



ECHELON
PARTNERS
Visionary Advice. Execution Excellence.

NEWS RELEASE

RIISING COSTS SUGGEST OUTSOURCING OPERATIONS

Managed Acct Outsourcing Still In Balance

February 2, 2004

Originally Published By Thomas Coyle, Fund Fire

Rising costs and mounting frustration are lending weight to the argument for managed account firms to outsource operations. But, according to attendees of a managed account technology conference in Boston last week, managers still harbor fears of diminished autonomy and compromised flexibility. Both converts and skeptics outlined their views at the conference.

"This isn't something you should jump into," says Mark Pare, a v.p. at Legg Mason Capital Management (LMCM), a company that has opted for outsourcing.

Managed accounts are expensive and tricky to administer for a number of reasons, say presenters at the *Managed Accounts Technology and Operations Summit*, a conference presented by Financial Research Associates. Private-client managed accounts are generally smaller than institutional holdings. That means managers have to juggle more accounts to achieve critical mass — which in turn means more customization, more performance analysis, more reconciliation, more record keeping and more reporting. At the same time, sponsors and end-clients are calling for lower fees and more sophisticated offerings.

Meanwhile McKinsey has issued a challenge to the industry. For the sake of sustainable growth, says the consultancy in a recent report, total yearly operating costs per managed account — now averaging between \$250 and \$300 — should come down to about \$150.

This makes operating efficiency a touchstone for progress in the managed account business, says Jamie Waller, v.p. of business development at Jersey City, New Jersey-based CheckFree Investment Services and chairman of the conference. It also makes outsourcing an increasingly attractive option for some asset managers.

LMCM, with \$9.5 billion in institutional and high-net-worth assets, outsources most of its support functions to Asset Management Technology Solutions, a fellow subsidiary of Baltimore-based Legg Mason. That came of a desire to concentrate on the business of managing money, says Pare. "For us it's an efficiency issue."

Like LMCM, Dreyfus Managed Assets, an affiliate of Pittsburgh-based Mellon Financial, with \$7 billion in assets under management, looked to its parent for an outsourcer. Bret Young, its president, says the greatest challenge to working with an outsourcer is maintaining control of the company's soul. "If you falter in that, your business goes down the drain," he says.

Both companies say that setting out precise ground rules for the outsourcer can keep an asset manager from losing control. Jim Prescott, portfolio administration manager with Burridge Group, agrees: "Outsourcing is about rules." Daniel Seivert, a managing partner at 3C Financial Partners, a Manhattan Beach, Calif.-based investment bank and consultancy, affirms that it's vital to draw up a contract detailing the outsourcer's responsibilities, complete with what-ifs, and to review it regularly. "You need to be good at anticipating issues — and if you fear not covering everything, get assistance," says Seivert.

The major outsourcers are Bank of New York, Mellon Financial, PFPC, State Street, SEI and BISYS -- with Bank of America, Citigroup, JPMorgan Chase, Northern Trust and Wachovia showing signs of wanting to enter the fray, says Seivert.

But few asset managers have actually taken the plunge. "There are probably more outsource providers than there have been deals to provide outsourcing," says Pamela Brewster, an analyst with Boston-based Celent Communications.

Chicago-based Burridge, with \$1.6 billion in assets under management, has taken a hybrid approach to outsourcing. It has farmed out reporting and accounts payable, but it keeps other functions in-house — though Prescott says the company is close to outsourcing its whole back office to Rorer Asset Management— like Burridge, a subsidiary of Affiliated Managers Group.

Prescott says that dealing with an affiliated outsourcer gives the process "a family feel." But Dreyfus' Young says having corporate ties to an outsourcer doesn't lessen the need for a detailed service agreement and rigorous oversight of the relationship. "We still have to be efficient, effective and profitable at the end of the day."

Roxbury Capital Management, a Santa Monica, Calif.-based asset manager with \$3.8 billion in high-net-worth and institutional assets, hasn't been able to find an outsourcer. Though spurred by shrinking fees to find ways to cut back, the company remains unimpressed by the options it has encountered. "We need a partner to help us maintain and improve our technology solution," says Chris Jostes, Roxbury's portfolio system manager. "In the short-run, outsourcers haven't convinced us they can do that."

Roxbury also worries about the effect of outsourcing on its culture and on employee morale. Francis Rankin, head of performance analytics at Neuberger Berman— another shop that has said no to broad-stroke outsourcing — puts the dilemma in blunter terms. "Who trains the outsourcers?" he asks. "Staff that could get laid off as a result of outsourcing?"

Roxbury's Jostes says another sore spot is fear of losing flexibility — a fear borne out by Young at Dreyfus. "We bring the outsourcer in when someone has an idea for a new [line of] business because we have to know if we have the [necessary] interfaces in place," he says. "Sometimes we have to say no; that didn't use to happen."

Roxbury is also wary of the time needed to build trust between client and outsourcer. "That takes us away from concentrating on our core business," says Jostes. LMCM's Pare agrees that building trust takes effort — even when, as in the case of LMCM, the outsourcer's personnel were previously in-house staff. "We had to learn to work together as a team."

But Roxbury's search for a suitable outsourcer continues. "We think that technology outlays and some loss of control and flexibility will be outweighed by the cost savings," says Jostes.

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

Daniel Seivert
Managing Director
dseivert@echelon-group.com

Tyler Resh
Principal
tresh@echelon-group.com