



Open Architecture & Its Role In Wealth Management Presentation to California Bankers Association

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Agenda

- Open Architecture – Definition and History
- The Case for Open Architecture
- Trends in Open Architecture
- Open Architecture and the Banking Industry
- Implementing Open Architecture
- Challenges, Requirements & Solutions

Industry Case

- The largest banks recognize the asset gathering opportunity. Almost 90% of the largest banks are selling non-proprietary investments.
- The industry is bracing for increased regulations on proprietary offerings & increased fiduciary risk
- Increasing pressure from competitors to include their products
- Shareholders are not satisfied with the performance of in-house asset management businesses

Source: Martiz Inc. "Investment Firms: Opportunity, Trust and Satisfaction Survey," October 27, 2005.

Source: http://www.pwmnet.com/news/fullstory.php/aid/575/Banks_offer_field_day_for_funds.html

Client Case

- Most investors are comfortable receiving a large part of their investment information from one source – but not all their investment choices
- Clients are demanding access to the best performing managers and specialized advice on how to manage their investable assets
- Clients want turnkey solution from advisors they trust
- \$1 trillion of assets annually within the next decade JUST from maturing DB and DC plans and IRA rollovers

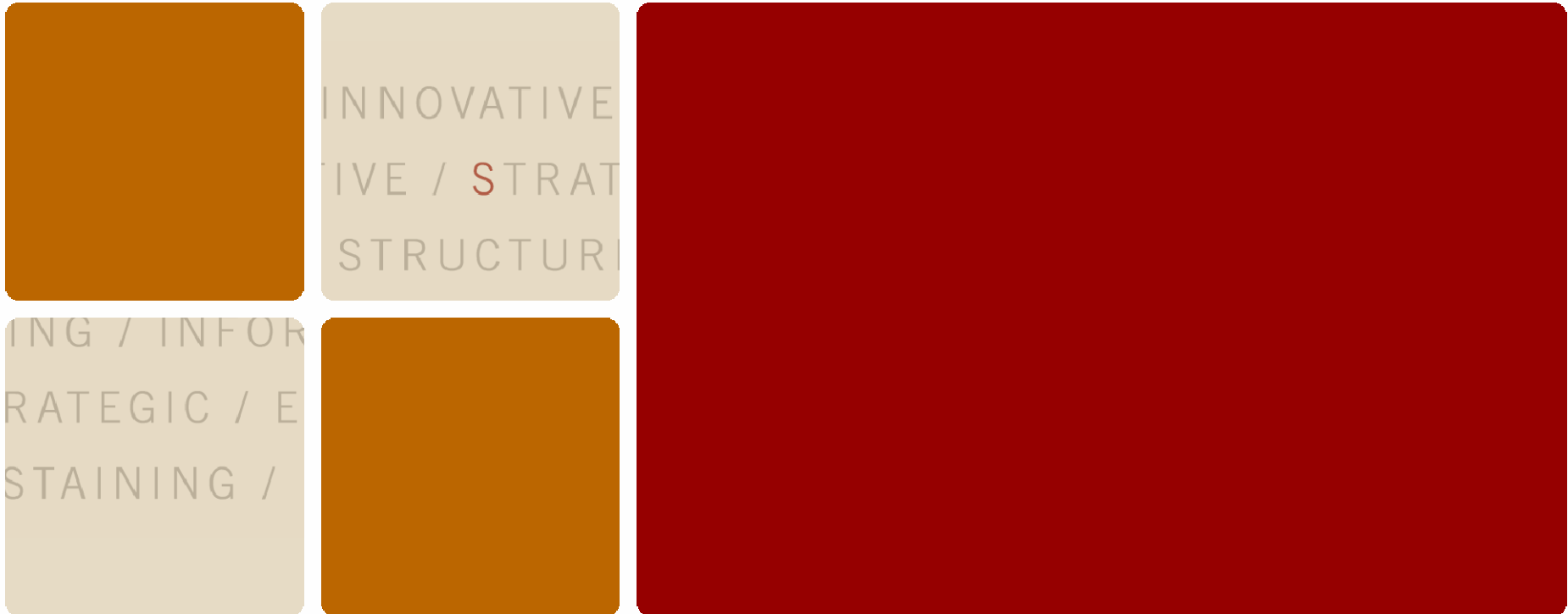
Source: Cerulli Associates. "In a Pinch: Pressure cause mutual funds to stay conservative." *The Cerulli Edge: U.S. Edition* June 2005: 3

Source: 3C Financial Partners. "Platform Made Perfect," 2005: 6.

Source: **Service matters most**, Christine Ross, head of financial planning, SG Hambros

Source: McKinsey & Company, "The Retirement Journey 2004 Study"

Open Architecture Defined & Current Trends



Architecture Options

Platform Architecture

Closed Architecture

Hybrid Architecture

Open Architecture

100% Proprietary

Combination of
Proprietary and Third
Party

100% Third-Party

Firms that employ closed architecture rely solely on proprietary products and services

Firms that employ hybrid architecture utilize both proprietary and third-party products and services.

Firms that adopt pure open architecture rely solely on third-party products and services.

***Hybrid Architecture and Open Architecture are often used interchangeably in the industry**

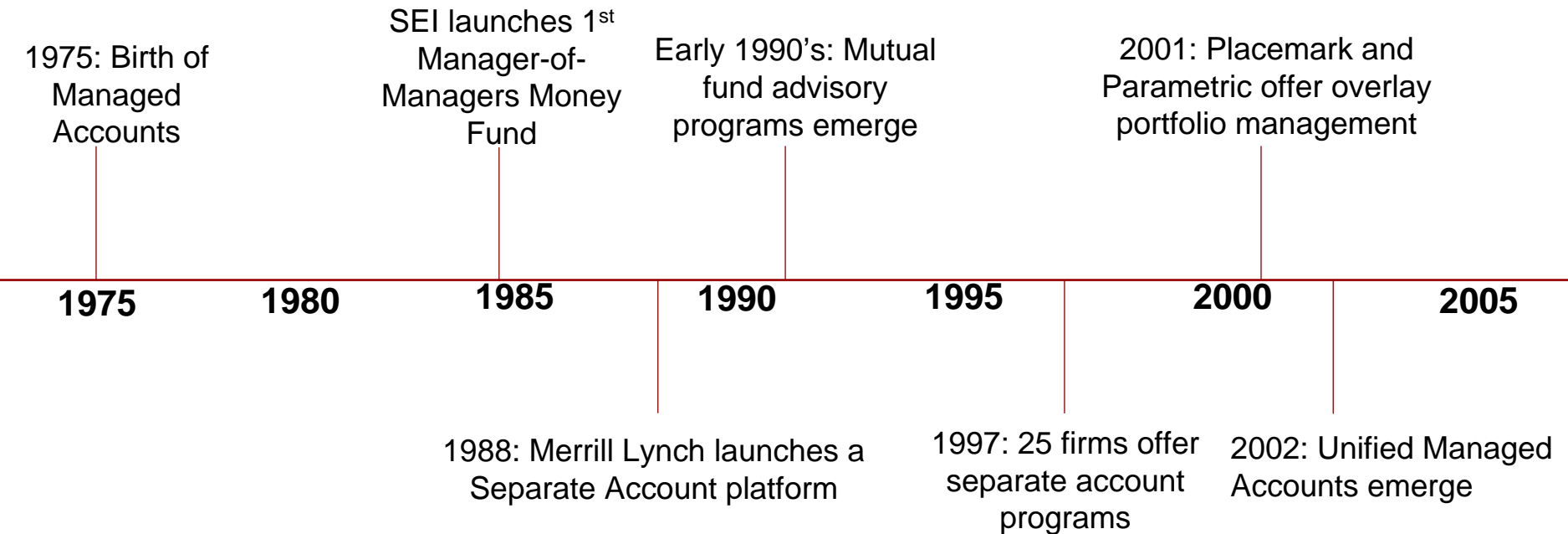
Source: 3C Financial Partners. "Platform Made Perfect," 2005: 17.

Managed Accounts – The Proxy

- **Separate Account Consultant Programs** – Discretionary programs by which asset managers manage investors' assets in separate accounts, whether proprietary, non-proprietary or both
- **Mutual fund Advisory Programs** – Discretionary and nondiscretionary programs designed to systematically allocate investors' assets across a wide range of mutual funds
- **Manager-of-Manager Mutual Fund Programs-** Uses the mutual fund '40 act wrapper to bundle institutional asset managers into diversified packages that can be consumed by individuals and institutional clients alike.
- **Rep as Portfolio Manager** –Discretionary programs in which financial representatives act as money managers for their clients by taking full responsibility for selecting a portfolio of securities

