

# Unified Flying Objectives

## DOES RAPID GROWTH SIGNAL WIDER ACCEPTANCE FOR UNIFIED MANAGED ACCOUNTS?

By Ed McCarthy

Unified managed accounts (UMAs) were promoted as the next big thing in portfolio management during the early 2000s. The financial crisis in 2008–2009 slowed their adoption as firms delayed installing new technologies. More recently, though, asset balances in UMAs have seen solid growth. According to research from the Money Management Institute (MMI) and Dover Financial Research, UMA assets grew from US\$30.8 billion in 2006 to US\$178.8 billion in the first quarter of 2012. Data from Cerulli Associates show similar results, with UMAs increasing from US\$79.5 billion in the second quarter of 2010 to US\$181.5 billion by 2012's second quarter.

Despite the rapid growth, however, UMAs still account for a small share of total managed account assets, according to MMI and Dover. Separate account consultant programs (US\$594.7 billion), mutual fund advisory programs (US\$697.8 billion), and rep-as-portfolio-manager or rep-as-adviser programs (US\$514.6 billion and US\$542.6 billion, respectively) were much larger than UMAs in the second quarter of 2012. Additionally, UMA assets are concentrated in a handful of large financial services firms. Morgan Stanley Smith Barney, Bank of America Merrill Lynch, Fidelity Investments, and Wells Fargo collectively hold more than US\$112 billion, with more than half of that total at Morgan Stanley Smith Barney.

### CRACKING THE RIA MARKET

The industry data do not segment the adoption of UMAs by independent registered investment advisers (RIAs),

but industry observers note that RIAs have been much slower to adopt the platform. That's at least partly because the RIA market is not homogeneous, says James Penman, director with Collaborative Consulting LLC in Burlington, Massachusetts. Many RIAs follow a unique business model, and in his experience, UMAs simply don't fit that model.

Alois Pirker, research director with Aite Group in Boston, Massachusetts, cites several other reasons for the low adoption.

Many independent RIAs manage clients' portfolios directly, and management fees are a significant part of their firms' income. If they start hiring outside separately managed account (SMA) advisers plus UMA overlay managers, their investment fee income from clients declines. Another drawback can be a lack of access to the model inputs and technology, says Pirker. Most RIAs aren't set up to buy and implement portfolio models from external investment managers that participate in UMA platforms. Additionally, while the RIA might have a portfolio-balancing tool, it's probably not equipped with the overlay technology needed to manage the process.

The independent RIA market is a prized target for UMA vendors, although adapting the technology to RIAs' multiple business models is a challenge compared with the wirehouse model. Wirehouses generally have a single approach on a single architecture to provide the same and recurring experience to all the clients of all the advisers, says David Gardner, senior vice president with Collaborative Consulting LLC. In contrast, RIAs often offer clients unique services supported by multiple product vendors and multiple custodians.

"The Holy Grail, at least from our view from an operations and technology standpoint, is, How do you efficiently capture all of those individual moving pieces and designs and desires of how they [RIA firms] want to service their clients?" says Gardner. "In the RIA market, that's very difficult. Many [UMA] firms continue to work diligently in trying to figure out how to mutualize the delivery of the same level of services that you can create at a consolidated wirehouse to tens of thousands of individual RIAs."

### THE MOTIVATION

In the right circumstances, it's easy to see UMAs' appeal to independent RIAs. For example, among advisers who work as managers of managers, the technology promises more efficient portfolio management and tax management decisions across clients' holdings. Brent Morse, CFA, managing director of Morse Capital Partners in Glen Allen, Virginia, cites UMAs' operational advantages over traditional SMAs as motivating his decision to adopt the UMA technology. "As markets have changed and become so fast and trading mechanisms and platforms have become so robust, it was hurting us that we had to talk to our clients, get in contact with our clients, get their approval and then sign paperwork just to hire and fire managers," says Morse. "That's what led us to Adhesion [Adhesion Wealth Advisor Solutions] and their UMA platform. It's more efficient not only for us internally, but we have found that it helps client performance if they let us do the hiring and firing of the managers without their approval every single time."

#### KEY POINTS

Assets held in unified managed accounts (UMAs) have grown significantly since the recovery from the financial crash.

Despite the recent growth, UMA assets still lag behind other managed asset strategies.

Several large financial services firms have been the most active UMA adopters; use among independent wealth managers appears to be much less widespread.

Several firms are working to adopt UMA overlay portfolio management platforms to the independent wealth manager market.

