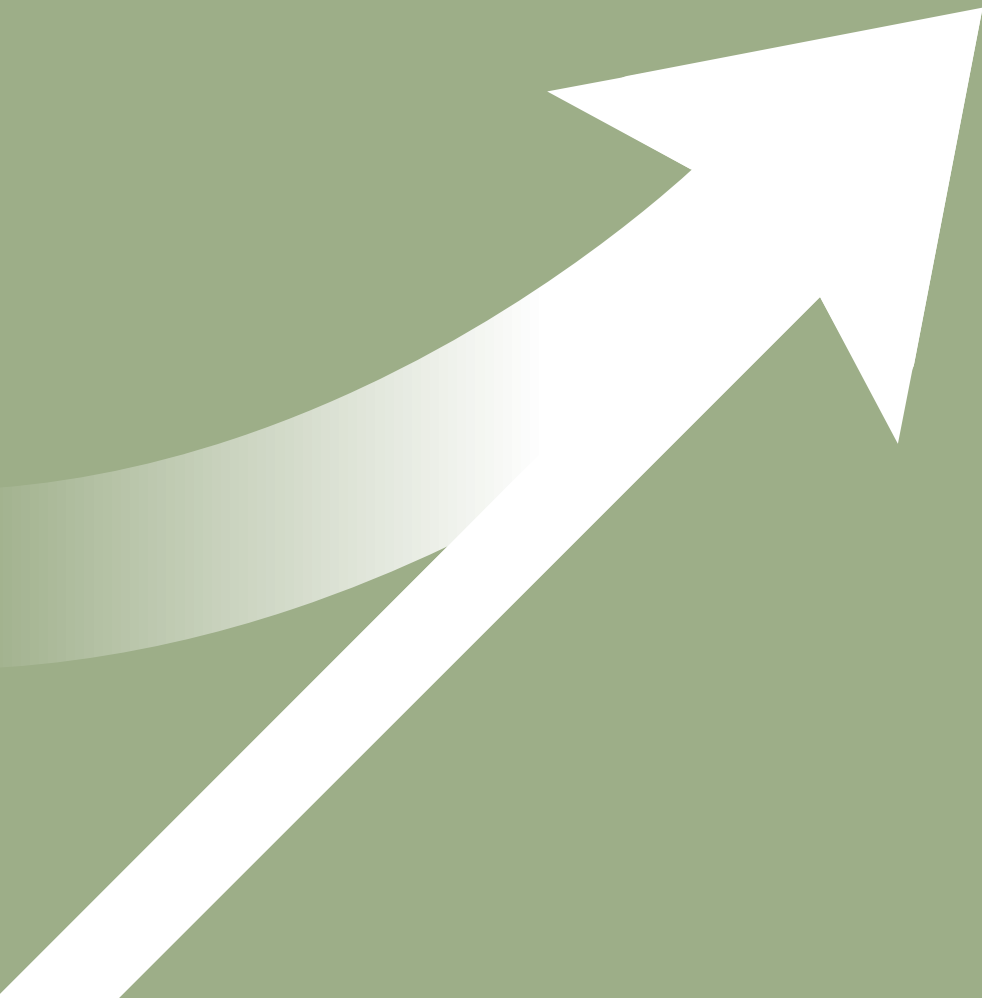


# Investment Management Outsourcing: Impact on Clients

FEBRUARY 2014



Northern Trust | Asset Management

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# Contents

<b>Executive Summary</b> .....	1
About the Survey .....	1
Summary of the Findings .....	2
<b>Introducing the Idea to Clients</b> .....	3
Are There Consequences? .....	4
Consequences by Firm Type and Firm Size .....	5
In The Advisors' Own Words .....	6-8
<b>Scope of Outsourcing</b> .....	9
What Percentage of Client Assets? .....	10
Client Accounts Outsourced .....	11
Impact on Fees Charged .....	12
In The Advisors' Own Words .....	13
<b>Outsourcing Decision Drivers</b> .....	14-15
Advisor Satisfaction .....	16
In The Advisors' Own Words .....	17
<b>Advisors Who Don't Outsource</b> .....	18
In The Advisors' Own Words .....	18-19
The Cost of Self-Sufficiency .....	20
In The Advisors' Own Words .....	22
<b>Survey</b> .....	23-25

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## THANK YOU

Northern Trust thanks Brinker Capital, Hanlon Investment Management and FolioDynamix for their partnership in this project. A special thanks to all advisors whose thoughtful survey participation made this report possible. This research initiative reflects Northern Trust's ongoing commitment to sponsors and participants in retail investment platforms. To learn more, please contact your Northern Trust Investment Relationship Manager or the Northern Trust Financial Intermediary Team at 877-867-1259.



# Executive Summary

The direction of Northern Trust's 2014 investment outsourcing research was cast during the Webinar presenting the results for the 2012 research. "But, how do clients react? What do they say? What do they do?" came the questions streaming into the Webinar.

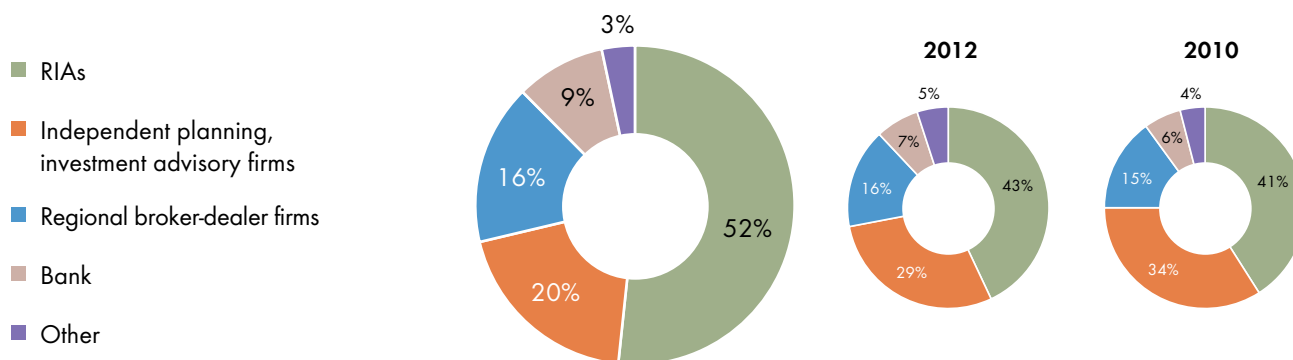
This is the third biennial report on advisors' use of investment management outsourcing. The first report, published in 2010, presented a lay of the land. The 2012 report was focused on advisors' expectations during the solutions provider vetting process versus their experience. In 2014, the focus shifted to what advisors most care about: clients.

At the highest level, the research allays advisor apprehension. Nine out of 10 (92%) advisors report that clients responded positively when they initially heard the outsourcing news, and eight out of 10 say no clients were lost in the business transition. Seven out of 10 advisors say their business grew as a result.

When the clients are happy, advisors are happy—as has been consistently reported in 2012 and 2010, 90% of advisors are satisfied with their firms' move to outsourcing.

## Composition of Survey Respondents

**2014**  
As a percentage of all responses



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

## ABOUT THE SURVEY

Over a three-week period in November and December 2013, emails were sent to subscribers of AdvisorPerspectives.com with the invitation to complete an extensive survey. Nearly 200 advisors responded.

Compared to the earlier surveys, the composition of the respondents to the 2014 survey reflects greater RIA representation. More than half (52%) of the respondents came from advisors from RIAs versus 43% in 2012 and 41% in 2010.

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 this report.

## A SUMMARY OF THE FINDINGS

- In a departure from what was reported in 2012, 57% of 2014 respondents say they're outsourcing specific asset classes while just 29% are outsourcing all activities. Half of the respondents to the 2012 research reported that they were outsourcing all activities.
- More than half (53%) of respondents use TAMPs, and 68% are using multiple firms—primarily because they want clients' assets to be diversified.
- Almost half (48%) of advisors surveyed say they outsource more than half of their clients' assets—36% say three-quarters to 100% of clients' assets are outsourced.
- Four out of 10 advisors say they outsource all client accounts.
- 92% of advisors say clients' initial reaction to outsourcing is positive.
- Four out of five (80%) report no loss of clients and/or firm revenue.
- Seven out of 10 advisors say growth in clients and/or firm revenue can be attributed to outsourcing.
- More than one-half (53%) of those surveyed say outsourcing has had no effect on fees charged to clients.
- What outsourcing achieves for the firm: more time to spend with clients, cited by 57% of respondents.
- Nine out of 10 advisors say they're satisfied with their outsourcing solution. Almost four in 10 (39%) say they're "very satisfied."
- As in the previous surveys, the leading reason provided (by 56% of all non-outsourcing respondents versus 54% in 2012 and 43% of respondents in 2010) for not outsourcing: Investment management is central to their firms' value proposition.
- What could change non-respondents' position on outsourcing? While "Our opinion won't change" has been the top consistent response, affordability jumps in the 2014 findings.



