Investment Management Outsourcing: The State of the Art in 2012

October 2012
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**Thank You**

Northern Trust thanks Brinker Capital and Hanlon Investment Management Inc. for their partnership in this project. A special thanks to all advisors whose thoughtful survey participation made this report possible.
Executive Summary

In the summer of 2012, Northern Trust revisited a 2010 research initiative and again surveyed financial advisors about their use of investment management outsourcing. The survey enabled us to tap the experience and insights of two groups:

- **Advisors whose firms are outsourcing investment management**

  These advisors say that outsourcing has positively impacted the productivity and efficient growth of their practices. With the possible exception of disappointing investment performance, outsourcing advisors are categorically satisfied with their solution and what it achieves for their firms.

- **Advisors whose firms are not outsourcing investment management**

  The majority of these advisors contend that their in-house management of client assets is central to their firms’ value proposition. The 2012 survey found a higher percentage of advisors maintaining this view—and across firm type, firm size and compensation model segments—than in 2010.

  As a consequence, this group reports spending a significant amount of time on related activities. Manager research, portfolio construction and monitoring tasks, in particular, consume even more time of advisors from larger firms than was reported two years ago.

  In the strongest response to any survey question, many non-outsourcing advisors acknowledge that they could use outside help in specific investment management tasks (e.g., accessing broader options, portfolio monitoring, performance reporting).

The following pages present additional detail about what’s being outsourced, the impact of outsourcing on a practice, and gaps between outsourcing expectations and experience. Additionally, survey data sheds further light on the perspectives of advisors who don’t outsource.

Northern Trust commissioned this research to better understand advisors’ thoughts about outsourcing and where additional help may be needed. Asset Management at Northern Trust provides expertise offered through an extensive range of investment strategies and structures.
A Summary of the Findings

- One-half of the outsourcing respondents outsource all investment management activities.
- Six out of 10 respondents outsource more than half of their clients’ assets—37% outsource 75%-100% of clients’ assets.
- While more than half (57%) of those surveyed say outsourcing has had no effect on fees charged to clients, almost one-third (28%) say they’ve increased fees and 15% say fees have decreased.
- The 2012 top outsourcing drivers: Access to asset allocation models, access to managers firms could not access on their own and the potential to generate alpha through best investment ideas.
- When advisors are asked for the single factor that most positively impacted the firm’s outsourcing experience, time freed up to spend on the business is valued even more highly than it was two years ago.
- Ninety-four percent of advisors say they’re satisfied with their outsourcing solution. One-third says they’re “very satisfied.” This is nearly identical to the results reported in 2010. However, advisors in 2012 are more forthcoming about the negatives—investment performance, notably.
- As in 2010, the leading reason provided (by 54% of all advisors vs. 43% of respondents in 2010) for not outsourcing: Investment management is central to their firms’ value proposition.
- While 67% of non-outsourcing advisors in 2010 said their position toward outsourcing won’t change, only 34% selected that response in 2012.
- Advisors from larger firms that don’t outsource are increasingly burdened with investment management-related tasks. More than six out of 10 advisors from larger firms report spending more than five hours a week—for a total of 15 hours/week or the equivalent of 1.5 workweeks a month—on three key investment management tasks.

A Summary of the Findings

- Ninety-four percent of advisors say they’re satisfied with their outsourcing solution. One-third says they’re “very satisfied.” This is nearly identical to the results reported in 2010. However, advisors in 2012 are more forthcoming about the negatives—investment performance, notably.
- As in 2010, the leading reason provided (by 54% of all advisors vs. 43% of respondents in 2010) for not outsourcing: Investment management is central to their firms’ value proposition.
- While 67% of non-outsourcing advisors in 2010 said their position toward outsourcing won’t change, only 34% selected that response in 2012.
- Advisors from larger firms that don’t outsource are increasingly burdened with investment management-related tasks. More than six out of 10 advisors from larger firms report spending more than five hours a week—for a total of 15 hours/week or the equivalent of 1.5 workweeks a month—on three key investment management tasks.

ABOUT THE SURVEY

Over a three-week period in June and July 2012, multiple emails were sent to subscribers of AdvisorPerspectives.com with the invitation to complete an extensive survey. A total of 510 advisors responded. Answers to the survey’s first question split respondents into two groups: those who outsource and those who don’t.

Analysis of the research included consideration of the advisors’ firm type (independent financial planning/investment advisory, RIA or regional broker-dealer), firm size (our smaller firms label applies to those with $150 million in assets or less, larger firms have $150 million in assets or more) and compensation model (asset-based or a combination of commissions and fees).