Source: Cerulli Associates: Managed Accounts Edition 3Q04

History

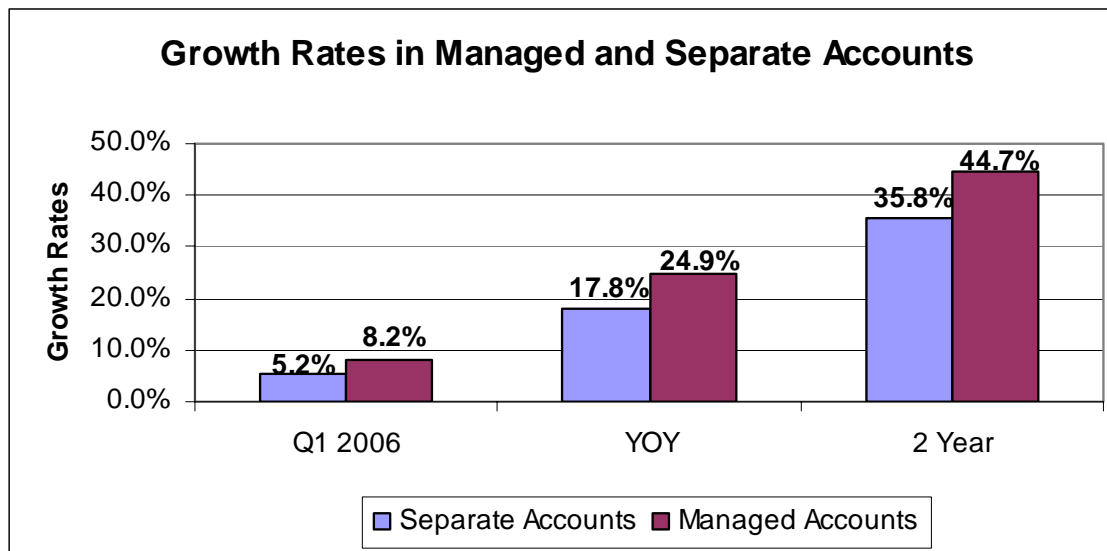
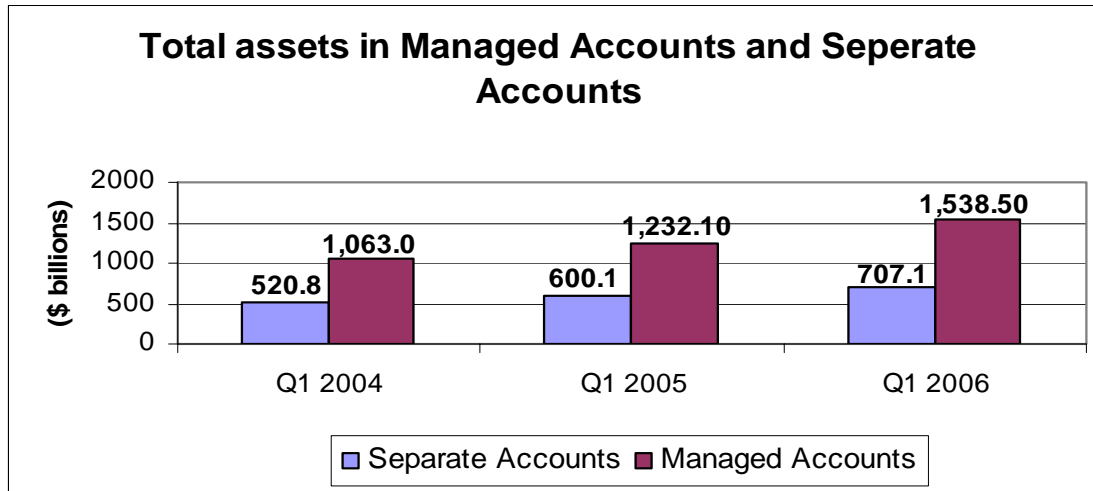


Cerulli Associates. "Everyone Wins: Managed account industry growth is a victory for all." The Cerulli Edge: U.S. Edition December 2005: 16.

Managed and Separate Accounts – AUM and Growth

➤ Managed account assets have increased from \$300 billion in 1997 to more than \$1.5 trillion in 2006

Cerulli Associates. "The Cerulli Report: Managed Account Groups: Impact on Future Distribution" 2005: 10.



Key Players

Firm	AUM (\$ billion)	Marketshare
Merrill Lynch	\$293.40	19.0%
Citigroup	\$290.00	18.8%
Morgan Stanley	\$143.60	9.3%
UBS	\$122.40	7.9%

Source: Cerulli Associates

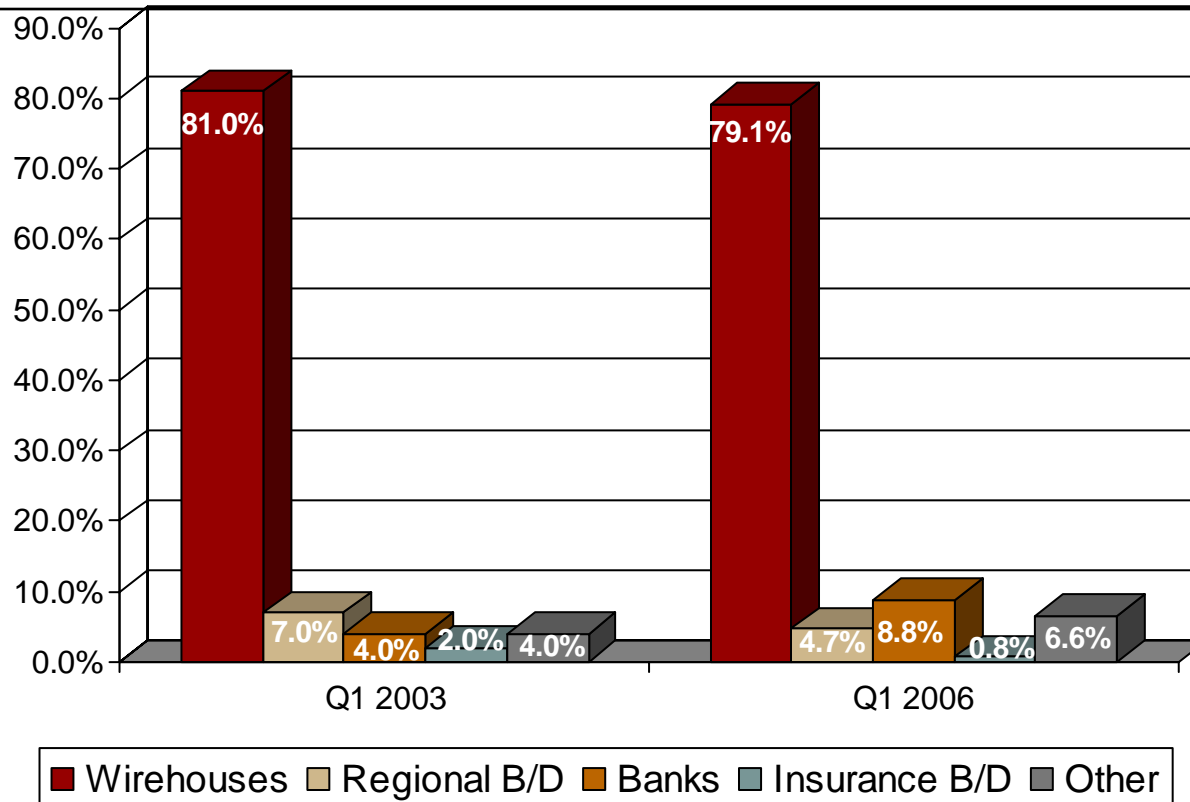
- As of March 31, 2006, the top 4 wire-houses managed approximately 55% of assets in the Managed Accounts industry

Rep as Portfolio Manager v. Non-Proprietary Separate Accounts – The Pond with Bigger Fish

	Average Account Size	Average Client Fee
Separate Account Consultants (Open)	\$1,067,000	1.69%
Rep as Portfolio Manager	\$361,000	1.29%

The Average Account is 296% Larger!

Managed Account Market by Distribution Channel



Source: MMI, Celent Associates

- In the US Marketplace, wirehouses dominate the marketplace, however, banks have gained traction over the last 3 years. In 2003, banks made up just 4% of the Managed Account market. In 2005, they account for close to 7% of the market

Full Service Brokerages Attract Investors With the Highest Levels of Investable Assets

	Full Service Brokerage	Discount Brokerage	Online Brokerage	Mutual Fund Company	Bank's Brokerage Group	Insurance Company Broker	Total
Base sizes	261	83	112	186	83	50	912
<i>Investable Assets</i>							
Under \$25K	12%	13%	25%	25%	29%	28%	22%
\$25K - \$50K	16%	19%	14%	26%	19%	24%	21%
\$50K - \$100K	21%	21%	24%	20%	25%	18%	21%
\$100K - \$250K	21%	21%	16%	15%	19%	16%	18%
\$250K +	31%	26%	21%	14%	7%	14%	19%

Question wording: "Which of the following best describes your total investable assets excluding 401k/403b and real estate?"

- Percentage based off a National Survey of 1,002 investors conducted by Martiz Inc. in March 2005
- Banks are attracting less affluent clients and must make platform enhancements to bring in more affluent clients
- Of the 6 firm options available, investors trusted banks the most with 93% saying "yes" to "Has your firm earned your trust?"

Source: Martiz Inc. "Investment Firms: Opportunity, Trust and Satisfaction," October 27, 2005

Key Factors To Move to OA

Q3. In your opinion, what are the key factors driving bank & trust institutions towards offering open architecture investment products?