# Introducing the Idea to Clients

Clients are at the center of advisory firms' deliberations about whether to outsource all or some of their investment management. It is a subject introduced with much care.

The survey provided respondents with four possible explanations and asked them to select the one they used

when announcing the decision to clients.

Four out of 10 advisors cite the desire to better allocate their resources. Resource allocation is the favored explanation across all firm types, sizes and compensation models.

## The Rationale Provided When Explaining the Decision to Outsource

As a percentage of outsourcing respondents

**Resource allocation:** "Outsourcing enables us to leverage my time and expertise, and focus on your needs. Meanwhile, you can be assured that we have professional managers managing your money at all times."

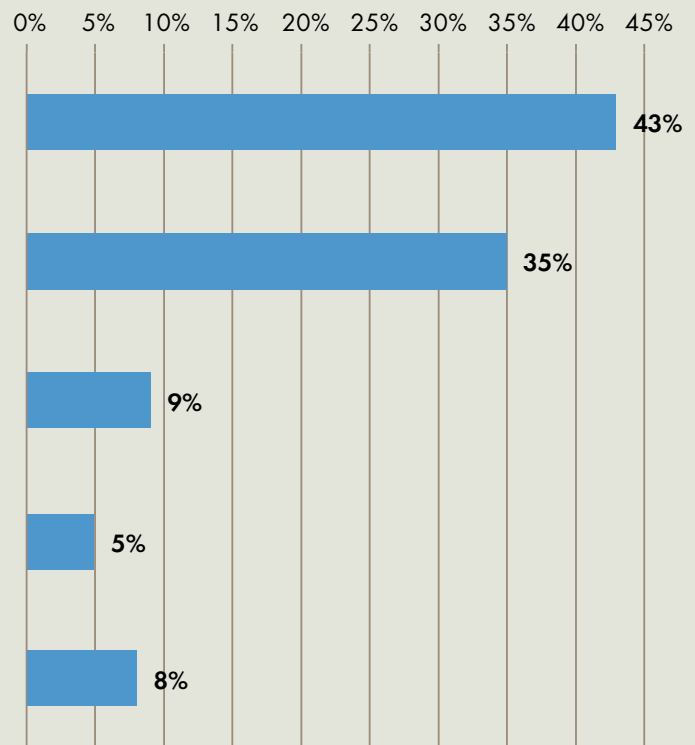
**Alignment:** "In our quest to make certain that your money works as hard as it can for you, we'll be in a position to hire some of the best money managers – and replace them when we need to."

**Service enhancement:** "We will be able to offer you the same level of services and technology capability as the very largest firms offer."

**Cost reduction:** "We can pass savings onto our clients as outsourcing enables us to do more with fewer in-house resources."

### Other

**Source:** "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



One advisor from a \$1 billion-plus RIA elaborated: "No one firm, no one company, no one team of people, much less a single person has all the investment know-how to effectively manage all types of money in all types of markets all over the globe. Even the best golfer doesn't use just one club when he/she plays the course.

"Why would we? Why would we use only one set of expertise? How about we fill the bag with all the clubs we should ever need, use the ones that work for us now, but have others ready if/when needed? Institutional firms or boutique, mutual funds or ETFs, qualitative, trend follower, whatever, you name it. Sound good?"

One-third of surveyed advisors say they cite the ability to use outside managers to better align with their clients' interests.

"I am a financial planner concerned with the big picture, not an investment manager," commented an advisor whose independent firm has less than \$50 million under management. "Outsourcing my investment management allows me to focus on clients' overall situation. I believe the manager selection and monitoring, and portfolio construction, particularly from a tactical view, is better than anything I could accomplish on my own. And if performance suffers over a long term, clients can change TAMPS, not advisors."

In preparing for the talk, advisors say they use a wealth of resources provided by their outsourcing partners, including presentations (72%), wholesalers' availability to take part in client meetings (25%), letter templates (16%) and scripts (12%).

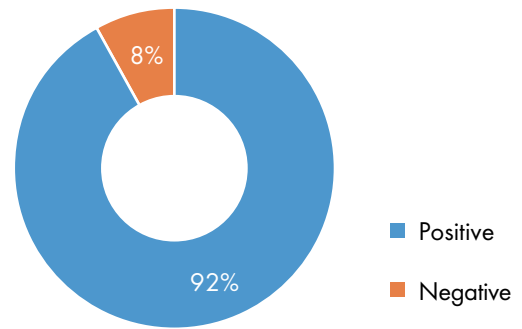
# Are There Consequences?

Respondents to Northern Trust’s research — advisors who have already had the conversation — say there’s little to worry about.

Clients respond positively to the idea initially, according to 92% of advisors. Four out of five advisors (80%) report no loss of clients and/or firm revenue as a result of outsourcing. And, seven out of 10 say growth in clients and/or firm revenue can be attributed to outsourcing.

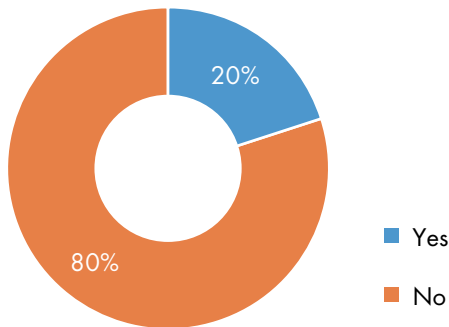
## Clients’ Initial Response to Outsourcing

As a percentage of outsourcing respondents



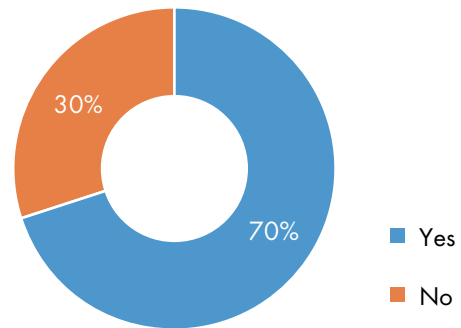
## Clients and/or Firm Revenue Lost as a Result of Outsourcing

As a percentage of outsourcing respondents

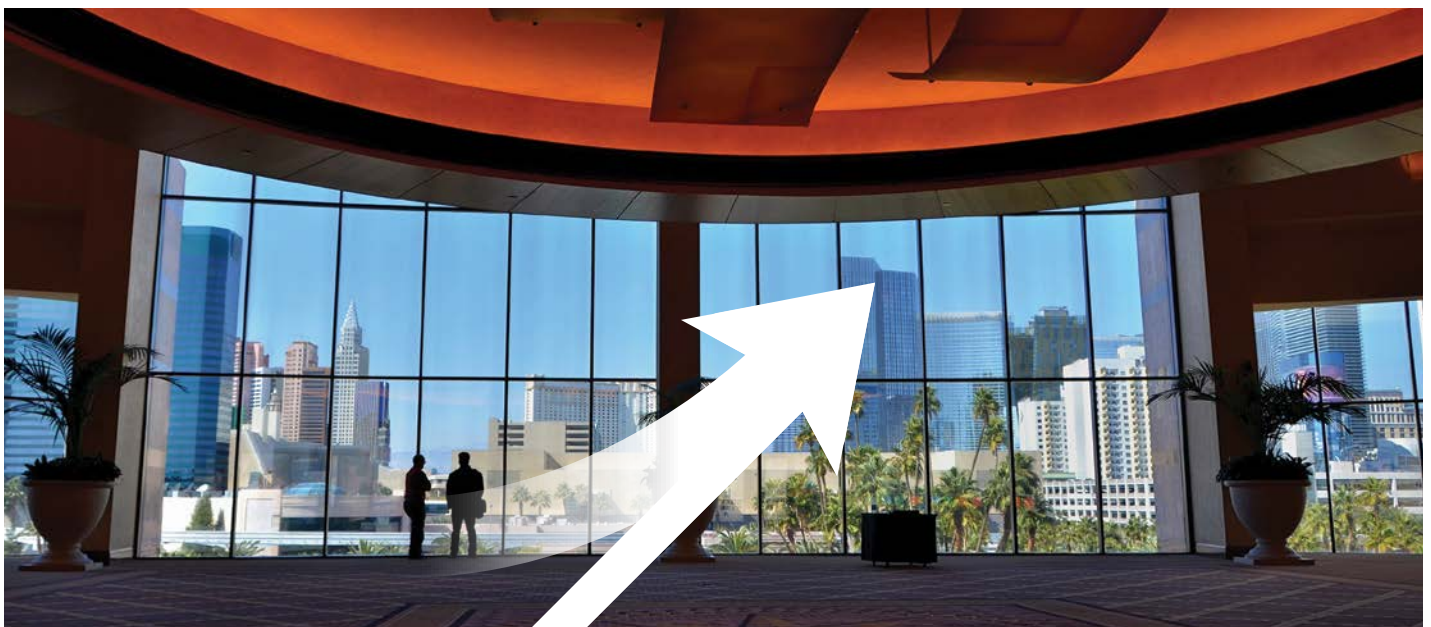


## Outsourcing’s Contribution to Growth in Clients and/or Firm Revenue

As a percentage of outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014





## CONSEQUENCES BY FIRM TYPE AND FIRM SIZE

Survey responses suggest that clients with independent financial planning/investment advisory firms reacted the most positively, and that financial planning/investment advisory firms may have benefited the most from the change. Advisors from regional broker-dealer firms reported their clients to be the least positive although

client or revenue loss was reported on par with the other firm types.