Financial advisors used the survey’s comment fields to add additional considerations or elaborate on their responses. Their verbatim comments appear throughout the report.
Insights Into the Outsourcing Advisory Practice

SCOPE OF OUTSOURCING
The 2012 survey asked respondents to specify which investment management activities and back-office operations are being outsourced.

Exactly one-half of the outsourcing respondents outsource all investment management activities, while 15% outsource just specific asset classes. Among larger firms, just 31% say they outsource all investment management. Two out of 10 advisors outsource all investment management-related back-office operations.

Via their write-in comments, advisors made it clear that their firms outsource to a finer degree than captured in the choices provided.

Outsourced Investment Management Activities
As a percentage of outsourcing responses

<table>
<thead>
<tr>
<th>Activity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>All investment management activities</td>
<td>50%</td>
</tr>
<tr>
<td>Just specific asset classes</td>
<td>15%</td>
</tr>
<tr>
<td>All investment management-related back-office</td>
<td>20%</td>
</tr>
<tr>
<td>operations</td>
<td></td>
</tr>
<tr>
<td>Just specific investment management-related back-</td>
<td>15%</td>
</tr>
<tr>
<td>office operations</td>
<td></td>
</tr>
</tbody>
</table>

The 15% of respondents who selected the “Just specific investment management-related back-office operations” response were asked to specify from among a list of activities. Custody services, statements and performance reports were the top three selections.

Outsourced Investment Management-Related Back-Office Operations
As a percentage of outsourcing responses

<table>
<thead>
<tr>
<th>Activity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Custody services</td>
<td>15%</td>
</tr>
<tr>
<td>Statements</td>
<td>14%</td>
</tr>
<tr>
<td>Performance reports</td>
<td>13%</td>
</tr>
<tr>
<td>Portfolio operations</td>
<td>13%</td>
</tr>
<tr>
<td>Recordkeeping</td>
<td>12%</td>
</tr>
<tr>
<td>Quarterly billing</td>
<td>12%</td>
</tr>
<tr>
<td>Trading</td>
<td>12%</td>
</tr>
<tr>
<td>Account on-boarding, account data download and</td>
<td>7%</td>
</tr>
<tr>
<td>reconciliation</td>
<td></td>
</tr>
<tr>
<td>Financial planning</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
</tr>
</tbody>
</table>

IN THEIR OWN WORDS:
ADVISORS’ COMMENTS ABOUT WHAT’S OUTSOURCED

“Manager due diligence”
“Outsource some investments with some clients”
“Asset allocation and security selection”
“Primarily qualified assets”
“Certain investment-related functions for certain products”
“Specific portfolio types”
“SMA sub-advisory”
“Third-party research”

CUSTOMIZATION ENABLED
More than half of advisors surveyed (52%) work with a solution that enables open architecture, with about one-third (31%) using limited customization and the remainder (17%) using a hybrid or other arrangement. Firm size may be a factor in determining the customization approach. Just 25% of advisors from larger firms report using a limited solution.

WHAT PERCENTAGE OF CLIENT ASSETS?
Advisors outsource a significant percentage of their clients’ assets. Six out of 10 (62%) advisors say they outsource more than half of their clients’ assets—37% say three-quarters to 100% of clients’ assets are outsourced.

Outsourcing of Particular Assets or Accounts
As a percentage of outsourcing respondents

<table>
<thead>
<tr>
<th>The investment products selected for the client</th>
<th>Client account size</th>
<th>The need for tax efficiency</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>48%</td>
<td>2%</td>
<td>13%</td>
<td>2%</td>
</tr>
<tr>
<td>37%</td>
<td>13%</td>
<td>37%</td>
<td>37%</td>
</tr>
<tr>
<td>12%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
</tbody>
</table>


WHICH CLIENT ASSETS?
What determines which assets or accounts will be outsourced? The leading consideration, cited by 48% of all advisors, is the investment products selected; 37% say the decision is driven by client account size. There is a marked difference in advisor responses when analyzed by compensation model.

What Determines the Outsourcing of Particular Assets or Accounts by Compensation Model
As a percentage of outsourcing respondents

<table>
<thead>
<tr>
<th>Client account size</th>
<th>27%</th>
</tr>
</thead>
<tbody>
<tr>
<td>The investment products selected for the client</td>
<td>38%</td>
</tr>
<tr>
<td>The need for tax efficiency</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>17%</td>
</tr>
</tbody>
</table>

OUTSOURCING CAN IMPACT FEES CHARGED

Outsourcing has led to fee changes, four out of 10 advisors (43%) say.

