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WHITE PAPER

THE TWILIGHT OF THE PRODUCT ACRONYMS

Emerging unified advisory platforms will simplify the taxonomy of managed accounts and usher in important changes to the industry

Anyone trying to make sense of the managed accounts space for the first time confronts a confusing array of acronyms: RPM, SMA, UMA, MFA, RA, UMH—the list seems to go on and on. But a major trend taking hold in the largest distributors of managed accounts will eliminate a number of these acronyms and the programs they stand for, thereby simplifying the managed account ecosystem. One acronym will remain—the UAP, shorthand for the unified advisory platform. The two largest firms in the managed accounts industry, Morgan Stanley and Merrill Lynch, have launched unified advisory platforms. Their managed account infrastructures now consist of a single, web-based portal that combines the various types of managed accounts that had previously existed in separate silos, eliminating the need to distinguish between RA and RPM, or MFA and SMA wraps.

The product architecture of the managed accounts industry has been slowly progressing toward a UAP. The unified managed account (UMA) initiated this process of breaking down distinctions between mutual fund advisory (MFA) programs, exchange-traded fund advisory (ETFA) programs, separately managed account (SMA) wrap programs, and rep-as-portfolio-manager (RPM) products. By combining ETFs, mutual funds, and model-delivered SMAs, the UMA removed the need to segregate these vehicles into different brokerage accounts.

Despite its power to simplify a client portfolio, the UMA suffers from one limitation: it is a single account. Yet few people can pack all their financial assets into one account. Most families require accounts with different registration types—say an individual retirement account (IRA) for one spouse, a second IRA for the other spouse, a joint taxable account, and perhaps some 529 accounts and a trust account. A single unified managed account can't incorporate all these legally distinct subsets of a family. The UAP can.

The UAP gives advisors a comprehensive view of a client's entire household portfolio. It extends the UMA concept of inclusiveness to all the client's assets, not just those in a particular account. It simplifies the process of managing a client's portfolio by allowing the advisor to organize all the client's advisory accounts from a single desktop portal.

Summary

Several large managed account sponsors have combined their disparate managed account products into unified advisory platforms (UAPs). This trend will alter the way asset managers and sponsors categorize and analyze the industry, and it will accelerate significant changes already happening in the managed account space.

Key Points

- Emerging unified advisory platforms will break down distinctions between mutual fund advisory (MFA) programs, exchange-traded fund advisory (ETFA) programs, separately managed account (SMA) wrap programs, rep-as-portfolio-manager (RPM) products, and unified managed accounts (UMAs).
- As the distinction between various products disappears, the most important characteristics that asset managers and sponsors will track in the managed accounts space will be the investment vehicles used and the type of discretion exercised.
- Unified advisory platforms will accelerate the growth of fee-based advisory accounts, advance the use of financial planning, and place further pressure on fees for asset management products.

Key Recommendations

- Participants in the managed account industry should begin to think of discretion and vehicle type as they analyze the space. Increasingly, these two attributes will overshadow program type as the most important attributes of a managed account.
- Managed account sponsors that have consolidated all their programs on a unified platform should direct their energy toward creating a more robust, holistic approach to financial planning for their advisors.

The Characteristics of a UAP

- A single portal, or log-in, that allows advisors access to various types of managed account programs
  - —No distinctive identification of branded RPM, RA, MFA, or ETFA accounts on the platform
- A fee-based, advisory relationship
- A single investment contract, and one set of compliance documents
- Streamlined pricing across accounts, including householded pricing
- Integration of middle-office services, such as new account set up
- Integration of back-office services, such as trading and settlement
- The capacity for tax optimization across accounts (asset location)

The most important feature of a UAP, which sets it apart from other managed account solutions, is the aggregation of all programs on a unified technology architecture. Firms that have a UAP platform no longer distinguish between MFA, SMA, RPM, or UMA products because the consolidation of these products on a unified platform, with a single-portal view for advisors, eliminates the need to differentiate among them. Managed account sponsors agree that a consolidated portal is the most salient aspect of a UAP, with 77% of those polled by Cerulli in 2017 indicating that "single technology portal with single sign-on" is the most important characteristic of a consolidated platform.