More smaller firms advisors reported positive client responses than larger firms (97% vs. 91%). A higher percentage of smaller firms (82% vs. 66%) attributed the growth in clients or revenue to outsourcing.

### By Firm Type

As a percentage of outsourcing respondents

	Independent Financial Planning/ Investment Advisory Firms	RIAs	Regional Broker-dealer Firms
<b>Clients' initial responses</b>			
Positive	100%	97%	83%
Negative	0%	3%	17%
<b>Clients and/or firm revenue lost as a result of outsourcing</b>			
Yes	21%	16%	17%
No	79%	84%	83%
<b>Outsourcing's contribution to growth in clients and/or firm revenue</b>			
Yes	89%	72%	67%
No	11%	28%	33%

### By Firm Size

As a percentage of outsourcing respondents

	Larger Firms (AUM>\$150M)	Smaller Firms (AUM<\$150M)
<b>Clients' initial responses</b>		
Positive	91%	97%
Negative	9%	3%
<b>Clients and/or firm revenue lost as a result of outsourcing</b>		
Yes	16%	27%
No	84%	73%
<b>Outsourcing's contribution to growth in clients and/or firm revenue</b>		
Yes	66%	82%
No	34%	18%

Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

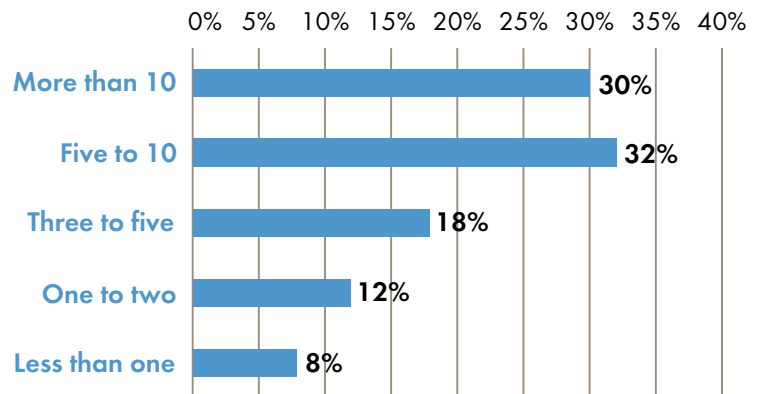
## IN THE ADVISORS' OWN WORDS

Respondents to the survey have significant outsourcing experience, with six out of 10 having outsourced for more than five years.

Even though the decision may have been made years ago, the questions about clients' reactions to outsourcing prompted the most narrative comments in the survey. A sampling follows below.

### Years Outsourcing

As a percentage of outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



**Overall, how would you characterize your clients' initial response to your firm's decision to outsource some or all of your investment management activities?**

- At first, they're hesitant until I explain that why would I or the team of two CFAs down the street think that we're smarter than a team of 30 CFAs, PhDs, CIMAs, CAIAs with a collective 600-plus years of experience? Then they're interested in hearing more about the process/platform. (*\$50 million and under independent financial planning firm*)
- **Our clients invest with us because of the relationship. The investment product has significantly less importance.** (*\$500 million to \$1 billion bank*)
- **Our clients appreciated our intense focus on them. We let them know they are the client, not their money.** (*\$50 million and under regional broker-dealer*)
- They appreciate the decision to add intellectual depth and ability to provide more advisory time with clients. Also, outsourcing reduces concern about the "what if" one of our partners became disabled, died or retired. (*\$1 billion and more bank*)
- We have offered a small degree of outsourcing for years, so the gradual increase was not too noticeable to clients. (*\$1 billion and more RIA*)





- Clients understand “highest and best use.” Investment management should not be a part-time activity by a quasi-specialist. (*\$150 million to \$500 million independent financial planning firm*)
- Clients really don’t see it as separate from the assets that I manage directly. (*\$50 million to \$150 million independent financial planning firm*)
- **Initially met with resistance but has gradually improved as clients have become more comfortable.** (*\$1 billion and more bank*)
- Our clients realize that their best opportunity to have world class management is to use world class managers. (*Independent financial planning firm*)
- It is an ongoing process. It has not been easy nor a quick transition. Legacy clients are the hardest as they will see their costs go up and not really get anything more than they were before. So it becomes a real challenge for me to persuade them of the potential benefits. (*\$50 million and under independent financial planning firm*)
- It all is fine until you can’t explain why things are not working—you have given up all control and reduced your value to the relationship. It is the reason I no longer use these products. Not worth blowing up a relationship over. (*\$1 billion and more RIA*)



**Have you lost any clients and/or firm revenue as a result of your firm’s decision to outsource some or all investment management activities?**



- **There are always some people who want it the way it always was done** and so, yes, they did not transition with us. But they are the minority. (*\$50 million and under RIA*)
- We had 98.5% client retention in making the transition. (*\$1 billion and more bank*)
- One client felt she would be better off with an advisor who picked stocks and funds himself. Her boyfriend remains a client and the longer I know her, the happier I am that she is not my client. (*\$50 million and under independent financial planning firm*)
- Lost a client due to his perception of underperformance. Based on performance numbers, client made an error. (*\$50 million and under independent financial planning firm*)
- Some clients are resistant to a third-party investment manager; they want an advisor who manages money directly. Consequently, they are not a good fit with our service model. (*\$1 billion and more bank*)



**Has your firm's use of investment management outsourcing helped grow your client base and/or firm revenue?**



- **I've landed larger accounts than I would have on my own.** (*\$50 million and under independent financial planning firm*)
- **I wouldn't say it's the reason we've grown, but it has been vital to client retention during 2008–2010 due to the fact we've had more time to spend with clients.** (*\$50 million and under RIA*)
- This has not been a factor in growing the client base. It has been a factor in transitioning certain clients from transaction to fee-based. (*\$50 million and under independent financial planning firm*)
- The ability to see more clients, increased productivity and added two new employees to help with client management. Two existing planners were freed up to do work with clients no longer having to deal with Compliance. Also outsourced HR, which also enhanced productivity. (*Bank*)
- **More prospects were interested in us once we broadened our access** to more asset classes and external managers. (*\$1 billion and more RIA*)
- It has freed up time to do more prospecting as well as do more for existing clients. (*\$1 billion and more RIA*)
- A better answer would be, "I'm not sure." (*\$150 million to \$500 million RIA*)



# Scope of Outsourcing

One of the biggest differences in the 2014 and 2012 survey results is in what respondents are outsourcing. In 2012, half of the advisors said they were outsourcing all activities. That number has dropped to 29% in the 2014 survey, with 57% outsourcing just specific asset classes.