Almost two-thirds of advisors from larger firms said fees were unchanged while advisors from smaller firms said fees had risen. Advisors compensated based on assets under management were the likeliest to report a decline in fees, although more than half (53%) of this segment said there had been no change.

IN THEIR OWN WORDS:
ADVISORS’ COMMENTS ABOUT FEES CHARGED

“Fees have increased compared to buy and hold mutual fund accounts.”

“I find that advisory accounts are much easier to manage and for that reason I charge representative fees of less than 1%.”

“Our management fee is the same, the TAMP has fees that are unique to the strategy implemented.”

“Generally, fees have remained the same; however, we have reduced some client fees due to less work required on our part to manage the assets.”

“For those clients who chose to allow their accounts to be managed on a more active, tactical basis, we use our providers’ algorithms. The provider charges us 40 bps/yr, we charge the clients 60 bps/yr. Half our assets use these programs.”

“The move to managed accounts from retail brokerage accounts over the last several years has made fees more visible to clients but also more cost-effective.”

The Outsourcing Experience

The composition of the respondents to the 2012 survey was comparable to the 2010 survey, with slightly greater RIA representation in 2012 (43% vs. 41%). This enables a comparison of responses to similar questions, and leads to insights about how advisors’ perspectives have evolved in the intervening two years.

Composition of Survey Respondents

<table>
<thead>
<tr>
<th>Category</th>
<th>2012 As a percentage of all responses</th>
<th>2010 As a percentage of all responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>RIAs</td>
<td>43%</td>
<td>41%</td>
</tr>
<tr>
<td>Independent planning, investment advisory firms</td>
<td>34%</td>
<td>34%</td>
</tr>
<tr>
<td>Regional broker-dealers</td>
<td>15%</td>
<td>16%</td>
</tr>
<tr>
<td>Other</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Banks</td>
<td>4%</td>
<td>5%</td>
</tr>
</tbody>
</table>


PRIMARY OUTSOURCING DECISION DRIVERS

This table compares the top 2012 and 2010 survey responses to related questions.

In 2010, respondents were asked, “Which of the following is driving your firm’s outsourcing/partnering considerations?” The survey provided a list of six choices and asked respondents to choose the top three. A follow-up question asked, “Which additional benefits does your firm look to obtain by outsourcing/partnering?” and respondents were asked to choose all that apply.

The 2012 survey combined all choices offered in the two 2010 questions, with four additional options, and respondents were asked to select their top three. The table below presents the top 10 decision drivers. The boldface options were not choices offered in the 2010 survey.

<table>
<thead>
<tr>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOP RESPONSES TO QUESTION THAT COMBINED CHOICES OFFERED BY TWO QUESTIONS IN 2010</td>
<td>TOP RESPONSES TO DECISION DRIVER QUESTION</td>
</tr>
<tr>
<td>Access to asset allocation models</td>
<td>Portfolio construction</td>
</tr>
<tr>
<td>Access to managers we could not access on our own</td>
<td>Access to alternative investments expertise</td>
</tr>
<tr>
<td>The potential to generate alpha through best investment ideas</td>
<td>Portfolio monitoring</td>
</tr>
<tr>
<td>Portfolio construction</td>
<td>Access to separately managed account (SMA) expertise</td>
</tr>
<tr>
<td>Portfolio monitoring</td>
<td>Access to asset allocation models</td>
</tr>
<tr>
<td>Access to separately managed account (SMA) expertise</td>
<td>Access to mutual funds expertise</td>
</tr>
<tr>
<td>Access to alternative investments expertise</td>
<td>TOP RESPONSES TO ADDITIONAL BENEFITS QUESTION</td>
</tr>
<tr>
<td>Superior back-office technology and support</td>
<td>Performance reporting</td>
</tr>
<tr>
<td>Access to unified managed account (UMA) capability</td>
<td>Superior back-office technology and support</td>
</tr>
<tr>
<td>Overlay management</td>
<td>Marketing support</td>
</tr>
<tr>
<td></td>
<td>Practice management support</td>
</tr>
</tbody>
</table>

The Impact of Outsourcing

Productivity and profitability—that’s what advisors say outsourcing has helped their firms achieve, as shown in this graph which rank-orders advisors’ multiple responses.