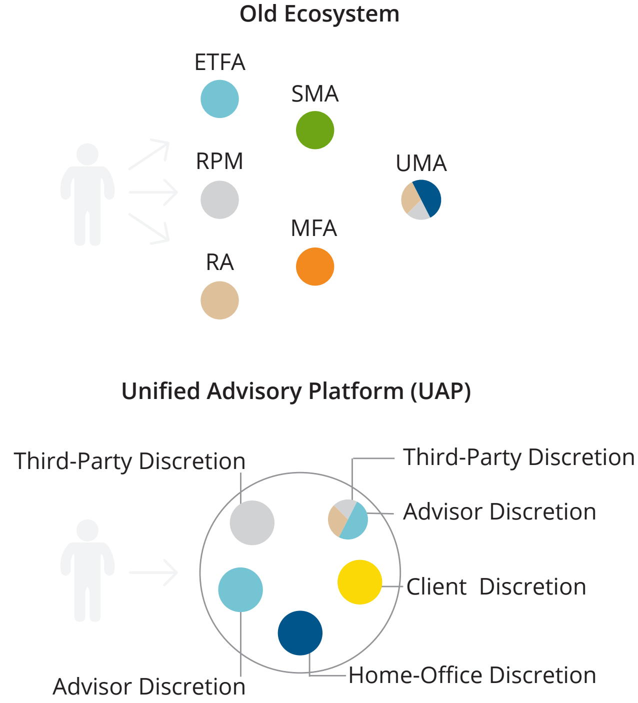
Origins of UAP in the UMH Concept

In the mid-2000s, the managed account industry developed the concept of the unified managed household (UMH), but in many ways it remained a concept rather than a product. The UMH was a philosophy—a way of thinking about how accounts might work together—but there was little technology underpinning the UMH that allowed it to become reality. Fintech firms developed tools that allowed advisors to coordinate among product types to perform activities such as asset location, but advisors still had to access different managed account platforms and cobble together various types of managed programs.

The UAP, on the other hand, breaks down the walls between MFA, SMA, RPM, and RA. Indeed, these products completely lose their distinctiveness as the UAP becomes the singular, all-encompassing advisory platform for the wealth management firm, subsuming them all into one advisory superstructure.

Exhibit 1: The Rise of Unified Advisory Platforms

Platform consolidation will break down the distinctions between program types, causing discretion to become an important characteristic of managed accounts.



Source: Cerulli Associates

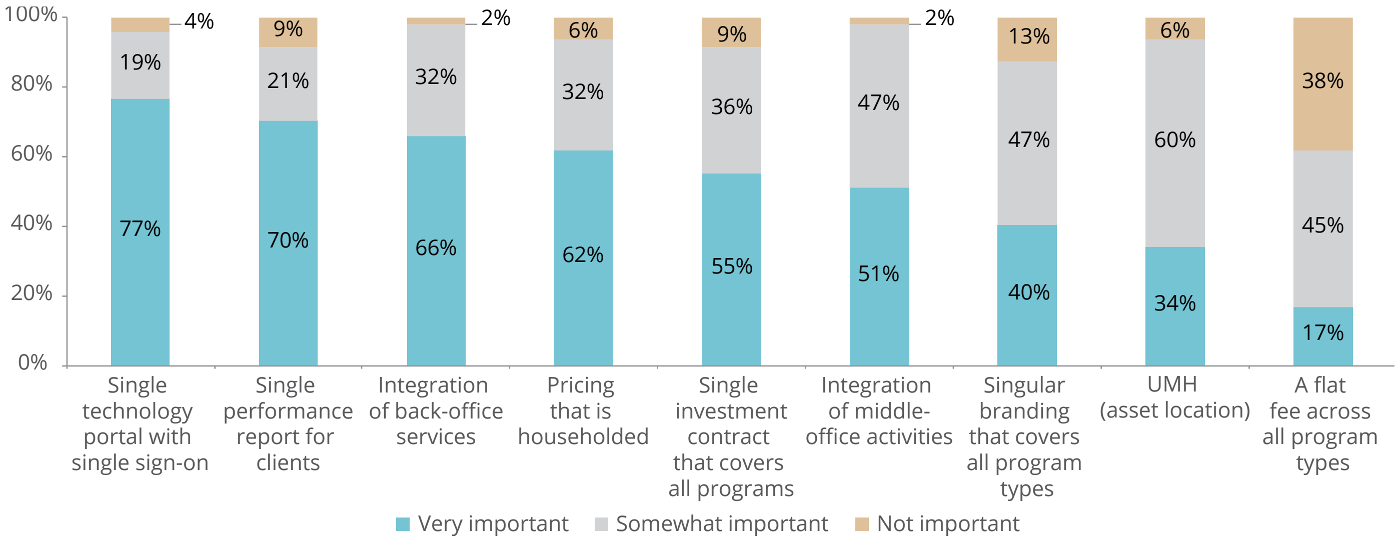
Moving the focus away from distributing product to implementing financial planning solutions