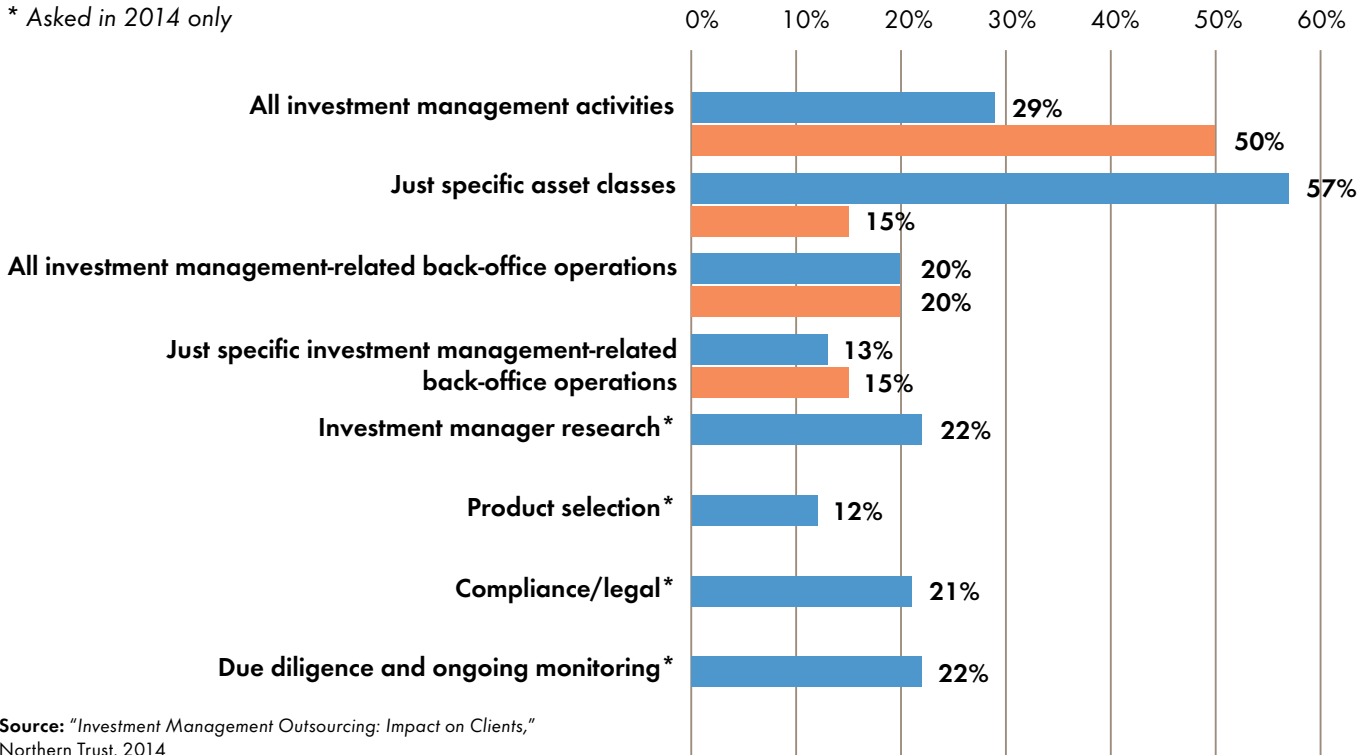
Slightly more than half of the respondents (53%) outsource via a turnkey asset management program (TAMP). More than two-thirds (68%) say they partner with or outsource to multiple firms. As was first noted in the 2012 survey, advisors are motivated more by a desire for client asset diversification and less because they haven't found one firm to meet all their needs.

## Outsourced Investment Management Activities

2014 2012

As a percentage of outsourcing respondents

\* Asked in 2014 only

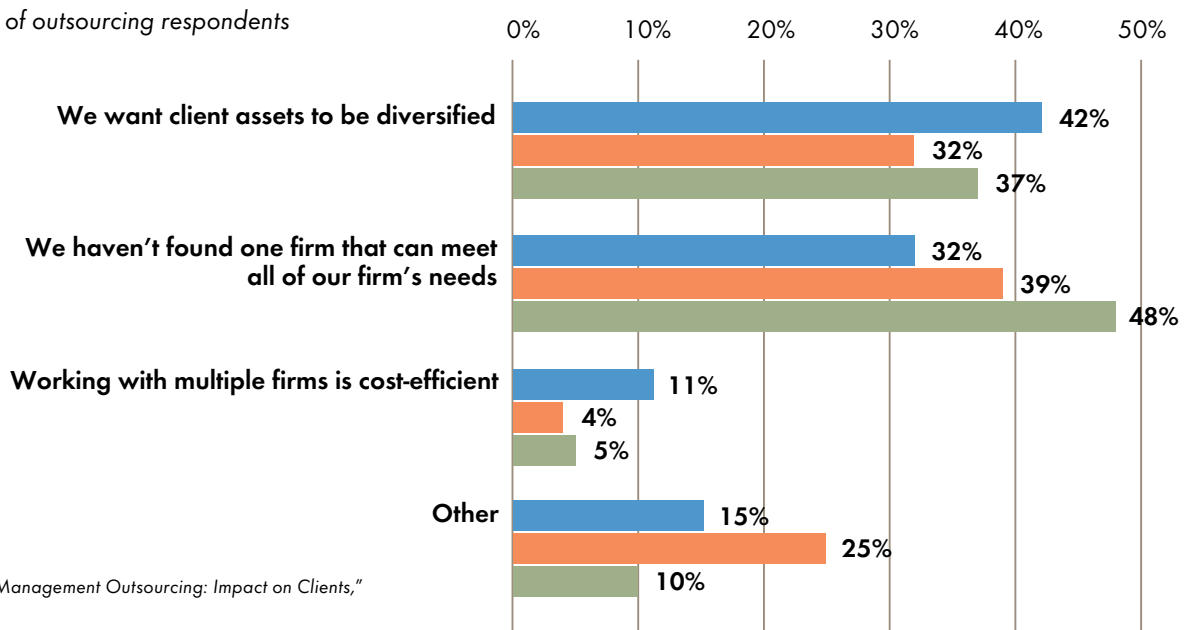


Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

## Why Firms Use Multiple Partners

2014 2012 2010

As a percentage of outsourcing respondents

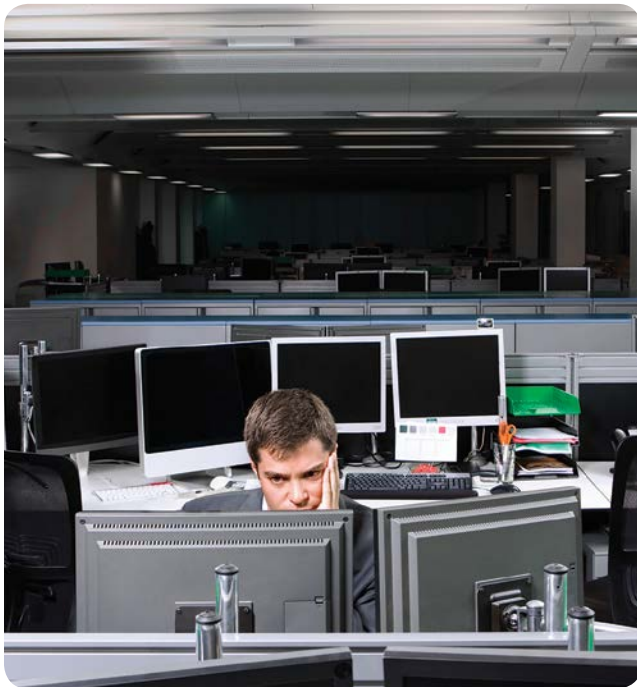


Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

## Customization Enabled

More than half of advisors surveyed (51%) have access to an open architecture solution, little changed from the 52% reported in 2012. Limited customization is available to one-quarter (25%), and the remainder (24%) use a hybrid or other arrangement. Firm size may be a factor. Almost two-thirds (63%) of advisors from larger firms use an open architecture solution.

How might investment program initiatives broaden in the coming year? Model-based UMAs (selected by 38% of respondents) edged out model-based SMAs on a list of options that also included rep-directed hybrid programs.

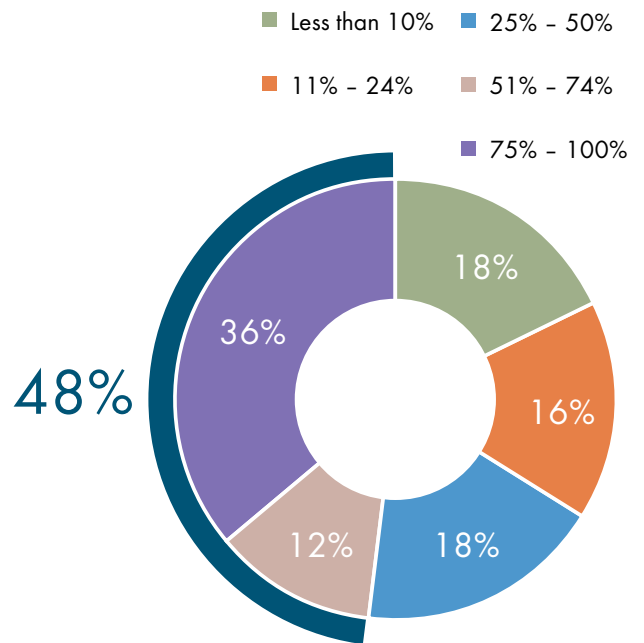


## What Percentage of Client Assets?

Almost half (48%) of advisors surveyed say they outsource more than half of their clients' assets—36% say three-quarters to 100% of clients' assets are outsourced. Smaller firms tend to outsource more and larger firms slightly less.

