firms.

The manager's guide does help explain how to work with Ameriprise's platform and includes general information about operations, sales and marketing, points of contacts, as well as answers to specific questions such as "how do the quarterly fact sheets work?". They update it and distribute it annually, Nordmeyer said.

What is the most challenging thing you ask managers to do when they have a product under coverage?

It's a challenge for managers should be supportive of and be aligned with Merrill's guidance, yet flexible enough to deliver their own business, Latta contended. This is more difficult for managers that have an extended distribution force, since they all need to understand Merrill's positioning.

When a manager's distribution force goes into the field they find that many Merrill advisors run their own book and have their own investment views, Latta emphasized. The Due Diligence Team asks that manager organizations to respond to those commercial opportunities with their best advice. However, managers should try to be connected to the Merrill organization and their goals, he advised. From a selfish perspective, Latta cautioned, "We expect managers to carry our book for us."

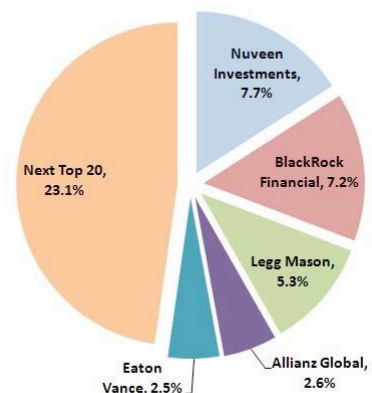
What's the best path for an emerging manager to engage you?

Cetera is not the type of firm that is looking to differentiate themselves by being first to market with a new strategy, Grist advised, and that makes it harder for startup managers. A startup manager should plan to meet the research team and look to build a long term relationship with them. They should not expect to get anywhere for the first 12-24 months, he cautioned.

Are there things that managers do that make life harder for you?

Things get complicated when a manager's capability is positioned differently in various parts of the organization than it was in Due Diligence, Latta said. Managers should establish their central guidance and message with the Due Diligence team and be consistent with their positioning.

Top 25 Managers by Market Share, 2Q 2011



Source: MMI Central 3Q 2011

Latta observed that managers also make life difficult when they overreact to market developments, either positive or negative. Bank loans are a good example. This past February, there was an enormous rush to offer bank loan funds. It was a tactical opportunity that generated lots of demand and managers wanted to respond to that, he observed.

However, the funds were being incorrectly positioned as a core response to the current environment, Latta complained. In these circumstances, the Due Diligence team tries to moderate the conversation and set expectations across the organization, he said. ♦

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Where Are We Today?

High Growth Solutions – UMA, UMH, RPM

The moderator was Hereen Pathak, CTO, Vestmark. The panelists were Tom Huddleston, SVP, Natixis Asset Management, Elba Cruz, Morgan Stanley Smith Barney, Andrew Rose, VP Redi2 Technologies and Josh Mayer, Managing Director Operations, EnvestNet.

This is a summary of a session from the MMI TechOps 2011 Conference.

Under what conditions do you handle the 13F/13G reporting versus requiring the model provider to do it?

Since Natixis is both a model receiver and provider, Tom said, they determine whether the provider or receiver has discretion on the model trades. It's usually the model receiver, he noted.

Josh countered that it depends on the manager's relationship with the program. The manager may have discretion based on prior agreements. In EnvestNet's program, model managers assign discretion to the firm. In a UMA world, there can be dual-discretion between the overlay manager and SMA sleeve manager, since both may have some trading authority, he explained.

What improvements are you making in operations?

13F/13G reporting is simpler, since it only requires providing the managers with a snapshot of their holdings, plus high/low cost, Elba said. In the case of international or small cap managers, they need more data, if they don't have 100% ownership across their account base. MSSB provides tools to allow them to slice and dice their model data, he noted.

Redi2 sits between many different platforms and acts as a consolidator, Andrew pointed out. Most firms have different standards and methods of communication and Redi2 tries to overcome this lack of standardization.

There's been a lot of focus around how models are delivered, Tom observed, including the information that's coming back from the model receiver. Natixis tries to give a better view to the model providers as the frequency of updates has moved to daily, he said.

EnvestNet has been feeling a lot of pressure from managers to improve

communication, so they built a Manager Console where managers have visibility into things like 13F/13G reporting, Josh commented. Managers want to be more integrated into the order flow and execution process.

How do you support the model providers from a sales and marketing perspective?

Model providers receive a running tally of their assets at Morgan Stanley, so they can measure their success by division and region, Elba mentioned. They sometimes provide data at the advisor and branch levels, he added.

The Manager Console at EnvestNet has a sales dashboard, so as advisors generate proposals, managers can see the data in real-time, Josh emphasized. The industry switch to Models-Only UMA has created a lot of velocity in switching between managers which has generated a tremendous amount of administrative work. However, managers that take advantage of the dashboard have higher asset retention rates and there is less switching between managers, he noted.

Manager CFO's are concerned about data on sales flows and being able to break them down into sales compensation schemas, Andrew claimed. One challenge in models-only programs, is that managers have too much client data where they can't just pass off discretion to other parties. Managers that are distributing on multiple sponsor platforms have operational issues since they all function differently, he commented.

Are you seeing any variability in pricing models?

There's downward pricing pressure on model-based products, Josh argued. Managers are using the data to assess how models are priced in the sponsor systems. EnvestNet believes they have a pretty good feel for competitive pricing, he said.

Redi2 is seeing a huge demand for assessments of distribution strategies and pricing points in solutions, Andrew announced, because managers want to become more efficient and need the data to improve their processes.

Hereen noted that some model programs are easier to work with and get data from. Managers are constantly evaluating the programs they participate in and whether it makes sense to stay in. ♦

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