What Outsourcing Has Achieved for the Firm

As a percentage of all outsourcing respondents

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>More time to spend with clients</td>
<td>64%</td>
</tr>
<tr>
<td>The ability to grow more efficiently</td>
<td>63%</td>
</tr>
<tr>
<td>The ability to develop a more consistent investment management process for the firm</td>
<td>60%</td>
</tr>
<tr>
<td>The ability to offer a wider array of investment products</td>
<td>58%</td>
</tr>
<tr>
<td>Institutional-level due diligence and monitoring</td>
<td>54%</td>
</tr>
<tr>
<td>Support for tactical asset allocation</td>
<td>49%</td>
</tr>
<tr>
<td>The ability to contain the expense of research staff</td>
<td>42%</td>
</tr>
<tr>
<td>Better investment results for clients</td>
<td>40%</td>
</tr>
<tr>
<td>The ability to contain the expense and need for technology infrastructure</td>
<td>36%</td>
</tr>
<tr>
<td>Superior tax management for clients</td>
<td>27%</td>
</tr>
<tr>
<td>The ability to contain the expense of compliance</td>
<td>25%</td>
</tr>
<tr>
<td>Help with a specific product set</td>
<td>18%</td>
</tr>
</tbody>
</table>


In Their Own Words: Advisors’ Comments on What Outsourcing Achieves

“Using our provider’s algorithm versus the modified buy and hold approach that we use for other clients has produced average annual returns that are consistently 200–300 bps better than our own portfolios for the past two years.”

“It was not really a ‘decision to outsource’ any more than our referring people to qualified counsel to draft estate planning documents is a ‘decision to outsource.’ Rather, it is merely our recognition of the fact that we are financial planners, not money managers, or lawyers, or accountants or bankers, etc...”

“It’s none of these [choices]. It’s fees for the firm and broker retention. The only reason outsourcing is allowed is greed and fear.”

“We’re financial planners, CFPs not CFAs.”

“We don’t outsource unless there is a kickback to the firm.”
POSITIVE AND NEGATIVE IMPACTS

In 2010 and in 2012, the survey asked respondents in what ways outsourcing positively and negatively impacted their business. Advisor responses show that an increasingly high premium is placed on the time outsourcing frees up to focus on the business. Fifty-five percent of advisors selected the choice in 2012 versus 44% in 2010. Favorable investment performance, a selection of 32% of advisors in 2010, was the most positive impact for 21% of today’s outsourcing advisors. Because only 12 advisors answered the negative impact question, the 2010 summary did not include the results. In the intervening two years, investment performance of the outsourced solutions has disappointed, and poor performance ranks as outsourcing’s single most negative impact in 2012, as cited by one-third of advisors.

The Single Most Positive Impact of Outsourcing

As a percentage of outsourcing respondents

- **More time to focus on the business**: 55% (2012) vs. 21% (2010)
- **Favorable investment performance**: 44% (2012) vs. 10% (2010)
- **Strong client service**: 32% (2012) vs. 8% (2010)
- **Good performance reporting**: 13% (2012) vs. 5% (2010)
- **Other**: 9% (2012) vs. 3% (2010)

The Single Most Negative Impact of Outsourcing

As a percentage of outsourcing respondents

- **Poor investment performance**: 33% (2012)
- **Other**: 27% (2012)
- **Too expensive**: 17% (2012)
- **Lack of communication**: 13% (2012)
- **Poor client service**: 6% (2012)
- **Poor performance reporting**: 4% (2012)

HIGH SATISFACTION ACROSS THE BOARD
Advisors are overwhelmingly pleased with outsourcing. That was the case in 2010 and continues to be true in 2012, with a total of 94% of advisors saying they’re satisfied—34% very satisfied.

More advisors whose compensation is based on their assets and advisors with small firms describe themselves as very satisfied. Fewer advisors from larger firms and those compensated based on a combination of fees and commission select the superlative.

Such high levels of satisfaction may be a measure not just of the providers but of the concept itself. No single partner’s name dominates the research results. And, as noted in 2010, advisors continue to have their choice of a wide variety of firms offering “outsourcing” solutions.

While the survey provided a list of 15 names as possible responses to the “Who is your firm’s primary outsourcing provider?” question, the top selection was “Other.” One-third of the respondents wrote in names not on the list. Despite the fragmented offerings, these disparate providers appear to be fully satisfying outsourcers’ needs.
**RELIANCE ON MULTIPLE PARTNERS**

Further, response to a related survey question suggests that advisors are increasingly finding what they need with one partner. The percentage of advisors who say they use multiple outsourcing partners because they haven’t found one firm to meet all their needs has dropped to 39% in 2012 from 48% in 2010. The desire for client asset diversification continues to be a secondary reason to work with multiple partners, although that’s declined, as well.