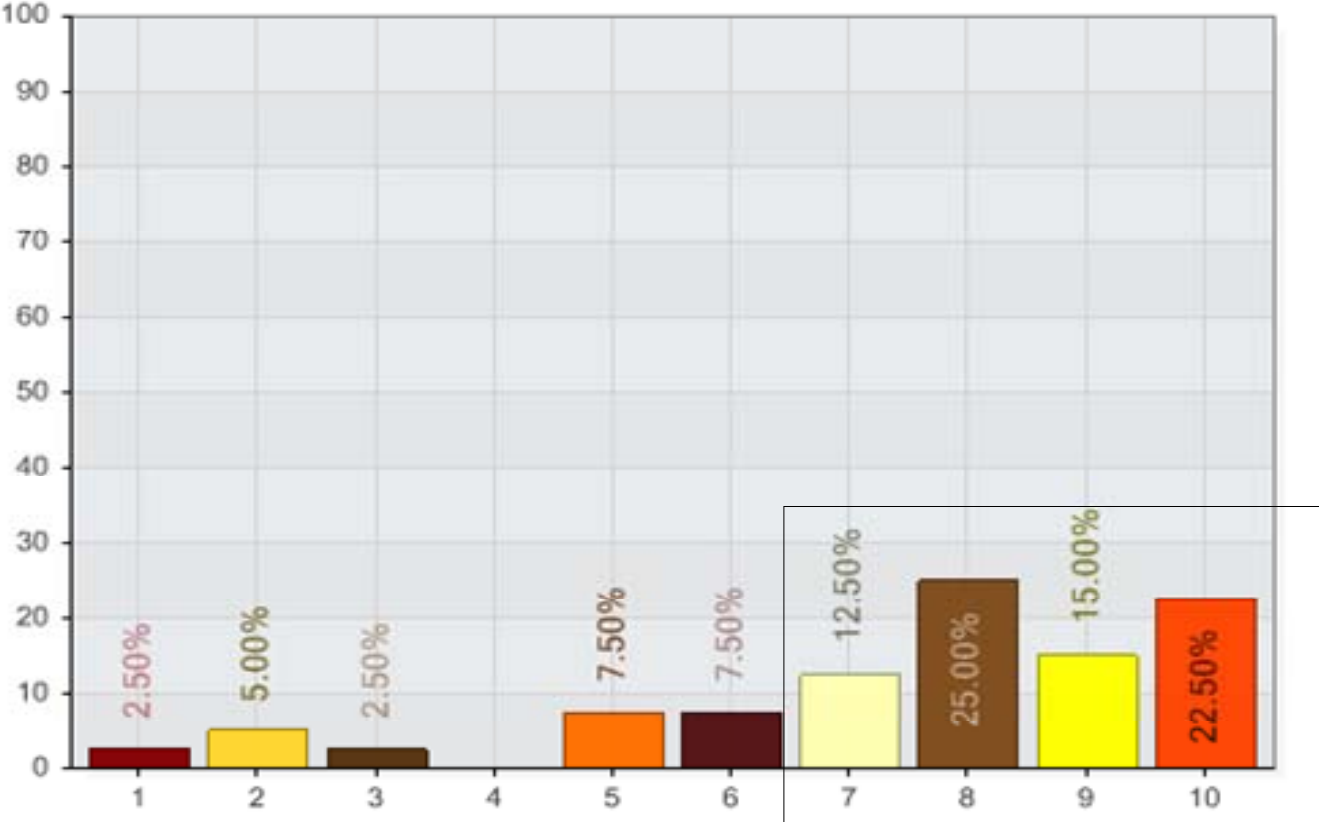
(Please rank the top three factors, "Rank 1" being most important)

Responses	Rank 1	Rank 2	Rank 3	Weighted Rank(Score)
Desire to be perceived by clients as objective and free from the conflicts of interest inherent in offering proprietary products	19	6	6	<u>1 (75)</u>
Need to respond to competitors' offerings	5	16	8	<u>2 (55)</u>
Ability to focus more resources on client-facing activities	9	6	12	<u>3 (51)</u>
Clients are requesting these products	7	4	12	<u>4 (41)</u>
Reduce risk in wealth management operations	0	8	2	<u>5 (18)</u>

Source: SEI Survey of Banking Clients, August 2006

OA – A Top Priority?

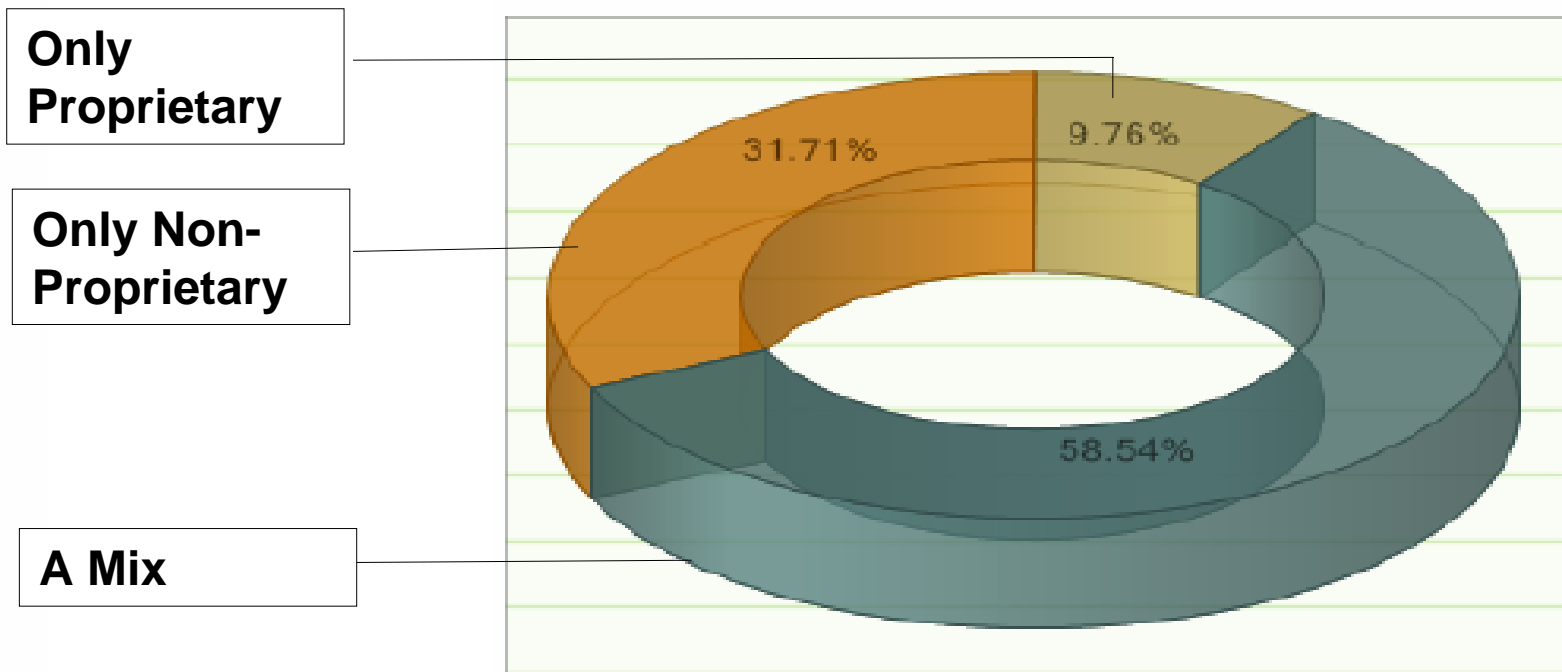
Q2. Please indicate your agreement with the following statement: "Within the next 12 months, the decision to offer open architecture investment products and expertise will be a top priority for wealth institutions."



→ **60% Say It Is!**

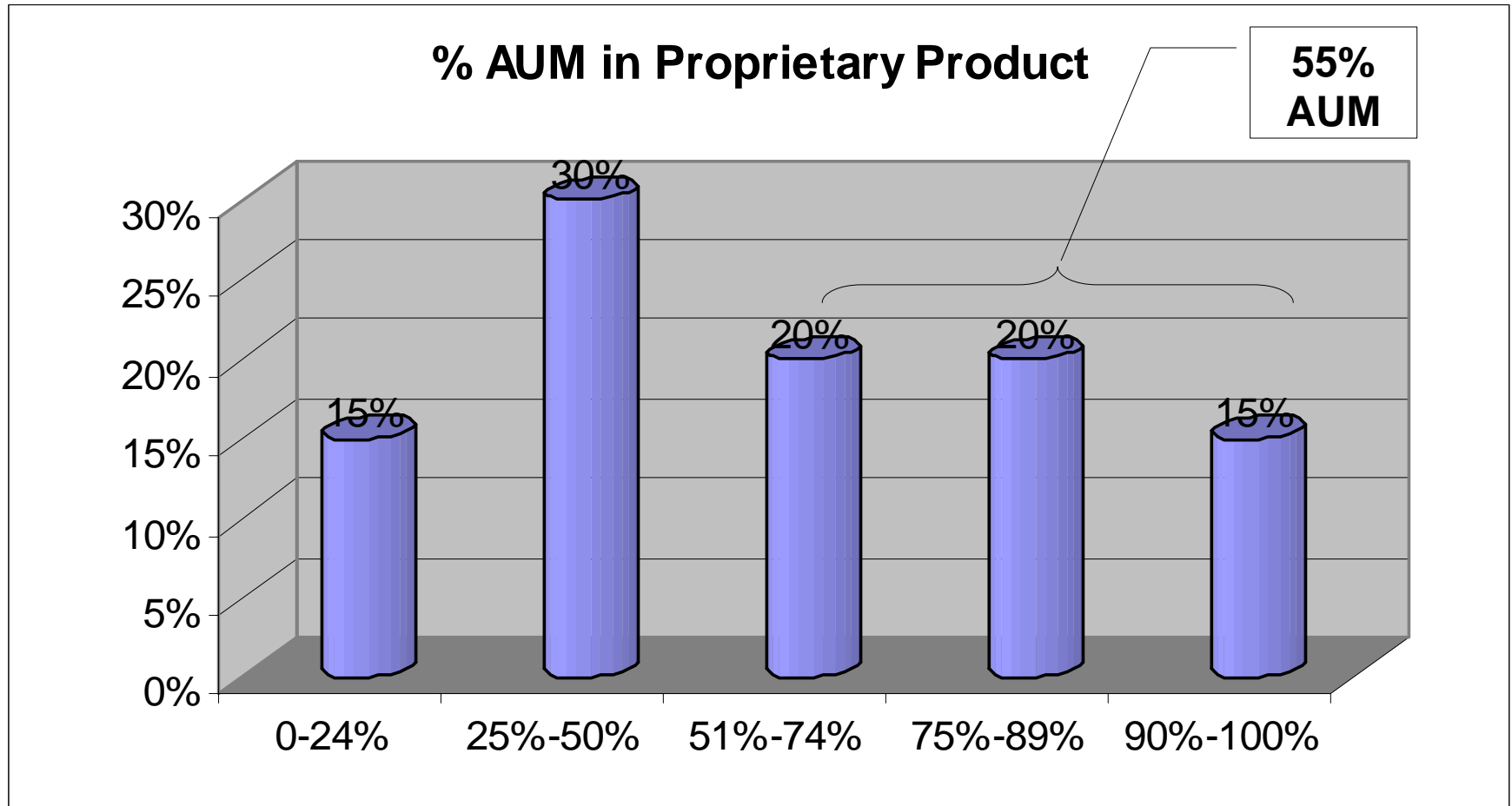
Source: SEI Survey of Banking Clients, August 2006

