Managed Accout Firms Urged to Outsource

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NEW YORK -- Faced with difficult economics and slim profit margins, managed account providers must control costs through outsourcing. That issue is becoming even more critical now as the industry continues its rapid growth, according to speakers at Financial Research Associates' *Annual Managed Accounts Summit* here yesterday.

Managed account companies can reduce their total costs by 2 to 13 percent by outsourcing back-office operations, says John Payne. He is senior corporate strategist at UBS Global Asset Management. He says outsourcing can reduce headcount by 30 to 40 percent. Costs can be reduced even further at firms that spend more on operations per account.

The urgency behind outsourcing stems from the high cost of operations and technology needed at a managed account firm. Operations and technology represent anywhere from 36 percent to 43 percent of these companies' costs, Payne says.

"Don't underestimate the complexity of operations and technology," Payne says. "Operations and technology are a major drag on profitability. For this reason, you have to consider outsourcing." He estimates that the cost savings from outsourcing could boost gross profit margins by 2% to 5%.

Among the operations that can be outsourced are account opening, account administration, rebalancing, and portfolio reporting. Payne also believes companies should outsource the tracking of the portfolio model, a function that tends to be done in-house. In addition to cost savings, better use of technology and outsourcing can provide improved administration and customer relations management. The trade-off is that firms must give up some measure of control when outsourcing, but he thinks costs are paramount.

"The margins are very thin in this business," Payne states. He notes that gross profit margins in managed accounts range from 18 percent to 35 percent, versus 24 percent to 48 percent for retail mutual funds. An average managed accounts firm could achieve 20 percent margins, while only the largest players can reap 25 to 35 percent margins.

The problem, which has been a recurring theme in the industry, is that the operational support and technology for managed accounts is not very scalable. Most companies' operational personnel can handle 450 to 650 accounts per person, Payne says. The top 10 managed accounts firms have only been able to push that number up to 1,000 accounts per person. So, for now, 1,000 accounts per operations employee "seems to be the natural ceiling," says Payne. But he is optimistic that technological advances that increase automation should be able to push beyond 1,000 accounts per person in the near future.

Because of the slim margins, firms need scale, says Daniel Seivert. He's the founder and managing partner of Manhattan Beach, Calif.-based 3C Financial Partners, a merchant bank to financial services companies. Seivert says that while a mutual fund business needs at least $50 million in assets under management to break even, a managed accounts firm needs $1.2 to $1.5 billion in assets to break even. And a managed accounts firm won't reach peak profitability until it gathers, on average, $6 billion in assets.

The industry has discussed outsourcing for some time without embracing it. So far, ING, which manages $160 billion in the U.S., has been the largest firm to outsource -- in February it retained Bank of New York to handle operations for its managed account group.

Even with slim profit margins, the managed accounts industry continues to grow. It now controls some $450 billion in assets, and that should grow to $930 billion in 2006, says Mike Evans. He is v.p. at Financial Research Corp., and another conference speaker. In addition, Evans says new players, such as bank and trusts, are poised to make a splash in the business.

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