When the focus of a wealth management firm is freed from operating the complex infrastructure of multiple, siloed managed account products, executives can redirect their efforts to developing more holistic advisory solutions for clients. A tremendous amount of energy goes into propping up five or six different managed account programs. Each program has different pricing, technology, operations, compliance procedures, and client paperwork. Often, different executives oversee each managed account product. As a result, the organizational structure of the firm becomes balkanized, with product managers advocating for their parochial interests instead of strategizing about how to solve client problems that transcend the product structure of the organization.

But when these siloed programs are collapsed into one unified platform, all that executive focus, dissipated across a conglomeration of branded managed account programs can be directed to developing higher-order financial

Exhibit 2: Sponsors' Views on the Importance of Various Features in a Consolidated Managed Account Platform, 2017

Sponsors rate a single advisor portal as the most important characteristic of a consolidated platform.



Source: Cerulli Associates

planning solutions rather than managing a multitude of products. Large firms, such as Merrill Lynch and Morgan Stanley, are doing just that by investing in new, goals-based planning tools that can coordinate a client's entire financial portfolio in a way that is unconstrained by the artificial boundaries caused when brokerage accounts are segregated by product or registration type.

Acceleration of fee-based, advisory relationships leads to less power for manufacturers

Since the early aughts, the retail financial services industry has undergone a slow but inexorable shift away from commission-based accounts toward advisory accounts. From 2008 to 2016, the proportion of retail assets managed under a fiduciary relationship has increased from 26% to 42%. The emergence of the UAP will accelerate this trend, as it will make it easier for advisors to engage in fee-based relationships.

The move from commission-based accounts to fee-based accounts will shift power further away from product manufacturers to distributors. When commissions predominated, asset managers could use the product as a vehicle to influence distribution by manipulating commission structures. In a fiduciary model, this leverage disappears, especially as distributors respond to the Department of Labor Conflict of Interest Rule by leveling compensation among products. Add price compression and shrinking shelf space to the mix, and the power of asset managers to leverage their product commissions as a marketing strategy has vanished.

Discretion and investment vehicles emerge as the most important attributes to track

As product acronyms disappear over time, different attributes will emerge as the most salient characteristics of the investment advisory space. Tracking assets in buckets associated with RPM, UMA, MFA, etc. will become less important over time. Instead, two characteristics—investment vehicles and discretion—will become the most significant attributes of managed accounts.

Investment Vehicles

Asset managers want to know what form their products should take as the UAP evolves. In particular, they have asked Cerulli to continue to monitor:

- Mutual funds
- Manager-traded separate accounts
- Model-delivered separate accounts
- ETFs

Some firms have asked Cerulli to track annuities, and while this investment vehicle shows some promise, it has yet to find widespread adoption in advisory platforms.