Does Your Institution Offer Proprietary Investment Products to Its Wealth Management Clients?



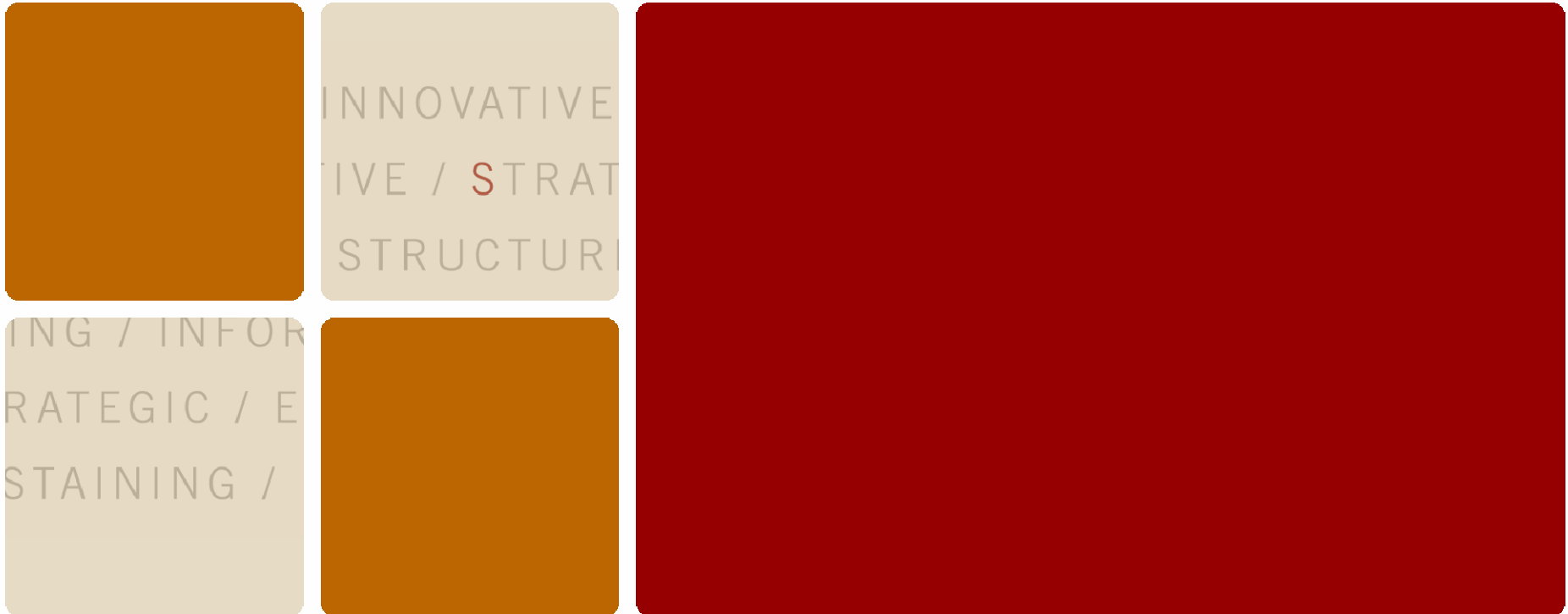
Source: SEI Survey of Banking Clients, August 2006

However, banks continue to use proprietary products



Source: SEI Survey of Banking Clients, August 2006

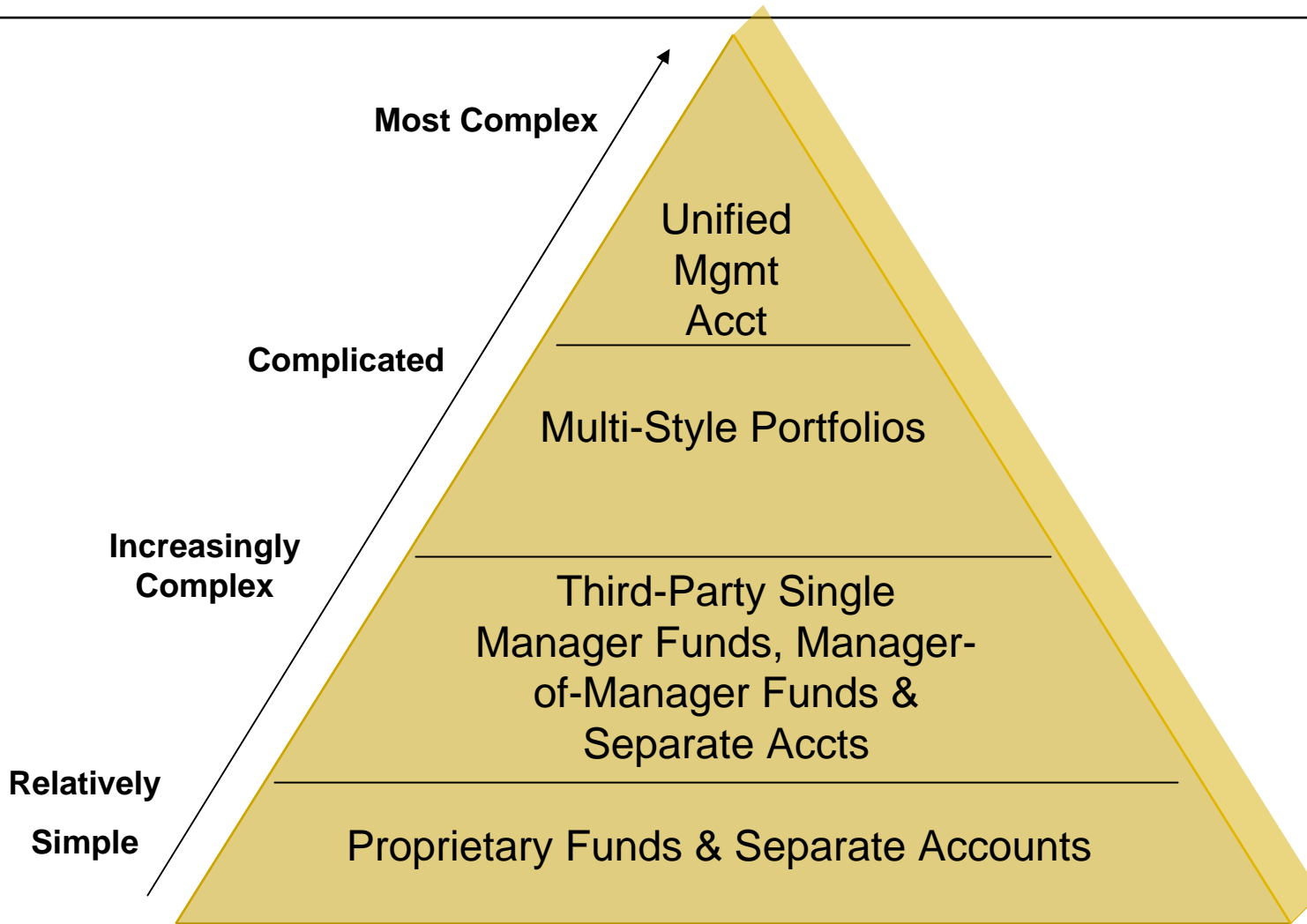
Implementing Open Architecture



Why Adopt OA in Your Bank's Business?

Pros	Cons
<ul style="list-style-type: none">• Capitalize on “most trusted institution” perception &, as a result, capture larger share of wallet due to existing depository/lending relationships• Can focus on segmenting client base by adopting multiple investment solutions• Maintain Objectivity & Mitigate Corporate Risk• Should increase client retention and competitiveness• Increase top-line growth	<ul style="list-style-type: none">• Lower Margins• Cannibalization of proprietary offerings• Employee Unrest & Disruption• Potentially higher initial start up & on-going costs to implement & oversee open architecture platform• Potentially more compliance requirements• The Bank's Trust Department v. Broker-Dealer

What Are Your Choices?



Source: Celent Associates

Separately Managed Accounts

- Separately Managed Accounts (SMA) : A single account that corresponds to a single investment strategy
 - Includes all the attributes of “managed account solutions” such as client profiling, fee-based pricing and research
 - Allows for client-level customization
 - Enables tax efficiency
 - Asset-based fee structure
- One fee includes investment counseling, portfolio management, brokerage fees and ongoing account administration.
- New technology allows more banks to offer SMAs

Source: Money Management Institute. MMI Central Spring 2006, Vol. 2 Issue 1.