### The Percentage of Clients' Assets Outsourced

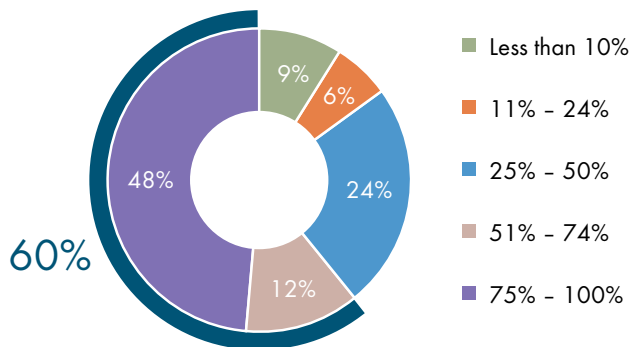
Percentage of all outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

### The Percentage of Clients' Assets Outsourced by Firm Size—Smaller Firms (AUM<\$150M)

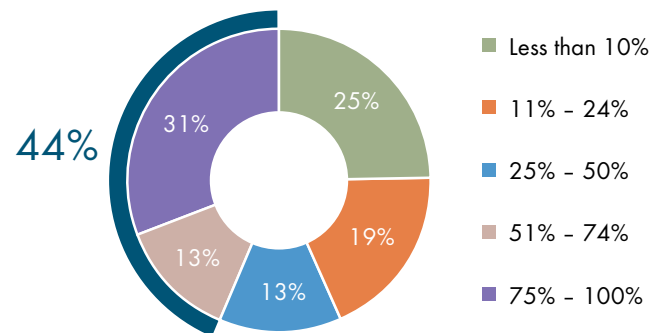
Percentage of all outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

### The Percentage of Clients' Assets Outsourced by Firm Size—Larger Firms (AUM>\$150M)

Percentage of all outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

# Client Accounts Outsourced

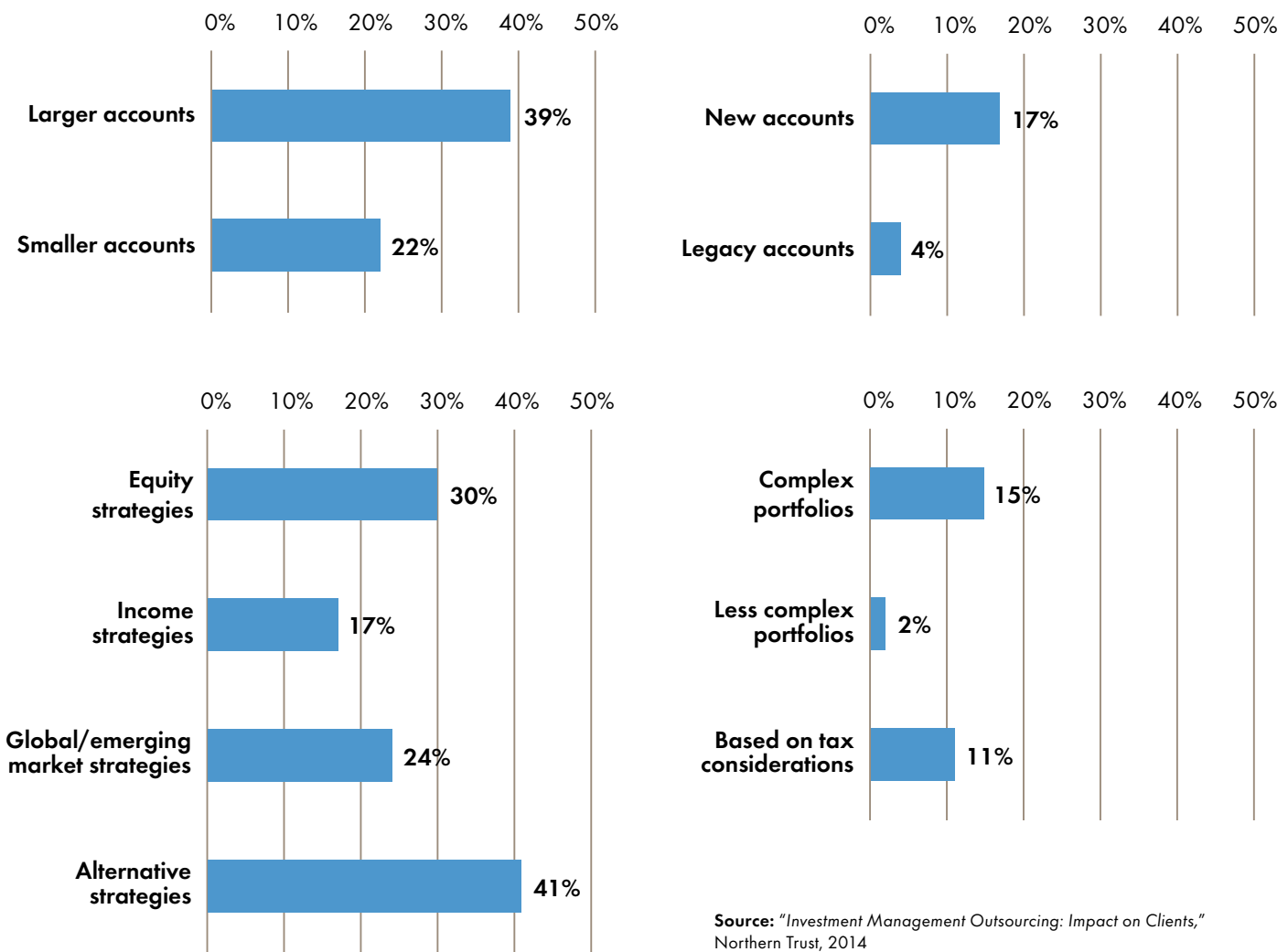
Which client accounts are outsourced and what are the implications? The 2014 research digs deeper into questions first asked in 2012.

Four out of 10 advisors say they outsource all client accounts. Beyond that, advisors are likelier to outsource large accounts than small, new accounts than legacy, alternative strategies than equity, income or global/emerging market strategies, and complex portfolios.

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## What Outsourcing Investment Decisions Are Based On

As a percentage of respondents who don't outsource all accounts



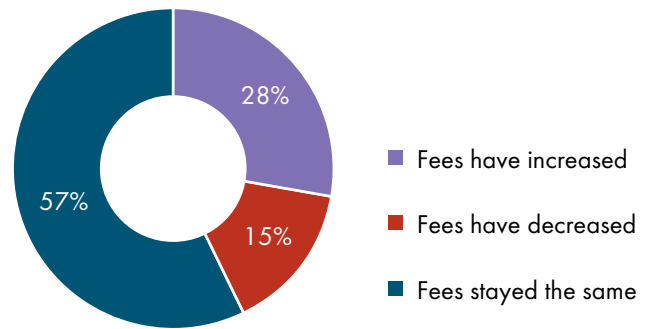
Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

# Impact on Fees Charged

As in 2012, more than half of advisors say their outsourcing of investment management has produced no change in fees charged. For added insight, the 2014 question provided additional responses. When fees increase, one-quarter of advisors pass the increase on to their clients. Advisors from smaller firms are most likely to leave fees unchanged.