Investment Discretion

The other dimension that firms have asked Cerulli to track is discretion. (We define discretion as the authority to determine what investments to purchase in a financial advisory account.)

Cerulli has identified four major categories of discretion :

- Advisor
- Home-office
- Third-party strategist
- Client

A Supermarket Effect Will Accelerate Price Compression

An important aspect of a UAP for asset managers is the supermarket effect created when different investment vehicles are juxtaposed to one another on the shelf. One example occurs when mutual funds are positioned next to relatively inexpensive model-delivered SMAs. Surveying the product lineup, financial advisors are realizing that they can replace mutual funds with portfolios managed by the same portfolio manager in a less-expensive model-delivered SMA.

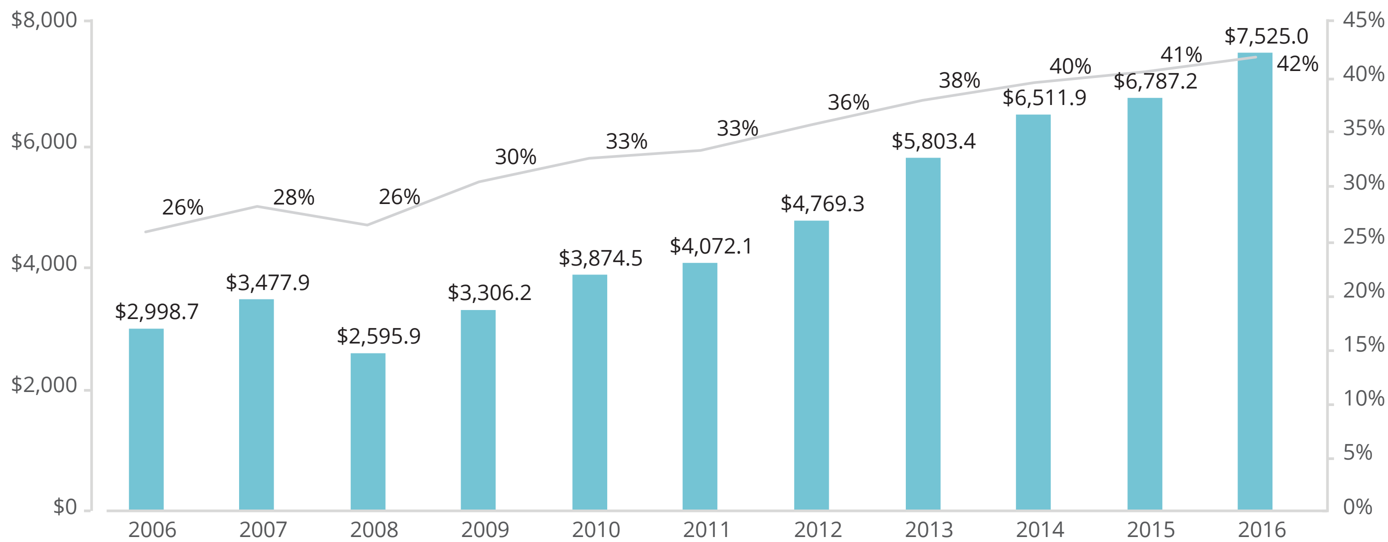
As financial advisors are pressured to reduce the total cost of a managed portfolio, they have been jumping at the opportunity to replace higher-cost mutual funds with cheaper model-delivered SMAs and ETFs. The UAP, which offers advisors flexibility in accessing a firm's investment portfolio through different types of investment vehicles will accelerate product substitution, thereby increasing the downward pressure on fees for asset management products.

How Fast Will This Happen?

Change in the managed account industry proceeds at a geological pace. Participants in the industry have been discussing platform consolidation for at least seven or eight years, and yet only a few firms have achieved

Exhibit 3: Growth in Retail Assets Managed Under a Fiduciary Standard, 2006–2016 ($ billions)

Fiduciary assets continue to grow as a percentage of total retail assets.