Trends in the SMA Industry

- Increased regulation due to a migration of assets from mutual funds to SMA's
 - Increased disclosure to investors
 - More oversight of advertising
 - Unbundling fees creating greater transparency within the industry
- As the mutual fund industry faces a number of scandals and increased competition with ETFs, SMA's become more attractive
- Lack of standardization – No incentive to standardize systems because 5 major players comprise the majority of the industry
- Large wirehouses beginning to lose market share smaller institutions due to technology advances
- Proprietary SMA programs continue to lose market share to hybrid architecture programs¹

Julie Segal, "Spotlight on SMAs: More Rules of the Way," Altnews, FundAction, June 30, 2006.

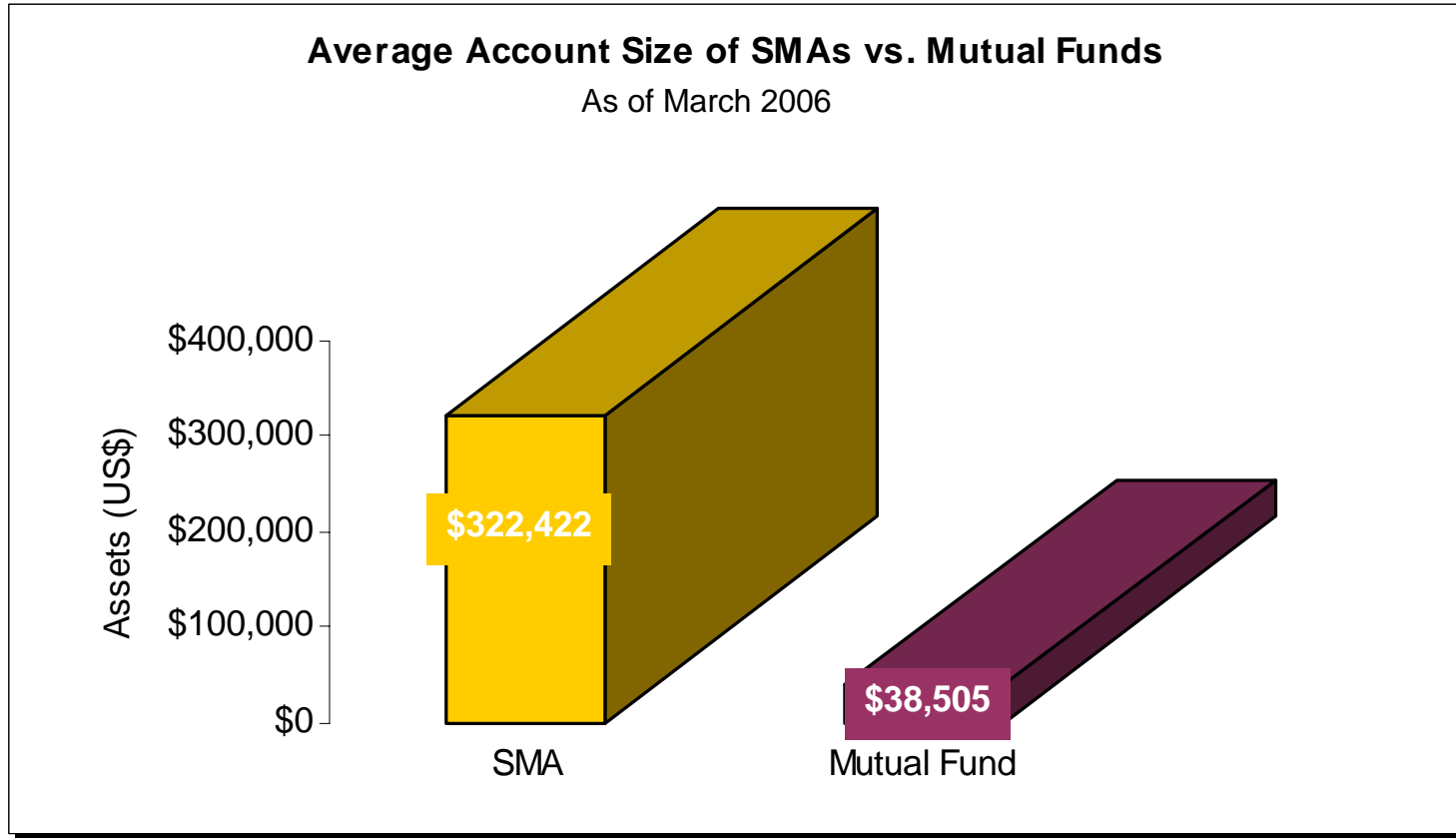
Julie Segal, "Spotlight on SMAs: Bank of America To Unbundle Fees," Altnews, FundAction, June 30, 2006.

Mutual Funds

- Mutual Fund Advisory Program: Allows investors to allocate their assets across multiple mutual funds
 - Includes capabilities such as client profiling, fee-based pricing and rebalancing
- Mutual funds have seen a recent upturn in net inflows with \$255 billion in 2005 and nearly \$145 billion through April of 2006 bringing total assets to \$9.5 trillion

Source: Cerulli Associates. Managed Account Research May 2006: 2.

SMA's vs. Mutual Funds – Average Account



Source: MMI, Celent Associates

- Though total assets in mutual funds tower over those in SMAs, the average account size of an SMA is more than 8 times that of a mutual fund.

Features of Mutual Funds vs. SMAs

	Mutual Funds	SMAs
Access to professional money managers	Yes	Yes
Diversified portfolio	Yes	Yes
Ability to customize portfolio	No	Yes
Typical Account Minimum	\$1,000	\$100,000
Separately held securities	No, investor owns one security, the fund, which in turn, owns a diversified portfolio	Yes, investor owns securities in an account managed by their money manager
Ability to customize to control taxes	No	Yes
Tax -Efficient handling of low cost basis stock	No	Yes
Gain/Loss distribution	Virtually all gains must be distributed, losses cannot be distributed	Realized gains and losses are reported in the year recorded
Expenses (excluding brokerage costs) (% of AuM)	1.42%	1.00%
Expenses (including brokerage costs) (% of AuM)	1.56% average	1.25%
Other costs	12b-1, sales loads, redemption fees, etc	None

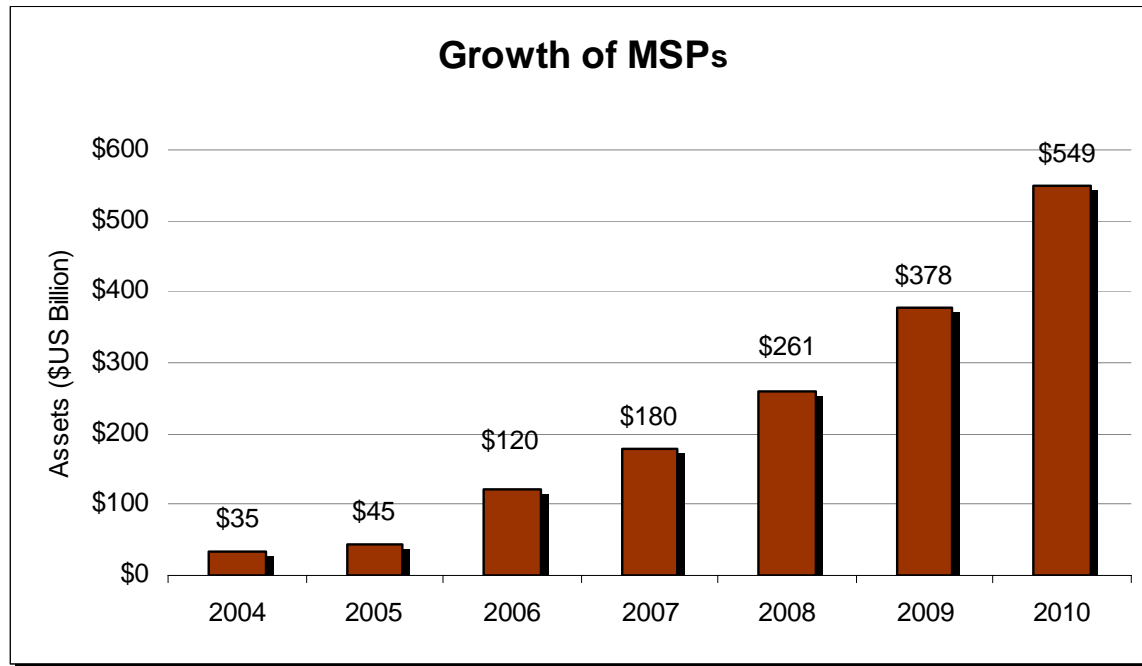
Manager-of-Manager Mutual Funds

Manager-of-Manager Funds: A mutual fund containing several institutional managers acting as sub-advisors for the purposes of delivering a diversified set of strategies (i.e. alpha sources) within an asset class. Benefits include:

- Economics of outsourcing investment management
- Multi-manager diversification
- Flexibility in replacing under-performing managers
- Brand name investment managers
- Ability to add a unique investment approach
- Superior performance (return / risk)
- Other (e.g., access to distribution)