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**Why Firms Use Multiple Partners**

*As a percentage of all outsourcing responses*

<table>
<thead>
<tr>
<th>Reason</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>We haven’t found one firm that can meet all of our firm’s needs</td>
<td>48%</td>
<td>39%</td>
</tr>
<tr>
<td>We want client assets to be diversified</td>
<td>37%</td>
<td>32%</td>
</tr>
<tr>
<td>Other</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Working with multiple firms is cost-efficient</td>
<td>10%</td>
<td>5%</td>
</tr>
</tbody>
</table>


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**IN THEIR OWN WORDS:**

**ADVISORS’ COMMENTS ON USING MULTIPLE PARTNERS**

“There’s no monopoly on good ideas.”

“More selection for our FAs”

“Single-sourcing exceeds our firm’s risk tolerance and constrains objectivity.”

“We use one platform for clients who want more control.”

“Client needs dictate”
EXPECTATIONS VS. EXPERIENCE

The identification and vetting of an investment management outsourcing partner requires great care and deliberation on the part of an advisory firm. But, is the outsourcing experience as expected? The research sought to reveal any gaps by asking advisors to compare the relative importance (critical/important/not important) of an array of decision drivers, both during the evaluation and selection process and once the firm began working with the outsourcing provider.

The graph below shows how advisors rank the factors, now that they are working with providers. Flexibility and philosophy—two qualitative factors—rank at the top of the list, ordered by critical considerations.

What’s Important: When Working with an Investment Management Outsourcing Provider

As a percentage of all outsourcing responses

<table>
<thead>
<tr>
<th>Factor</th>
<th>Critical</th>
<th>Important</th>
<th>Not important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flexibility (investment selection, managers, portfolio construction, trading rules, pricing, reporting options)</td>
<td>19%</td>
<td>7%</td>
<td>2%</td>
</tr>
<tr>
<td>Philosophy/chemistry</td>
<td>15%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Back-office support</td>
<td>13%</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>Technology</td>
<td>12%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Pricing</td>
<td>11%</td>
<td>12%</td>
<td>3%</td>
</tr>
<tr>
<td>Compliance support</td>
<td>8%</td>
<td>11%</td>
<td>12%</td>
</tr>
<tr>
<td>Access to alternative investments</td>
<td>7%</td>
<td>11%</td>
<td>13%</td>
</tr>
<tr>
<td>Support in growing my business (i.e., via marketing/recruiting/other business functions)</td>
<td>6%</td>
<td>10%</td>
<td>18%</td>
</tr>
<tr>
<td>Training</td>
<td>5%</td>
<td>12%</td>
<td>15%</td>
</tr>
<tr>
<td>Access to CIO, analysts</td>
<td>4%</td>
<td>10%</td>
<td>18%</td>
</tr>
</tbody>
</table>

EXPERIENCE MOSTLY ALIGNS WITH EXPECTATIONS

What advisors considered to be important during the buying process is largely in line with their experience working with their provider.

This graph compares expectations versus experience by dimension. It suggests that while advisors' focus on the critical items aligned with their ultimate experience, they were slightly less accurate when considering which dimensions would be important and which not important.

Support in growing the business, back-office support and compliance support are three dimensions whose importance was underestimated by advisors. Conversely, advisors overestimated the importance of pricing and access to alternative investments.

Outsourcing Expectations vs. Experience

As a percentage of all outsourcing responses

Flexibility (investment selection, managers, portfolio construction, trading rules, pricing, reporting options)

Philosophy/chemistry

Pricing

Technology

Back-office support

Compliance support

Support in growing my business (i.e., via marketing/recruiting/other business functions)

Access to alternative investments

Training

Access to CIO, analysts

Advisors Who Don’t Outsource

Advisors who don’t outsource are certainly aware of the productivity and profitability claims made by their outsourcing colleagues. As in 2010, the research sought to understand where non-outsourcing advisors stand. Are there some for whom outsourcing is a foregone but not yet acted upon conclusion or is it their intention to keep investment management in-house indefinitely?

“Which best describes the reason that your firm does not outsource the investment management capability?” The same question was asked this year as was asked in 2010, with some variance in the possible reasons provided. This year’s survey provided three new choices—“Our firm has not found a solution that supports our business,” “Our firm is currently considering outsourcing” and “Other.” The 2010 response, “Investment research in-house is a competitive advantage” was omitted.