RIAs face a built-in challenge when managing multiple SMAs, says Scott Welch, senior managing director with Fortigent LLC in Rockville, Maryland. The traditional model has been that wealth managers build portfolios of third-party managers for their high-net-worth clients. Assets are spread across SMAs to meet the client's investment allocations. That arrangement is unnecessarily labor intensive, Welch maintains. "That's different sets of paperwork for each of those separate account managers, and rebalancing is troublesome," he says. "You have to get involved in the wire transfers and all kinds of stuff that goes along with rebalancing and managing a portfolio of SMAs."

Fortigent, which was acquired by LPL Financial in January 2012, provides a UMA program with roughly US\$730 million of assets. Welch maintains that a UMA can eliminate much of the administrative work for the wealth manager. "If I have those same managers willing to participate in a UMA program and trading within sleeves of a UMA, all of that noise goes away and I'm delivering a very comparable investment experience but with better operational efficiency for the adviser, better tax efficiency for the end client, and just a better experience," Welch says.

## LOOKING AHEAD

Collaborative Consulting's David Gardner says that, despite the challenges in adapting UMAs to RIAs, providers are making significant progress toward meeting independent advisers' needs. "The service providers in the industry are literally almost making monthly strides towards being able to create the system architecture and platform capabilities to be able to try to rationalize all the RIAs that are out there," says Gardner. It's an impressive effort, he believes, "especially considering how they [RIAs] use multiple systems, multiple providers, and multiple vendors to deliver the level of service they do to their clients."

His colleague James Penman also cites the importance of recent advances in UMA technology in gaining RIA support for the platforms. Five years or so ago, he says, UMA adopters had to do their own systems integration to bring the platforms together. Firms had to select a trading vendor, a portfolio management vendor, a compliance vendor, and a firm for fee billing performance because the processes were disjointed. That's changed, says Penman: "What you're finding now is the vendors either offer a complete bundled approach or they've partnered with other vendors to encapsulate a product offering. You're seeing a lot more bundled capability, a lot more maturity in the platform now."

Another factor in UMAs' favor is their increased ability to handle a wider range of investment strategies. SMAs comprise the majority of UMA assets, followed by mutual funds and ETFs. However, it's now possible to run an actively managed long-short strategy inside a UMA sleeve, says Scott Welch. The trend toward greater investment flexibility bodes well for UMA adoption among RIAs, he believes. "To the extent you can

include more of those sophisticated strategies in actively managed sleeves inside the UMA, not only do you garner the operational efficiency that comes along with the UMA program generally, but you now have the ability to optimize taxes across a broader array of sleeves within that program."

Although several UMA vendors work with institutional clients, Adhesion Wealth Advisor Solutions in Charlotte, North Carolina, is one of the vendors that focus on independent advisers. Barrett Ayers, managing director for Adhesion's overlay portfolio management, agrees that RIAs' high degree of client portfolio and client service customization creates challenges. He says that his firm's approach to UMA technology allows advisers to retain their desired level of customization while still realizing the process's broader benefits. "In our platform, we push all the client customization, all the deviations, down to the account level," he says. "An account may be following one of a dozen different kinds of higher level asset allocations, but there are lots of deviations down at the account level for things like tax management, for minimum trade sizes, for cash handling, for concentrated positions. We've been able to optimize the technology to make it follow a strategy but deviate at the account level."

Another key objective for the technology is to make it simpler for the financial adviser to use a UMA account, according to George Raffa, senior vice president for sales in the Asset Management Group with Raymond James Financial in St. Petersburg, Florida. In his view, increased ease of use leads to a change of perspective: "Instead of the advisers choosing a manager or a firm to put in a UMA, their objective is to find the right model to match with the client's goals and objectives."

As of late November 2012, the outlook for U.S. tax policy and global economic growth remains uncertain. Despite that uncertainty, the consensus is, Welch believes, that taxes will increase over time and investors will face a relatively volatile, perhaps low-return environment in the future. Taxes and fees will play a larger role in determining net investment results in that scenario and will make UMAs' optimization features important. "As an adviser, it could be hard over the next two to three years to present yourself as someone who can deliver excess performance versus your competition," he argues. "That's going to be a challenge because the market environment is going to be difficult. But what you can control as an adviser is ease of use, client experience, cost, and taxes. Those are things that are in your direct control as an adviser, and all of those things play right into the use of UMAs."

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## KEEP GOING

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