Multi-Style Portfolios

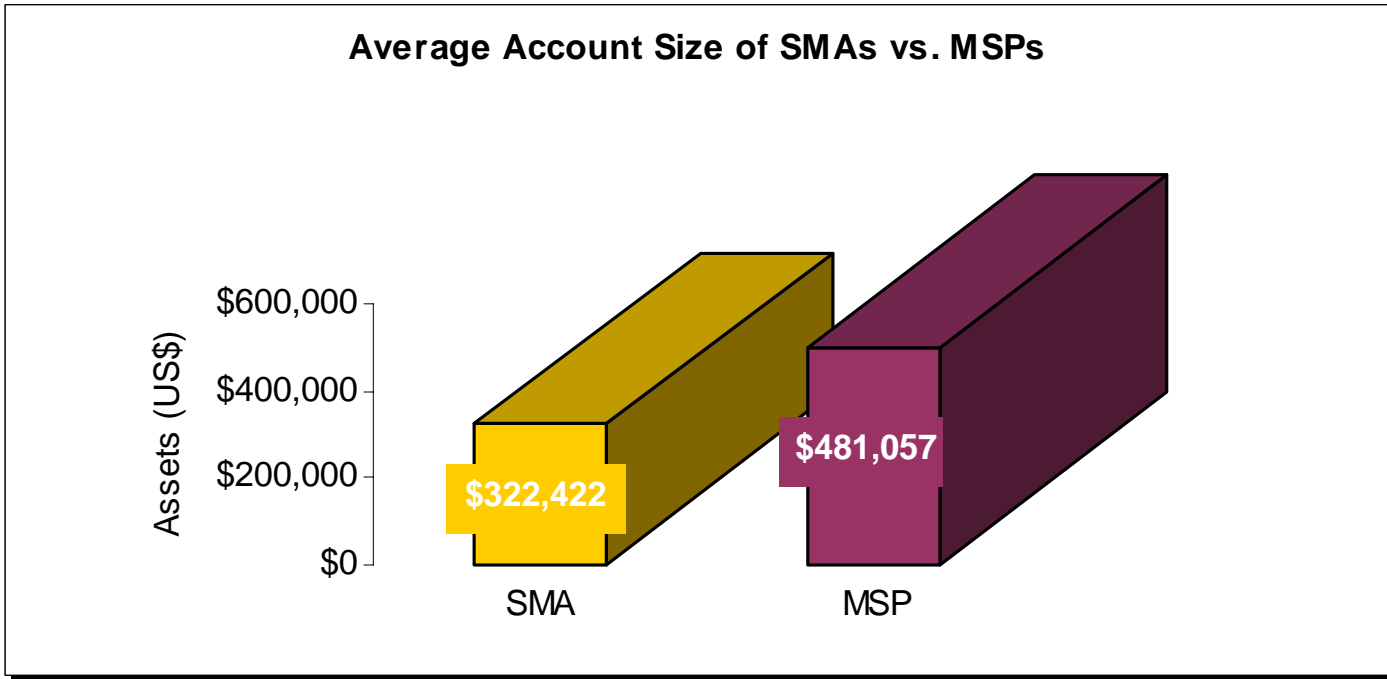
- Multi-style portfolio (MSP): Combines several managers representing various styles within one portfolio.



Source: Celent Associates and Industry estimates

- MSP's are expected to grow exponentially over the next few years. Part of this growth will be fueled by conversion of assets from traditional SMAs

MSPs vs. SMAs – Average Account Size



Source: Celent Associates and Industry estimates

- Currently the average account size of an MSP is greater than that of an SMA
- MSPs were created to attract the mass affluent market – one size fits all

Unified Management Accounts

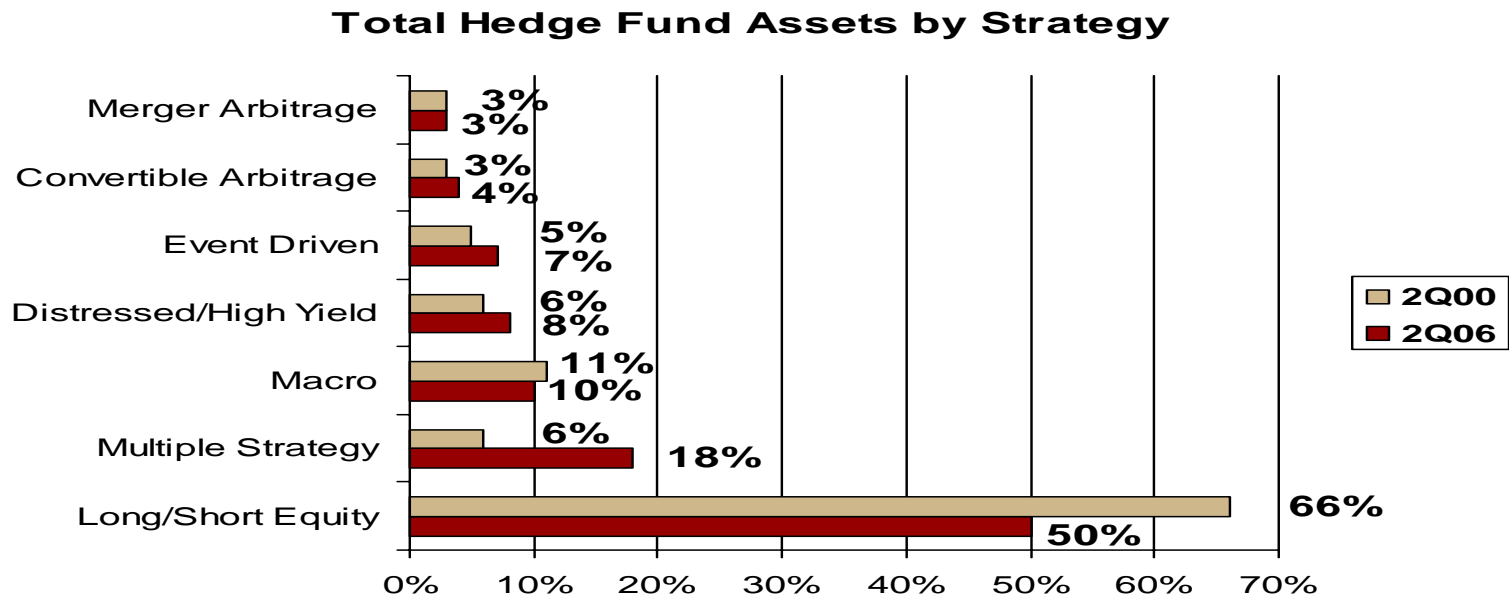
- Unified Management Account: A product-neutral platform that simplifies the delivery of multiple investment vehicles such as separate accounts, mutual funds, ETFs and individual securities through the integration within a single environment.
- Empowers client advisor to provide and implement best-of-breed advice
- Banks can utilize third-party firms that offer a UMA, with overlay services, or the ability to coordinate the investment models of multiple managers in order to provide customized portfolios to investors.

Source: *The Cerulli Edge*, September 2005 pg. 9; **Fund Action** Bank of America to Open UMA July 7, 2006

Hedge Funds

Hedge Fund: Private investment vehicle that may use non-traditional investing techniques (e.g. short selling & leverage) pursuing superior returns relative to risk.

- \$1.2 trillion industry
- Over 7,000 hedge funds worldwide

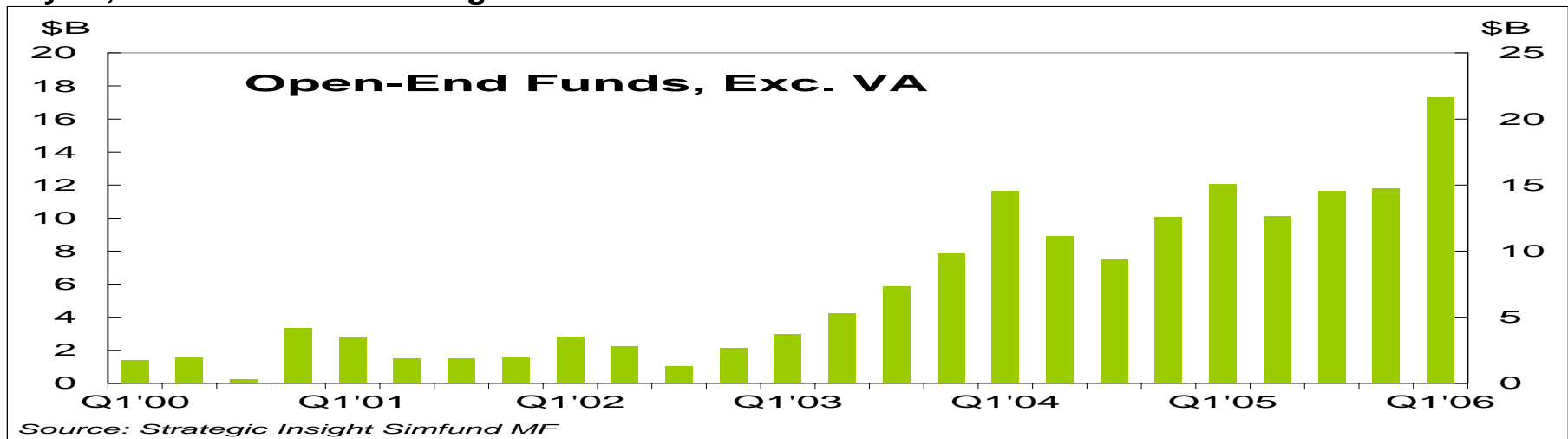


Source: *Multi-Strategy Funds' Growth May Force FOFs to send SOS* by Jeff Benjamin InvestmentNews July 17, 2006