### Reason for not Outsourcing

<table>
<thead>
<tr>
<th>Reason for not Outsourcing</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our firm considers investment research part of its value proposition</td>
<td>43%</td>
<td>54%</td>
</tr>
<tr>
<td>Our firm wants to retain maximum flexibility</td>
<td>11%</td>
<td>7%</td>
</tr>
<tr>
<td>Our firm cannot justify the expense</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Our firm has not found a solution that supports our business (2012 only)</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Our firm is not currently considering but has not ruled it out</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Our firm has assessed outsourcing and decided against it</td>
<td>6%</td>
<td>8%</td>
</tr>
<tr>
<td>Our firm is currently considering outsourcing (2012 only)</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Our client mix doesn’t warrant it</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Investment research in-house is a competitive advantage (2010 only)</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Other (2012 only)</td>
<td>10%</td>
<td></td>
</tr>
</tbody>
</table>

The leading reason selected by more than half of the advisors surveyed (54%) was that investment management is considered central to the firm’s value proposition. And, the percentage of advisors who gave this response increased across every segment analyzed.

“Our firm considers investment research part of its value proposition.”

By Firm Type

<table>
<thead>
<tr>
<th>Firm Type</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent financial planning/ investment advisory firms</td>
<td>43%</td>
<td>42%</td>
</tr>
<tr>
<td>RIAs</td>
<td>39%</td>
<td>48%</td>
</tr>
<tr>
<td>Regional broker-dealers</td>
<td>22%</td>
<td>35%</td>
</tr>
</tbody>
</table>

By Compensation Model

<table>
<thead>
<tr>
<th>Compensation Model</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset-based</td>
<td>39%</td>
<td>38%</td>
</tr>
<tr>
<td>Combination</td>
<td>29%</td>
<td>38%</td>
</tr>
</tbody>
</table>

By Firm Size

<table>
<thead>
<tr>
<th>Firm Size</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Larger (AUM &gt;$150M)</td>
<td>38%</td>
<td>63%</td>
</tr>
<tr>
<td>Smaller (AUM &lt;$150M)</td>
<td>25%</td>
<td>47%</td>
</tr>
</tbody>
</table>

WHAT WOULD HAVE TO CHANGE

While this suggests some digging in on the advisors’ part, responses to a follow-up question asked both in 2010 and 2012 raise the possibility of a weakening of advisors’ resolve. In 2010, two-thirds of non-outsourcing survey respondents said that their position on outsourcing would not change. That was the dominant response. While the response continues to be dominant in 2012, the percentage who said their opinion would not change has been halved to 34%. Note that this year’s survey provided additional choices to choose from.

What Would Need to Occur in Order for Opinions to Change

As a percentage of all non-outsourcing responses

<table>
<thead>
<tr>
<th>Requirement</th>
<th>2012</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our opinion won’t change</td>
<td>67%</td>
<td>34%</td>
</tr>
<tr>
<td>Today’s solutions need added capabilities such as alternative investments or a broader selection of models</td>
<td>34%</td>
<td>20%</td>
</tr>
<tr>
<td>Today’s solutions need to be more affordable for our firm</td>
<td>19%</td>
<td>11%</td>
</tr>
<tr>
<td>Our firm’s assets under management must grow substantially</td>
<td>7%</td>
<td>19%</td>
</tr>
<tr>
<td>Our firm’s client base must grow substantially</td>
<td>15%</td>
<td></td>
</tr>
</tbody>
</table>


IN THEIR OWN WORDS: ADVISORS’ COMMENTS ON WHAT WOULD HAVE TO CHANGE

“Have not heard of one that focuses on retirement income”

“Much more flexibility in portfolio options”

“Hell must freeze over”

“Confidence in a third party”

“Outsourcing providers need to show a history of justifying the expenses paid.”

“Demonstrable, sustainable superiority over our in-house approach”

“The returns need to be as good or better than my own”

“Business expansion to include smaller accounts”

“Outsourcing needs tax efficiency options”

“A better way to articulate outsourced value proposition”

“Today’s solutions need better performance and flexibility”

“Vendor options need to do a better job marketing the benefits of their work.”

“If there are better advisors than us available in the alternative space”
WHERE OUTSIDE HELP IS RELIED UPON AND WANTED

Notwithstanding a firm’s decision to keep investment management in-house, 85% of non-outsourcing advisors say they use outside help in investment management-related areas. The leading selection: investment product analysis, used by four out of 10 advisors.

Advisors’ response to the question: “Apart from your firm’s decision not to outsource investment management, what could you use outside help with today? Choose all that apply” produced the strongest response of the survey. The top identified areas are comparable to the 2010 list with one exception: RIAs’ inclusion of compliance.