Source: Cerulli Associates

consolidation. Product and platform transformation in the financial services industry takes time. It involves not only technological innovation, but also changes to compliance and legal infrastructure, service and operations models, and distribution systems. What's more, innovations must be implemented across a large enterprise weighed down with ponderous, legacy technology platforms and organizational interest groups resistant to change, especially financial advisors.

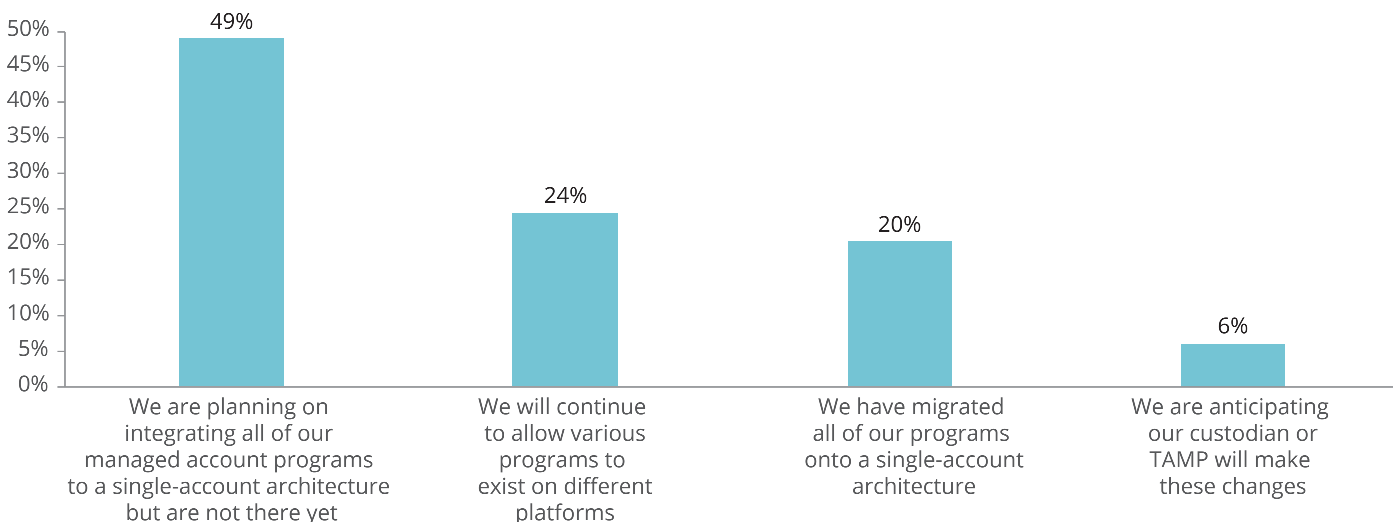
One-fifth of managed account sponsors indicate that they already have migrated to a single account platform. We believe that number to be overestimated as many sponsors consider their UMA to be a consolidated platform.

About half (49%) of sponsors state that they are developing a consolidated platform, while 6% indicate that they will rely upon their turnkey asset management provider (TAMP) to deliver this capability. One-quarter (24%) tell Cerulli that they will continue to allow managed account products to exist on a variety of platforms. But in interviews conducted since this survey, Cerulli has learned that many firms, which had decided to forgo developing a UAP, are now reconsidering. In any event, the move toward a consolidated platform will affect the majority of firms, but Cerulli anticipates some will remain laggards in implementing this capability.

Of those firms considering moving toward a UAP, more than three-quarters believe the transition will take longer than one year or possibly two years or more. Most managed account sponsors have been distracted in the past several years by the rise of robo-advisors and the DOL Conflict of Interest Rule. In 2015, the top priority of managed account sponsors was addressing the DOL Conflict of Interest Rule, followed closely by responding to robo-advisors. Platform consolidation ranked third as a priority. In 2016, platform consolidation returned to the top spot in the list of priorities for firms. Managed account sponsors are just now getting back to developing their UAP. While some may estimate it will take one to two years, Cerulli believes these estimates are overly optimistic.