Fund of Funds

- Model that is diversified among several different mutual funds, hedge funds and/or money managers
- Diversification among hundreds or even thousands of securities in one account
- Disadvantages can include two or three layers of fees, high expense ratios, and transaction costs which decrease or negate returns

Fund of Funds Flows: No Longer Just “1-Great-Fund-At-a-Time” but Pre-Assembled Advice, Life Cycle, Comfort Zone Investing



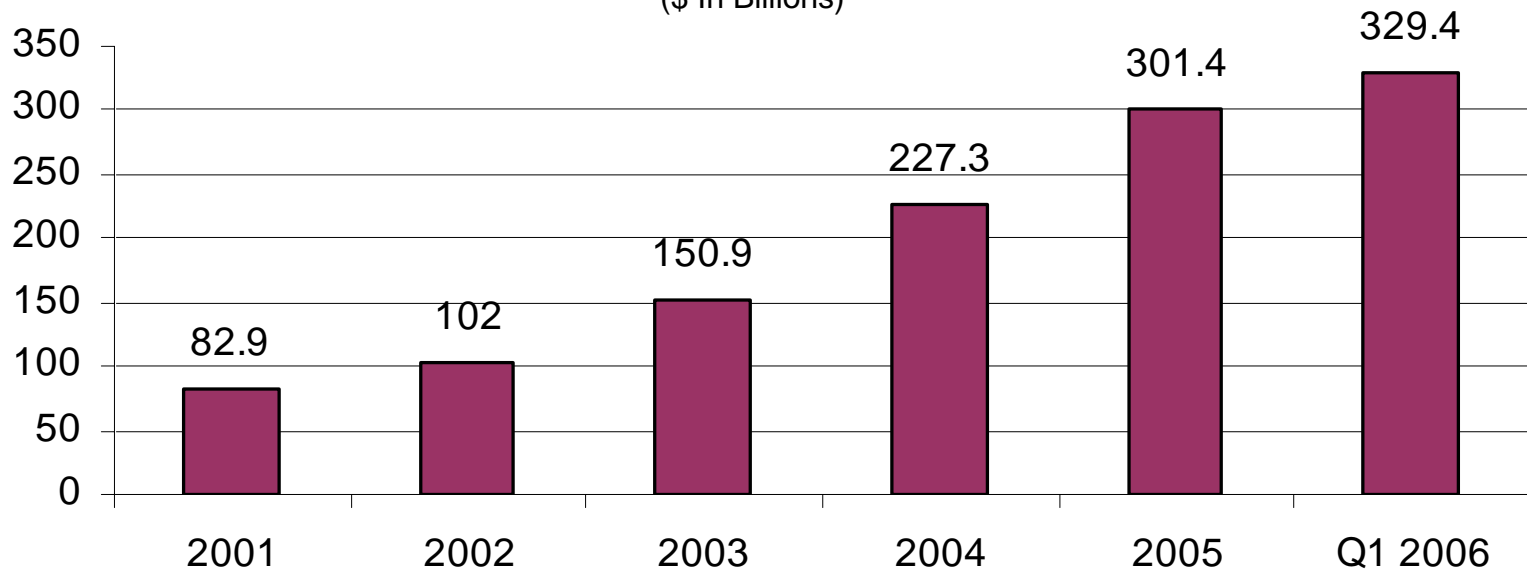
Source: <http://mutualfunds.about.com/library/weekly/aa111900a.htm>

Exchange Traded Funds (ETF)

- Baskets of securities that track the performance of an index and thus are passively managed investments- bought and sold like stocks
- Highly transparent with low expense ratios and fees, and very tax efficient
- Approximately 250 ETFs available to investors.

ETF Assets Under Management

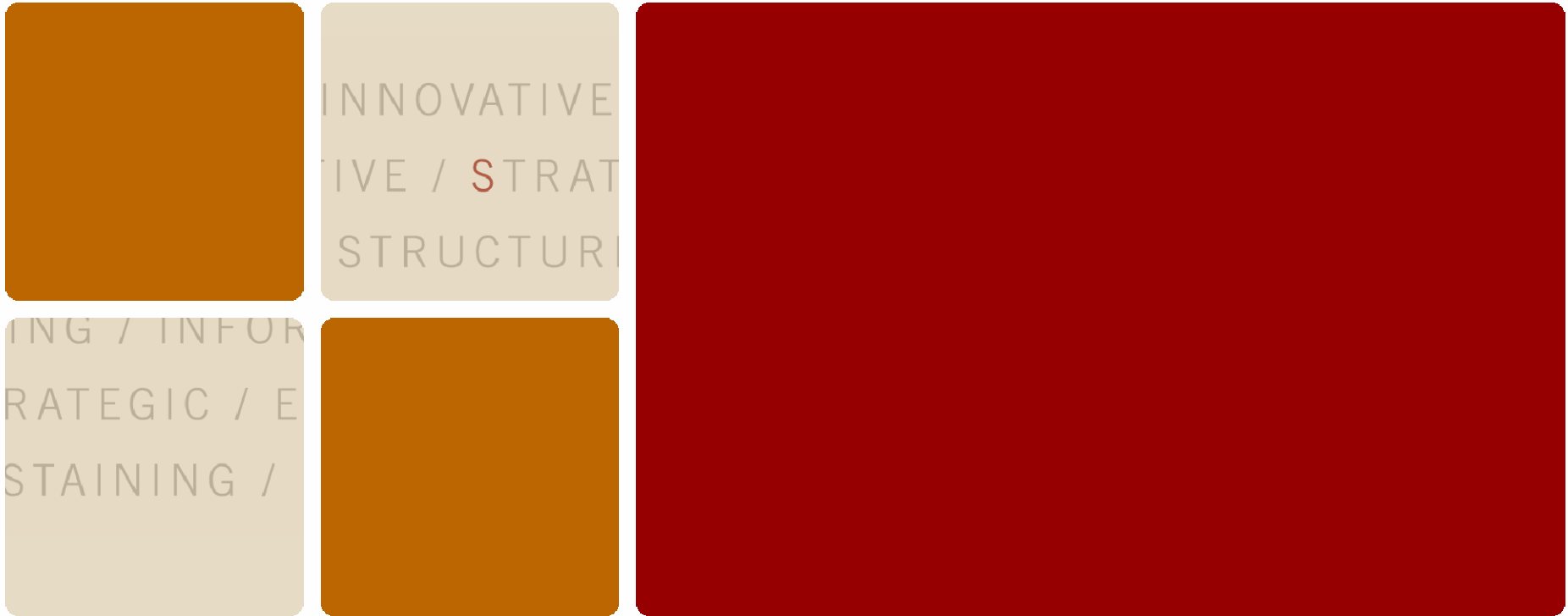
(\$ In Billions)



Source: Strategic Insight, Cerulli Associates

Cerulli Associates. "ETF 3.0?" Cerulli Edge: U.S. Edition May 2006: 3.

Challenges, Requirements, & Solutions



What have been the biggest challenges?

**4. In your opinion, what are the biggest challenges to implementing an open architecture investment solution?
(Please rank the top three challenges. "Rank 1" being most important)**

Responses	Rank 1	Rank 2	Rank 3	Weighted Rank (Score)
Integrating the open architecture platform within the current client sales, service and investment processes	11	7	11	1 (58)
Integrating the open architecture platform with the current operations infrastructure	10	5	7	2 (47)
Changing the client fee structure to maintain profitability while paying an open architecture platform provider	8	7	8	3 (46)
Developing the investment manager selection and oversight capability that many open architecture platforms require	6	8	2	4 (36)
Selecting and managing an open architecture platform provider	4	5	8	5 (30)
Selecting the appropriate investment managers while at the same time negotiating favorable account minimums and management fees	2	9	5	6 (29)

**11. What have been the biggest challenges to your sales, service and investment activities as you implement an open architecture solution?
(Please rank the top three challenges, "Rank 1" being most important).**

Responses	Rank 1	Rank 2	Rank 3	Weighted Rank (Score)
Training investment officers and portfolio managers to act as client advisors and asset allocators	11	13	5	1 (64)
Developing a client relationship process that delivers objective advice to clients	9	8	9	2 (52)
Locating and retaining business development and relationship management talent	7	7	11	3 (46)
Developing an investment manager selection and oversight capability	6	3	5	4 (29)

Source: SEI Survey of Banking Clients, August 2006

Successful Introduction of Open Architecture Requires....