TOP THREE AREAS WHERE ADVISORS SAY THEY COULD USE HELP

By Firm Type

Independent financial planning/investment advisory firms
- Marketing support
- Access to broader investment options, including institutional-type investment management research and strategies
- Performance reporting

RIAs
- Marketing support
- Compliance
- Superior back-office technology and support

Regional broker-dealers
- Marketing support
- Portfolio monitoring
- Access to broader investment options, including institutional-type investment management research and strategies

IN THEIR OWN WORDS:

ADVISORS’ COMMENTS ON WHERE OUTSIDE HELP COULD BE USEFUL

“Would like to have outsourcing resources in place in case they were needed”

“None—we have no problem doing everything”

“Consolidated client reporting”

“Cost-effective straight through processing block trading across multiple custodians”

“Specialized alternative investments”

“Finding new clients”
TIME SPENT WEEKLY ON INVESTMENT MANAGEMENT-RELATED TASKS

The 2010 research found that “time spent on investment management-related tasks could consume the equivalent of two workdays/week.” Advisors in 2012 report spending even more time on investment manager research, portfolio construction and portfolio monitoring.

These tasks are taking a significant bite out of the schedules of advisors from larger firms, in particular. More than six out of 10 advisors from large firms report spending more than five hours a week on investment manager research, portfolio construction and monitoring. That’s a total of 15 hours/week or the equivalent of 1.5 workweeks a month.

TIME SPENT BY ALL ADVISORS IN 2012

**Investment Manager Research**

As a percentage of non-outsourcing responses

**Portfolio Construction**

As a percentage of non-outsourcing responses

**Portfolio Monitoring**

As a percentage of non-outsourcing responses

1. Does your firm currently outsource its investment management capability, including one or more of the following: investment manager research, product selection, due diligence and ongoing monitoring and management?
   - Yes
   - No (if no, direct respondents to the ‘no’ track)

If the respondent answered YES to question 1 they were directed to the following questions Q2–Q16 below. If the respondent answered NO to question 1 they were directed to the set of questions Q17–Q21 beginning on page 20. All respondents were asked the profiling questions.

2. Which of the following investment management activities does your firm outsource? (Choose all that apply)
   - We outsource all investment management activities
   - We outsource just specific asset classes
   - We outsource all investment management-related back-office operations
   - We outsource just specific investment management-related back-office operations (if you selected this please answer the following question)

3. Which specific investment management-related back-office operations do you outsource? Please only answer if you outsource just specific back-office operations. (Choose all that apply)
   - Portfolio operations
   - Performance reports
   - Statements
   - Recordkeeping
   - Custody Services
   - Financial Planning
   - Quarterly Billing
   - Trading
   - Account on-boarding, account data download and reconciliation
   - Other

4. Who is your firm’s primary outsourcing provider? (Choose one)
   - Adhesion Wealth
   - Advisor Solutions
   - Brinker Capital
   - Curian Capital
   - Dorsey Wright
   - Envestnet | PMC
   - Fidelity
   - Fortigent
   - Genworth
   - Hanlon Investment Management
   - Lockwood Advisors
   - Loring Ward
   - Morningstar Managed Portfolios
   - Placemark Investments
   - SEI Advisor Network
   - Other

5. If your firm outsources to multiple partners, please select the answer that best explains your rationale. (Choose one)
   - We want client assets to be diversified
   - We haven’t found one firm that can meet all of our firm’s needs
   - Working with multiple firms is cost-efficient
   - Other

6. What level of customization does your primary investment management outsourcing solution enable? (Choose one)
   - Limited customization—we have a selection of manager models
   - Hybrid—we manage one or more asset classes while others are outsourced to third-party managers
   - Open architecture, which may include mutual funds, ETFs, equities, SMAs, UMAs

7. What percentage of clients’ assets does your firm outsource? (Choose one)
   - Less than 10%
   - 11%–24%
   - 25%–50%
   - 51%–74%
   - 75%–100%

8. Has outsourcing all or some of your investment activities resulted in a change in fees charged to clients? (Choose one)
   - Fees have increased
   - Fees have decreased
   - There has been no change
   - Comment

9. Which of the following primarily drove the decision to outsource your firm’s investment management? (Choose the top three that apply)
   - Access to separately managed account (SMA) expertise
   - Access to unified managed account (UMA) capability
   - Access to alternative investments expertise
   - Access to mutual funds expertise
   - Access to asset allocation models
   - The potential to generate alpha through best investment ideas
   - Portfolio construction
   - Portfolio monitoring
   - Overlay management
   - Access to managers we could not access on our own
   - Superior back-office technology and support
   - Performance reporting
   - Client profiling
   - Production of client proposals
   - Education and training
   - Marketing support
   - Practice management support
   - Other

10. Please indicate the importance of each to your firm when evaluating and selecting an investment management outsourcing provider.