Exhibit 4: Managed Account Sponsors' Attitudes Toward Platform Consolidation, 2017

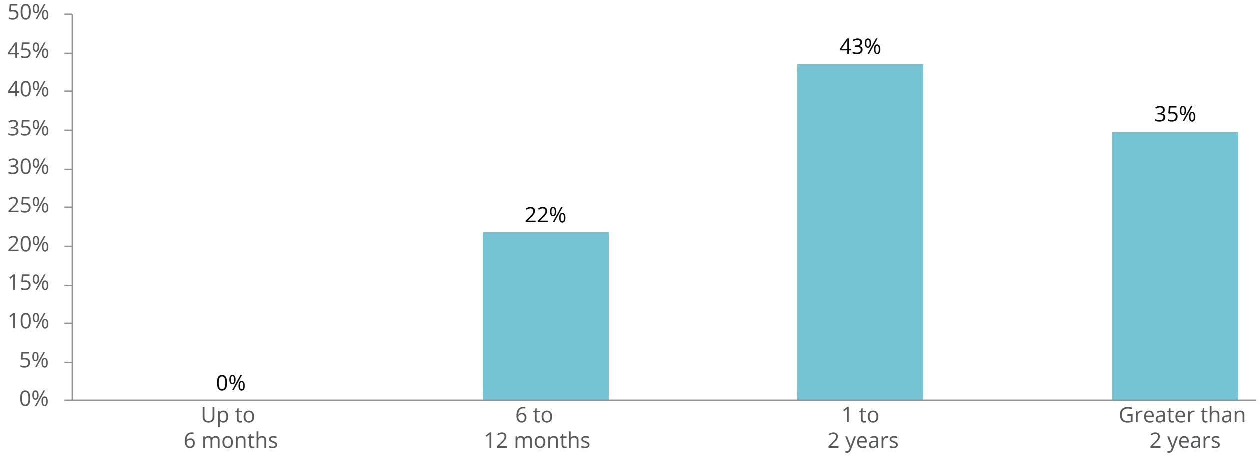
Most firms plan to develop a consolidated platform.



Source: Cerulli Associates | *Analyst Note: Sponsors were asked, "What best describes your opinion of platform consolidation (getting all managed account programs on a single chassis)?"*

Exhibit 5: Managed Accounts Sponsors' Estimated Time to Complete Consolidation, 2017

Sponsors will need two to three years to complete the development of a consolidated platform.



Source: Cerulli Associates | *Analyst Note: This question was posed to those respondents indicating that their firm is currently working toward the goal of a consolidated platform. Respondents were asked: "How long do you think it will take for you to complete the consolidation of programs on to a single platform?"*

Conclusion

This white paper begins with the assertion that the complex array of managed account programs and the acronyms that signify them will slowly disappear. An astute reader will recognize that we propose to replace several acronyms—RPM, UMA, UMH, etc.—with one acronym: UAP, the unified advisory platform. Acronyms pervade the jargon of the financial services industry. They describe regulatory bodies (the SEC, FINRA, and MSRB), brokerage trading (FIX protocol and OATS reporting), and operations (ACAT and TOA). It would therefore be unrealistic to expect they will completely disappear from the vernacular of the managed accounts industry. However, Cerulli does believe managed account executives will be using fewer acronyms as the unified advisory platform simplifies the managed accounts space, removing the structural silos that make all these acronyms necessary.

Beyond a change in naming conventions, the unified advisory platform will drive profound changes throughout the financial services industry. The emergence of the UAP will continue to strengthen the power of distributors over manufacturers of asset management products, accelerate the ongoing adoption of fee-based, fiduciary relationships with clients, encourage the build-out of higher-order financial planning solutions, and present advisors with less-expensive product alternatives, thus causing the displacement of expensive mutual funds with ETFs and low-cost SMAs.