## 2012: Impact of Outsourcing on Fees Charged

As a percentage of all outsourcing responses

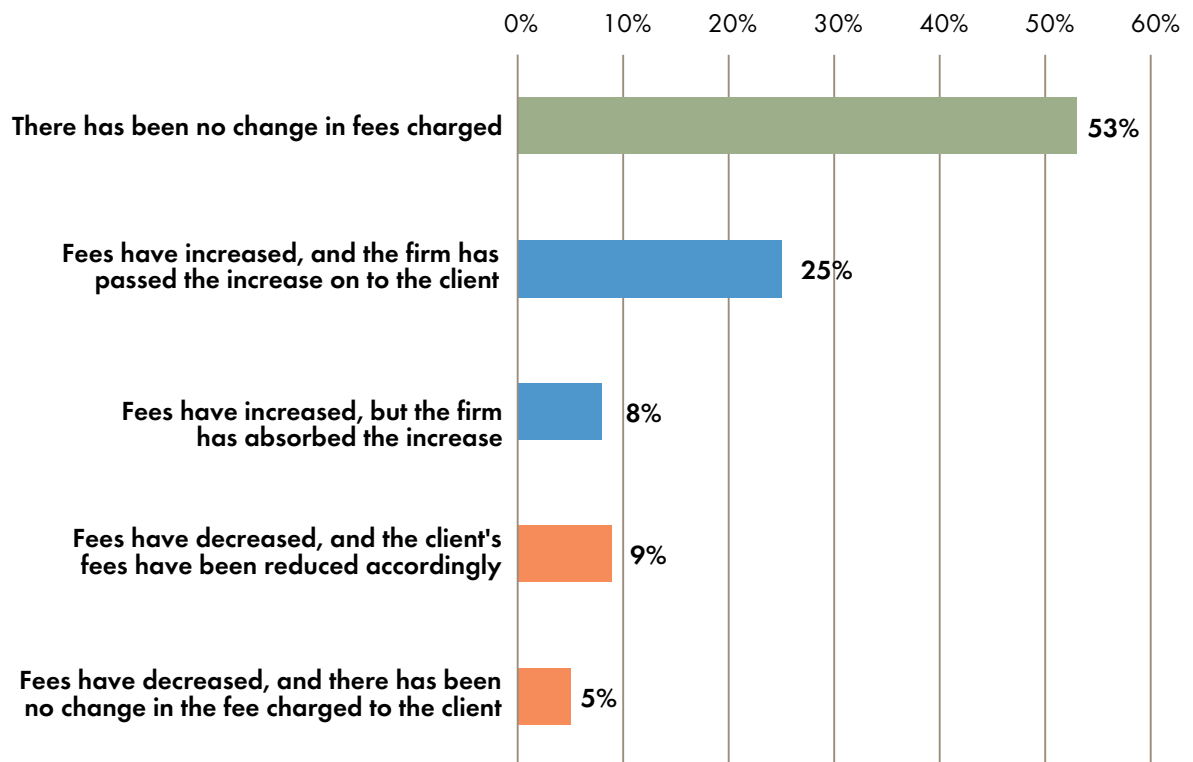


Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

## 2014: Impact of Outsourcing on Fees Charged

As a percentage of outsourcing respondents

■ Fees stayed the same ■ Fees have increased ■ Fees have decreased



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014





**Has outsourcing some or all of your investment management activities resulted in a change in fees charged to clients?**



## IN THE ADVISORS' OWN WORDS

- Annual costs to clients have been about the same; moving to a TAMP has eliminated up-front sales charges to the client. (*\$50 million and under independent financial planning firm*)
- The fee structure for AUM has remained the same for all existing clients. However, we are increasing our advisory fees via having a comprehensive fee for all clients and doing away with the hourly planning/advisory fee structure. (*\$1 billion and more bank*)
- **Outsourcing results in higher fees to the client or they were being charged too much previously for in-house management.** (*\$50 million and under independent financial planning firm*)
- Specialist funds have higher fees than a rebate of our own fees. (*\$500 million–\$1 billion RIA*)
- Our fees have been consistent for nearly 20 years. **It's operational efficiencies that enable increased margins.** (*Regional broker-dealer*)
- If someone is opposed to paying fees (% of AUM or flat fee), then they shouldn't be talking with a financial advisor. They should be doing it on their own with ETFs since they obviously believe that paying for active management will not result in the potential for a higher risk-adjusted return. Not to mention what is all involved in that fee whether it be flat or % AUM (e.g., tax planning, Roth conversion analysis, tax preparation, risk management, RMDs, college funding, etc.). (*\$50 million and under independent financial planning firm*)



# Outsourcing Decision Drivers

A multitude of issues drive the outsourcing decision and, as in previous surveys, advisors were asked to choose three from a list of 18. Access to alternative investments expertise shot to the top of the list of 2014 responses. While the composition of the list is largely the same as in 2012, superior back-office technology and support has rolled off. It's been replaced in the 2014 responses by cost efficiency, a selection not offered in 2012.

## PRIMARY OUTSOURCING DECISION DRIVERS

2014 Top Responses	2012 Top Responses
Access to alternative investments expertise	Access to asset allocation models
Portfolio construction	Access to managers we could not access on our own
Portfolio monitoring	The potential to generate alpha through best investment ideas
The potential to generate alpha through best investment ideas	Portfolio construction
Access to separately managed account (SMA) expertise	Portfolio monitoring
Access to managers we could not access on our own	Access to separately managed account (SMA) expertise
Cost efficiency (2014 only)	Access to alternative investments expertise
Access to asset allocation models	Superior back-office technology and support



More time for clients and the ability to grow efficiently—that’s what respondents to Northern Trust research have consistently named as the leading benefits of outsourcing across the board. When compared to 2012 responses, support for tactical asset allocation has dropped as an outsourcing advantage.

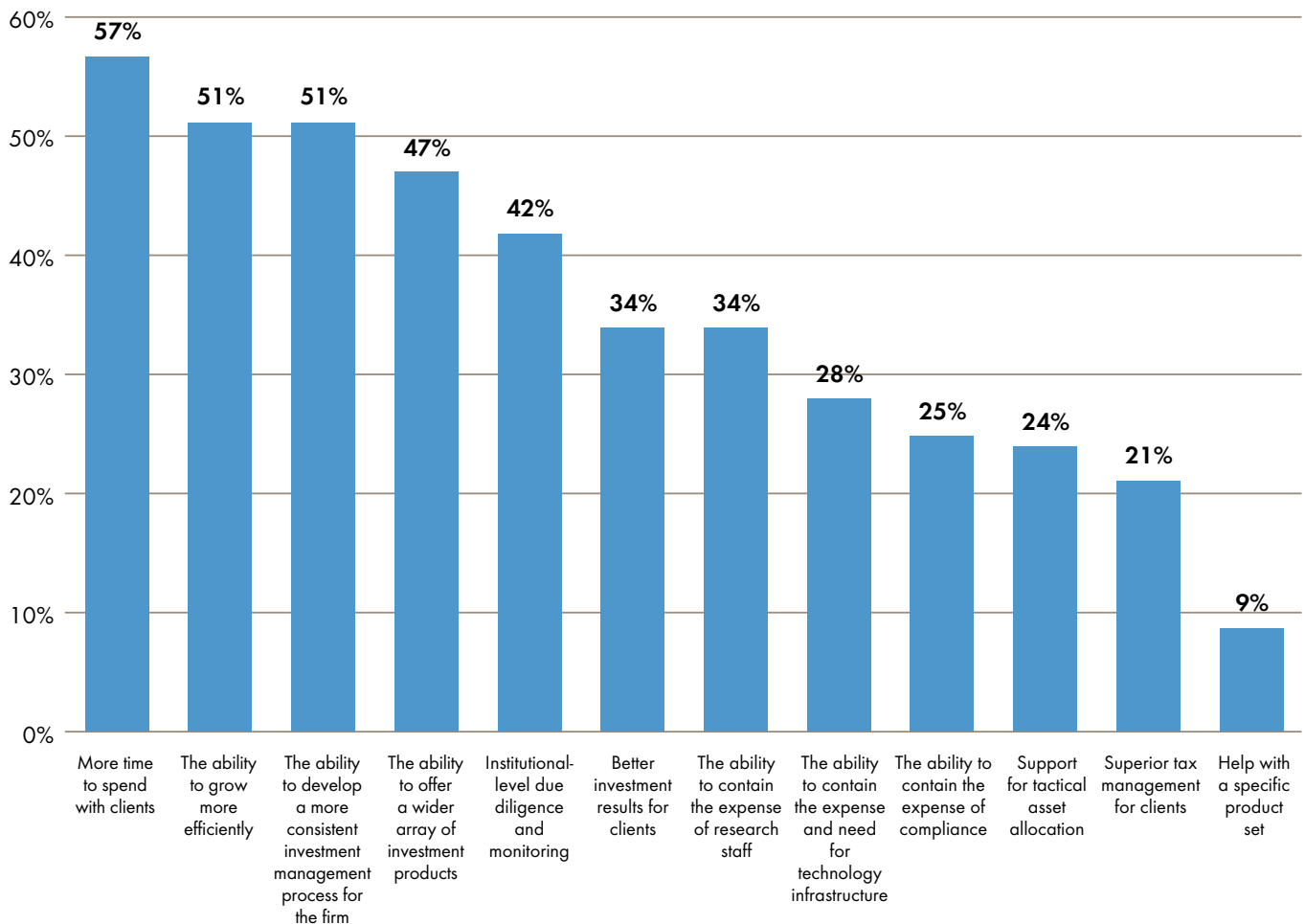
A few differences can be seen across firm types. RIAs especially value the ability to offer a wider array of investment products while advisors from independent

financial planning/investment advisory firms rank institutional-level due diligence and monitoring as a top benefit.

