Firms Fight to Dominate Managed Account Processing

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SEI has just scored a significant win in the separately managed account (SMA) processing space. In picking up ING Investment Management's $3-billion, 7,500-account retail program, the Oaks, Pa.-based investment processor has established itself as a leader in a crowded field of managed account back-office outsourcers.

SMA outsourcing may seem removed from the world of the client-facing advisor. In fact though, it bears watching by fee-based advisors of all stripes because its emergence is changing the economic dynamics of the wealth-management business, according to Daniel Seivert, managing partner of 3C Financial Partners, a Los Angeles-based investment banking and consulting firm.

Right now CheckFree's APL dominates the SMA space as the primary SMA-portfolio accounting and connectivity provider. Much of CheckFree's pricing power rests in its having "a one-to-many" relationship with SMA managers. But as the outsourcers claim more business in the space -- each in effect standing in for groups of managers -- CheckFree's relationships will inevitably shrink in number, giving the outsourcers more control; an effect aggravated by the emergence of APL competitors such as Market Street Advisors and Vestmark.

From that "there's the potential [for the outsourcers] to put downward pressure on the overall expense of SMAs," says Seivert, resulting either in cheaper product to the consumer or -- since sponsors seem unlikely to raise management fees any time soon -- more money going to the distribution side.

Advances in outsourcing technology can also help make more exotic offerings like multiple-discipline portfolios and unified managed accounts more readily available to independent advisors through improved workflow and other processing capabilities including smarter ways to handle and account for multi-currency transactions and fixed-income holdings.

They'd know

ING's new outsourcing deal is significant because spotlights SEI as the industry's only two-time recipient of business from asset-management firms -- ING and TCW -- that had previously outsourced SMA administration to other processors.

"We love the educated buyer," says John Alshefski, head of business development for SEI's investment processing group, referring specifically to ING, which selected SEI after its old provider the Bank of New York got out of SMA processing earlier this year to concentrate on institutional-asset and mutual-fund processing.

Alshefski won't comment on TCW, which is widely thought to have dropped Mellon as its SMA processor in favor of SEI early in 2005. Mellon still administers TCW's institutional accounts and mutual funds.

Sandy Schwartz of the McNamara Group, a Rockville Centre, N.Y.-based consultancy, says these deals points to consolidation in the SMA outsourcing space -- with liftout-style processors like the Bank of New York and Mellon losing ground to the "more technology-based" approach used by SEI and several others.

"With a liftout you're saying, 'We can do the job better than you've done with the same people and the same resources -- we didn't hire any of the people, and we didn't train them, but we can do it better.'" says Schwartz. "That's a tough statement to make."

"That's not to say liftouts can't work," adds Schwartz. "But with a more technology-based approach, you're saying, 'We can do this work better using our own resources.

ING's head of operations David Bercaw says the principal drawback of the liftout model is stasis. "[The Bank of New York] took over what we were doing and it never changed," he says. "The danger of a liftout is that the environment stays pretty much the same."

ING's experience with the Bank of New York might have been better in that regard -- and cheaper overall -- if the bank had managed to attract more clients than ING and few small spillover contracts from institutional deals. "It just didn't get off the ground," says Bercaw.

Working with SEI, on the other hand, is "like dealing with a software vendor," says Bercaw. "You do business with a software vendor to get a jump on whatever it is you're doing *and* you're buying into the vendor's future innovations that will help you change and grow."

ING went with SEI in its second go-around with SMA outsourcing because of its superior workflow capabilities, according to Bercaw. "It gives us imaging and document-tracking capabilities and a more user-friendly interface so you don't have to be an APL expert see what's going on."

Growth business

SEI has been in the SMA outsourcing business since it bought the rights to market Rorer's processing platform in 2003. It has eight clients, three of them brought in this year with another two or three due in by Christmas.

In addition to SEI and Mellon, the remaining outsourcers are Citigroup, State Street, JPMorganChase, PFPC and BISYS. Some industry observers -- 3C Financial's Seivert among them -- say that's four or five too many, and that a shakeout is inevitable.

Events of the last 18 months seem to indicate that SEI and Citigroup have moved away from the pack. SEI can point to strong deal flow and the extra bragging rights of winning business from at least two managers in a position to compare them to others in the field.

Citigroup, the last to enter the fray, has half a dozen publicized wins to its credit since March 2005 -- including Lazard's $17-billion SMA program.

JPMorgan, the second-last entrant in the outsourcing space, has had a decent run of three or four wins over the past year or so, making it a strong contender for the third-place spot.

State Street, which counts Seligman, Brandywine and State Street Global Advisors as clients, announced in 2004 that it would stop funding its SMA outsourcing business. For all that though, Schwartz says it's still a significant player. Having developed a "decent processing system," State Street has been "flying under the radar," he says.

PFPC has two or three clients. If BISYS has any at all, they're in stealth mode.

Of the 25 or so deals that have been struck in the space, three or four -- like TCW's and ING's -- have come undone. Still up for grabs, according to SEI, are 85 of the top 100 SMA managers.

In addition to a good supply of existing SMA managers, SEI and Citigroup say they're getting increased interest from managers who want outside processing in place *before* they branch off into retail SMAs.

"We definitely see this as a growth business," says SEI's Alshefski.

Schwartz agrees. "The bubble definitely hasn't burst yet," he says. But he adds that developments at this stage can set the board for the end game.

"This is the sort of information the market looks for," Schwartz says of SEI's latest deal. "It's telling the street where the conviction lies." -FWR

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.

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