<table>
<thead>
<tr>
<th>Flexibility (investment selection, managers, portfolio construction, trading rules, pricing, reporting options)</th>
<th>Critical</th>
<th>Important</th>
<th>Not a factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pricing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to alternative investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to CIO, analysts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Back-office support</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Support in growing my business [i.e., via marketing/recruiting/other business functions]</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compliance support</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philosophy/chemistry</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Comment
11. Please indicate the importance of each to your firm when now that you are working with your investment management outsourcing provider.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Critical</th>
<th>Important</th>
<th>Not a Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flexibility (investment selection, managers, portfolio construction, trading rules, pricing, reporting options)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pricing</td>
<td></td>
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</tr>
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<tr>
<td>Back-office support</td>
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<td></td>
</tr>
<tr>
<td>Technology</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Comment</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12. What has your decision to outsource investment management achieved for your firm? (Choose all that apply)

- Better investment results for clients
- The ability to grow more efficiently
- The ability to offer a wider array of investment products
- The ability to develop a more consistent investment management process for the firm
- More time to spend with clients
- Help with a specific product set
- Support for tactical asset allocation
- The ability to contain the expense and need for technology infrastructure
- The ability to contain the expense of research staff
- The ability to contain the expense of compliance
- Institutional-level due diligence and monitoring
- Superior tax management for clients
- Other

13. What’s your level of satisfaction with your outsourcing solution? (Choose one)

- Very satisfied
- Satisfied
- Dissatisfied
- Very dissatisfied

14. Which of the following has most negatively impacted your firm’s outsourcing experience? (Choose one)

- Poor investment performance
- Poor client service
- Poor performance reporting
- Too expensive
- Lack of communication
- Other

15. Which of the following has most positively impacted your firm’s outsourcing experience? (Choose one)

- Favorable investment performance
- Good performance reporting
- Strong client service
- More time to focus on the business
- Other

16. Which of the following factors determines whether your firm will outsource the investment management of particular assets or accounts? (Choose one)

- Client account size
- The investment products selected for the client
- The need for tax efficiency
- Other

17. Which best describes the reason that your firm does not outsource the investment management capability?

- Our firm has assessed outsourcing and decided against it
- Our firm considers investment research part of its value proposition
- Our firm cannot justify the expense
- Our firm wants to retain maximum flexibility
- Our client mix doesn’t warrant it
- Our firm has not found a solution that supports our business
- Our firm is itself an advisory solutions provider
- Our firm is currently considering outsourcing
- Our firm is not currently considering outsourcing but has not ruled it out
- Other

18. Which of the following needs to occur for your opinion on investment management outsourcing to change? (Choose all that apply)

- Our firm’s client base must grow substantially
- Our firm’s assets under management must grow substantially
- Today’s solutions need added capabilities such as alternative investments or a broader selection of models
- Today’s solutions need to be more affordable for our firm
- Our opinion won’t change
- Other

19. Apart from your firm’s decision not to outsource investment management, what could you use outside help with today? (Choose all that apply)

- Access to broader investment options, including institutional-type investment management research and strategies
- Access to asset allocation models
- Portfolio construction
- Portfolio monitoring
- Portfolio operations
- Compliance
- Superior back-office technology and support
- Performance reporting
- Client profiling
- Production of client proposals
- Education and training
- Marketing support
- Practice management support
- Recruiting support
- Other
20. Do you use outside help for any of the following? (Choose all that apply)

- Multi-manager mutual funds
- Asset allocation models
- Investment product analysis (e.g., Morningstar)
- Web-based practice management sites
- Marketing agencies
- I don’t use any outside help for these
- Other ____________________________

21. How much time per week do you estimate that your firm spends on:?

<table>
<thead>
<tr>
<th>Activity</th>
<th>1 hour</th>
<th>1–2 hours</th>
<th>2–5 hours</th>
<th>5 or more hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment manager research</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Portfolio construction</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Portfolio monitoring</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

These questions answered by all respondents.

Are you associated with any of the following?

- Independent financial planning firm or investment advisory firm
- Registered investment advisory firm
- Regional broker-dealer
- Bank
- Other ____________________________

Please indicate your firm’s current AUM. This information is strictly confidential.

- $50 million and under
- $50 million–$150 million
- $150 million–$500 million
- $500 million–$1 billion
- $1 billion and more

Which best represents the bulk of your firm’s revenues?

- Asset-based fee
- Commission
- Combination of commission and asset-based fee
- Hourly or planning fees

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