When the findings are analyzed by firm size, they show that smaller firms more value the ability to develop a more consistent investment management process for the firm. Larger firms appreciate outsourcing as a means of containing the expense of research staff.

## What Outsourcing Has Achieved for the Firm

As a percentage of outsourcing responses



Source: “Investment Management Outsourcing: Impact on Clients,” Northern Trust, 2014

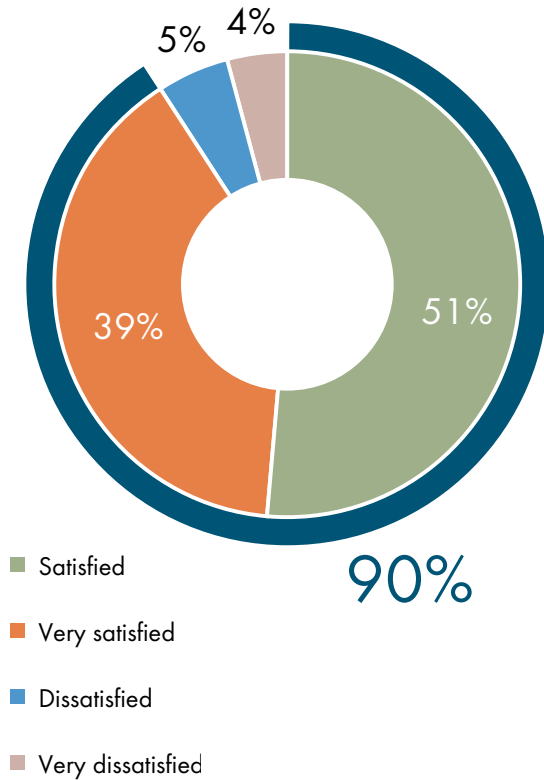
# Advisor Satisfaction

Nine out of 10 advisors are satisfied—and four out of 10 are very satisfied—with their decision to outsource. This has been a consistent finding in the previous two surveys. In 2012, 94% of advisors were satisfied. That included 34% who were very satisfied.

By firm type, RIAs report the highest satisfaction and independent financial planning/investment advisory firms the lowest. A full 97% of advisors from the larger firms are satisfied, and 44% are very satisfied.

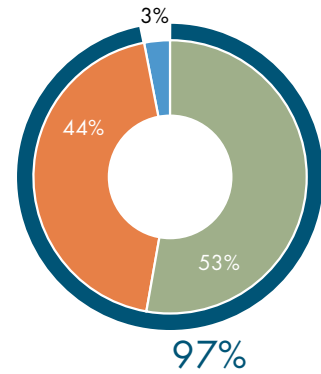
## Satisfaction with Outsourcing Solution

As a percentage of outsourcing respondents

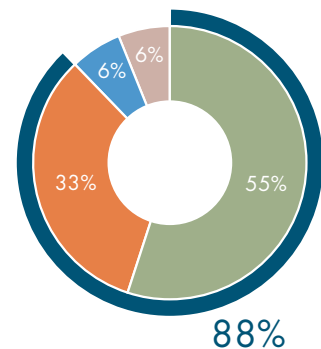


## Satisfaction by Firm Size

### Larger Firms (AUM > \$150M)

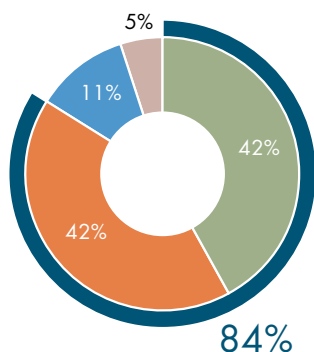


### Smaller Firms (AUM < \$150M)

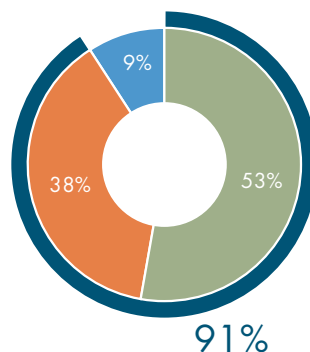


## Satisfaction by Firm Type

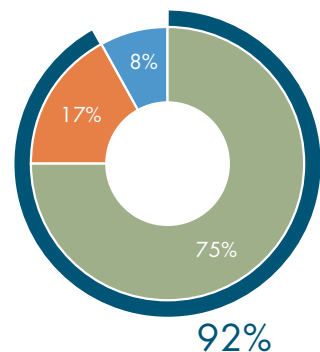
### Independent Financial Planning/ Investment Advisory Firms



### RIAs



### Regional Broker-Dealer Firms



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



**At the completion of the survey, outsourcing respondents were invited to provide additional comments. A sampling follows.**

- We determined that we were able to retain the most important decisions in-house—the asset class decisions and the strategic and tactical asset allocation. We also determined that supplementing our proprietary management with outsourced managers was superior to complete outsourcing. It allowed us to retain great investment talent who can provide valuable input on the major macro decisions. *(\$1 billion and more RIA)*
- We outsource only alternative research. Other investment decisions such as asset allocation and manager selection are done in-house. *(\$1 billion and more RIA)*
- If you're not outsourcing, you will be left behind. *(\$150 million to \$500 million independent financial planning firm)*
- I still have a mental block on outsourcing but I do know that I will not pay enough attention to smaller accounts. *(\$150 million to \$500 million RIA)*
- While I have outsourced a portion of my assets, I continue to monitor them closely and **when I see an opportunity that I cannot take advantage of in the TAMP environment, I pull those assets back in-house.** I do not see my TAMP relationship as an ultimate solution, only one of many I need to provide a superior investment experience for my clients. *(\$50 million and under independent financial planning firm)*
- Sorry I waited this long! *(\$1 billion and more bank)*
- I think outsourcing puts you on the same side of the table as the client. If the portfolio value rises, we make more money, if it declines, we earn less. I think clients appreciate that. While we monitor and oversee all investment portfolios, we do not make any day-to-day decisions and **the value of my planning practice is not tied to portfolio returns.** We “partner” with institutions’ portfolio managers and made that decision 15 years ago. It has been the single best business decision I ever made. *(\$50 million and under RIA)*
- **Expectations for management outsourcing were perhaps too high.** Their stories were compelling but led to the assumption that their performance would provide better net returns to clients than our current MPT portfolios had provided. They did not. *(\$50 million to \$150 million independent financial planning firm)*
- When you manage assets of clients on average of \$10 million per investor, you need a plethora of investment choices and a lean cost structure. *(\$500 million – \$1 billion regional broker-dealer)*
- It's the only way to go for smaller trust departments. *(\$150 million to \$500 million bank)*
- As we continue to grow, we are looking to outsource even more. Our current structure is not scalable. *(\$500 million – \$1 billion bank)*

# Advisors Who Don't Outsource

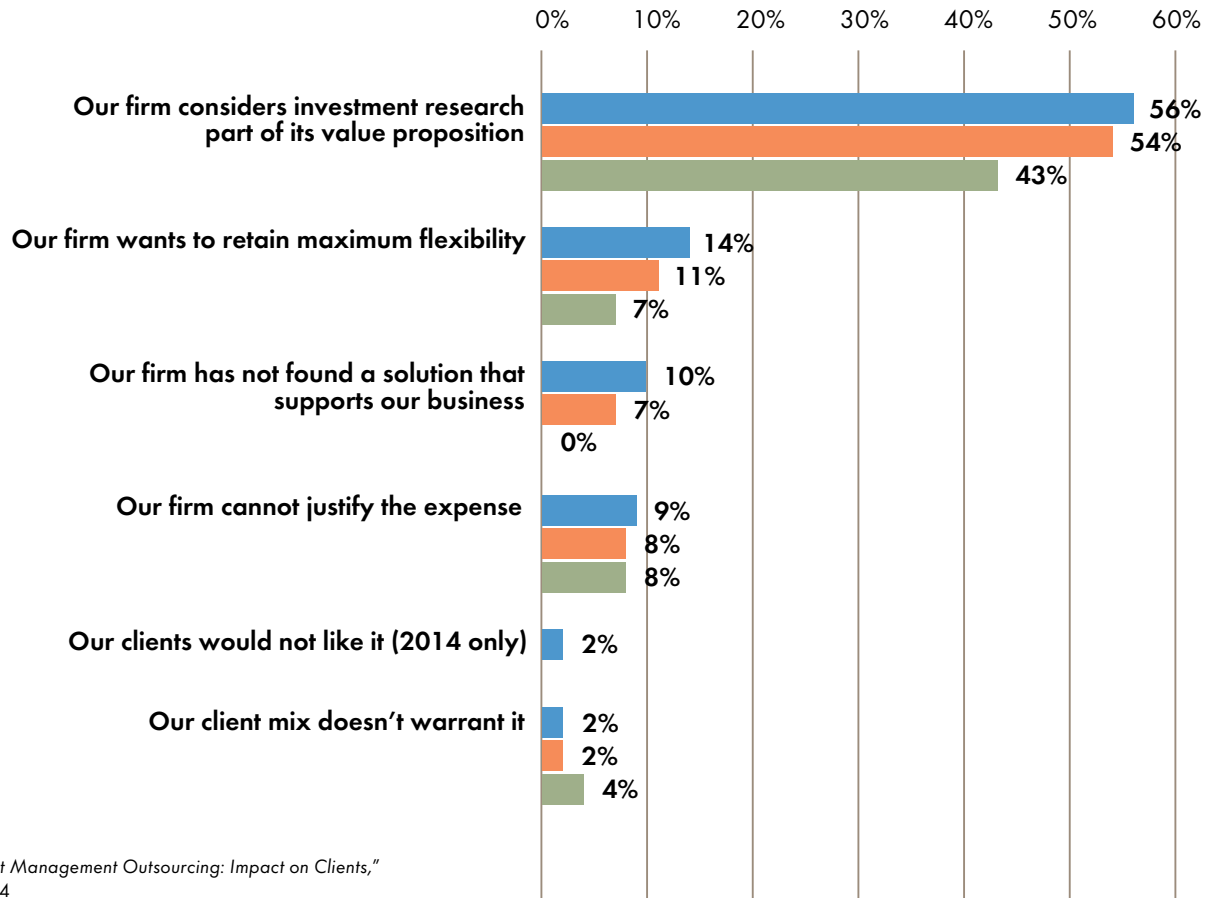
The majority of advisors don't outsource their investment management capability, and the 2014 survey provided another opportunity to check in on these advisors and their attitudes toward outsourcing.