- Overcoming fear about bank's proprietary products & the loss in certainty of profits earned due to the introduction of other firm's products and services
- Hiring and retraining talented advisors and business developers and provide incentives to stay
- Building and/or subcontracting world-class manager search, selection and oversight capabilities
- Building and/or buying the appropriate technology & operations infrastructure to support the program
- Securing senior management commitment

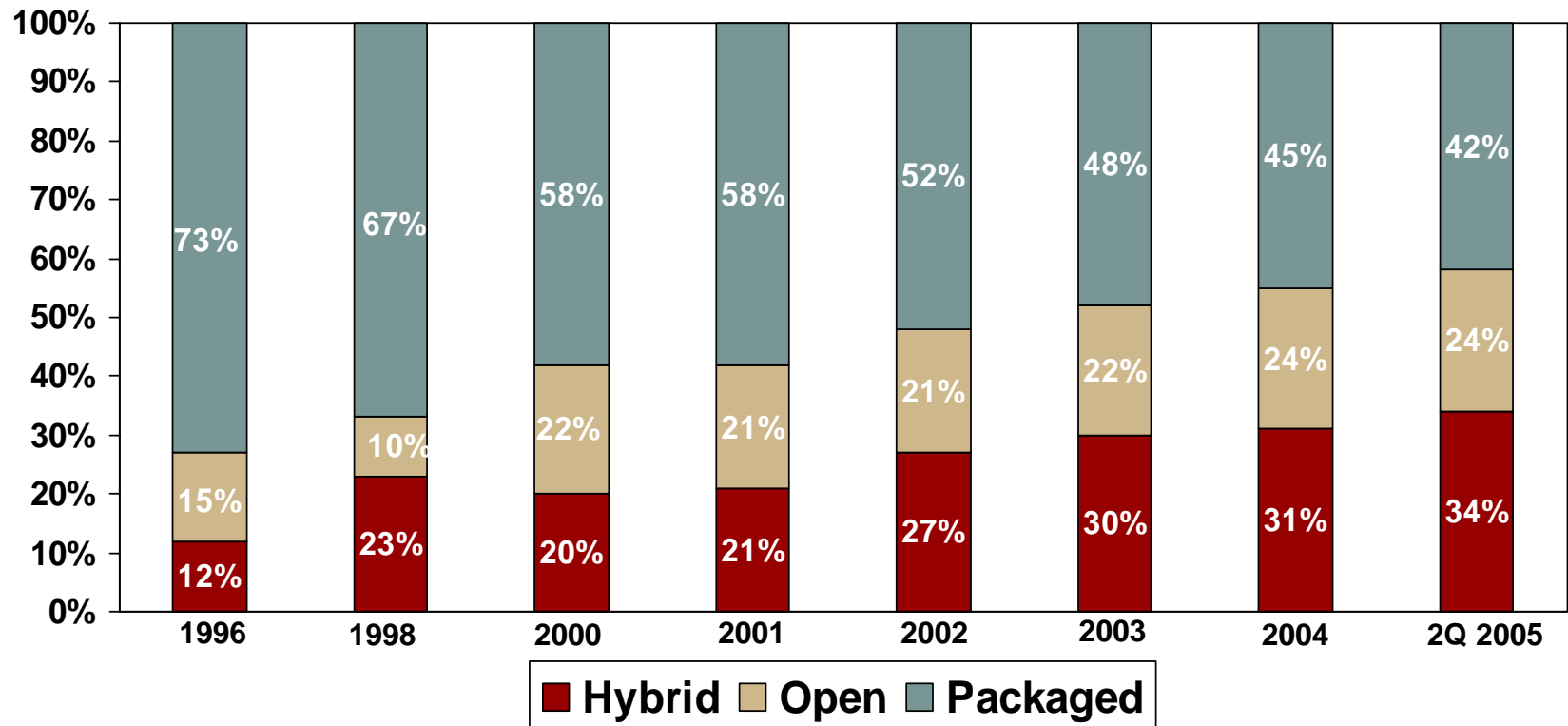
Source: Cerulli 4Q04 Distribution Channels Issue Volume 2

3 Potential Forms of Open Architecture

- **Open or Super-Market Approach:** Advisors choose from virtually an unlimited number of Mutual Funds or SMAs and maintain wide-ranging flexibility in adjusting investment portfolio models
- **Hybrid or Mini-Market Approach:** Advisors may make some adjustments to investment portfolio model allocations and mutual funds selected to populate these allocations but Bank management maintains moderate degree of control of what's delivered to the client.
- **Packaged or Intel-Inside Model:** Advisors select from packaged investment portfolio models for clients based upon their profile with little flexibility to change investment choices or allocations

Sources: http://www.pwmnet.com/news/fullstory.php/aid/575/Banks_offer_field_day_for_funds.html

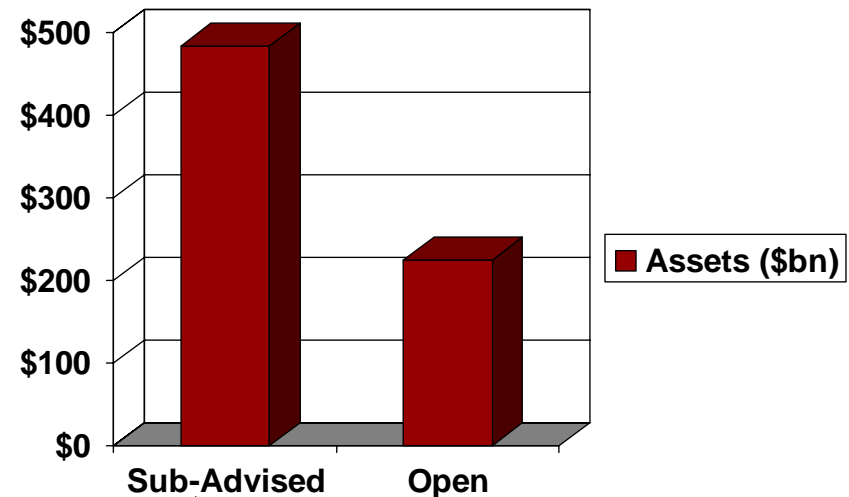
Mutual Fund Growth by Program Type



Source: The Cerulli Edge September 2005, Client's Choice Issue pg.12

Sub-Advisory vs. Open-Architecture Platform: Separately Managed Account Choices

- Open: dual-contract relationships
 - Any manager can be used
 - Different fees for different managers
 - Held off-platform
- Sub-Advisory Format: the typical “wrap” program.
 - Contract is with the provider,
 - Uniform client fee structure
 - Provider has ability to hire and fire managers



41% Growth in 2yrs

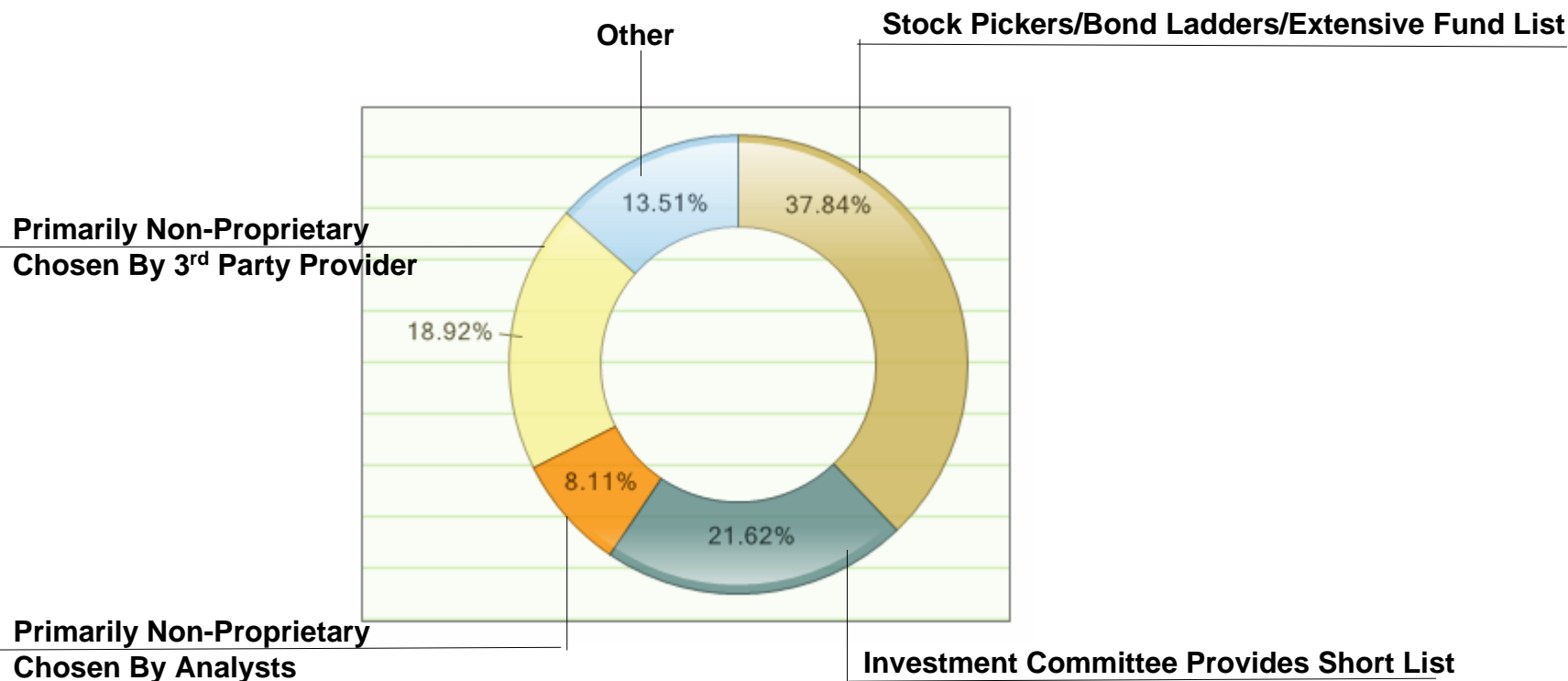
26% Growth in 2yrs

Platform Solutions - Options

- Outsource 100% of the business – bundled solution
 - Hire one or several outside companies to maintain technology, investment research, creation of funds, etc.
- Outsource a portion of business: technology or investment platform
 - Partnering with a Third-Party Platform (TPP) to enhance an existing platform is a very efficient way of ensuring the delivery and support of the optimal range of available products and services that wealth managers require to service the HNW market
 - The optimal mix of proprietary and third-party solutions will vary from firm-to-firm based on individual strengths and weaknesses, as well as their vision for success

Source: 3C Financial Partners. "Platform Made Perfect," 2005: 6, 11-12.

Which statement best describes your investment offering?



Source: SEI Survey of Banking Clients, August 2006