As in previous years, half of the non-outsourcing advisors say investment research is part of their firms' value proposition.

## Reason for Not Outsourcing

2014 2012 2010

As a percentage of non-outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



**Which best describes the reason that your firm does not outsource investment activities?**

- Investment philosophy not available as a pre-packaged offering. (*\$50 million and under RIA*)
- In all sincerity, we are somewhat "stuck in the middle."** (*\$150 million to \$500 million RIA*)
- Client account performance is reduced by excess fees. (*\$150 million to \$500 million regional broker-dealer*)
- Our individual account performance is higher than [outsourcing] advisors. (*\$1 billion and more regional broker-dealer*)



The non-outsourcing respondents represent a mix of advisors. Four out of 10 say their firm has considered outsourcing and decided against it. Half of the respondents have not ruled it out (38%) or are currently considering it (12%).

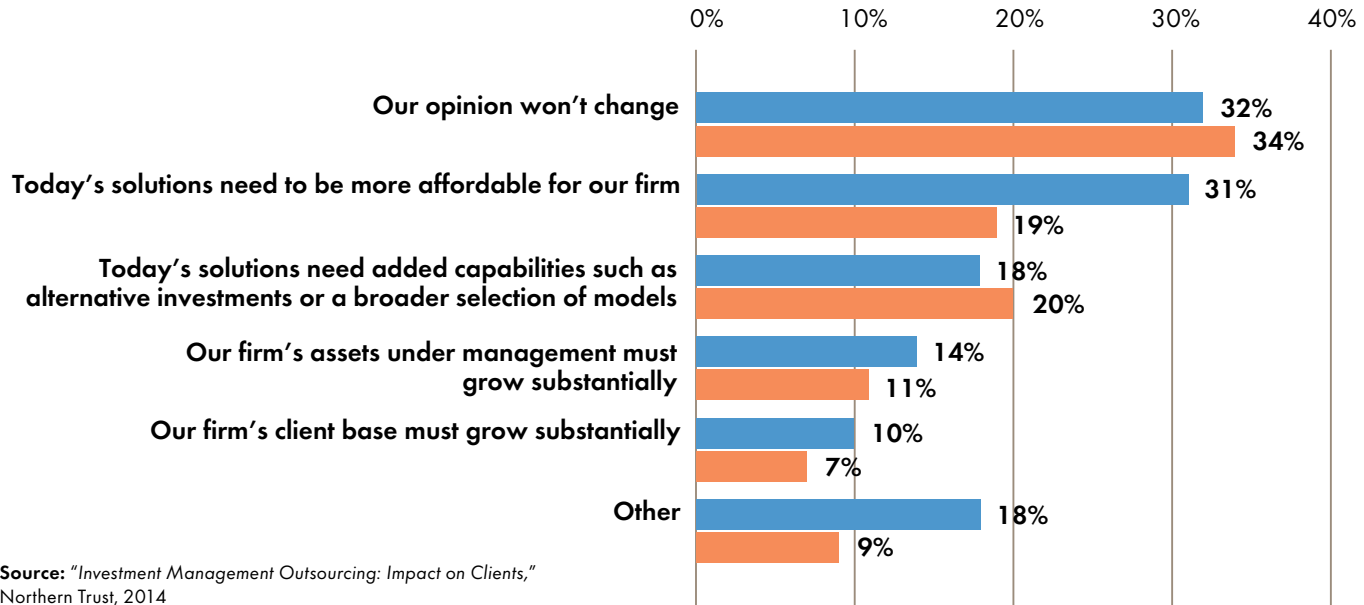
What would have to change to persuade non-outsourcing advisors to change their minds? One-third

of advisors say they won't change their minds, as is consistent with previous research. The 2014 work reveals a greater sensitivity to price, as 31% of advisors versus 19% in 2012, say solutions need to be more affordable. Affordability is a concern for RIAs and smaller firms, in particular.

## What Would Need to Occur in Order for Opinions to Change

2014 2012

As a percentage of all non-outsourcing responses



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



### Which of the following needs to occur for your opinion on investment management outsourcing to change?

- Need to see more value than what we can provide. (*\$500 million – \$1 billion independent financial planning firm*)
- Finding an investment manager not bogged down by modern portfolio theory. (*\$50 million to \$150 million RIA*)
- More individualized portfolios. (*\$50 million and under independent financial planning firm*)
- Performance needs to justify cost. (*\$150 million to \$500 million RIA*)

These advisors do turn to the outside for some services, of course. Almost two-thirds (65%) say they use investment product analysis (e.g., Morningstar).

At least one-quarter of non-outsourcing respondents say they could use outside help for the following (ranked in order):

- Marketing support
- Performance reporting
- Portfolio monitoring
- Social media training (a new survey choice in 2014)
- Access to broader investment options, including institutional-type investment management research and strategies
- Compliance

# The Cost of Self-Sufficiency

Self-sufficiency comes at a cost. As in previous years, the research sought to quantify the cost in terms of time to advisors who conduct their own investment manager research, portfolio construction and portfolio monitoring.

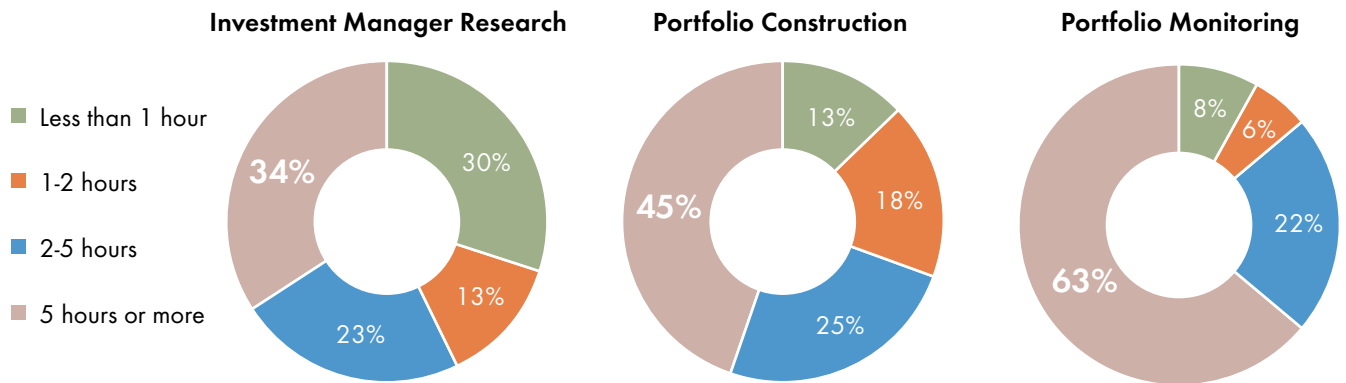
While the time invested in these functions is marching higher for all advisors, the impact is particularly severe on larger firms. About half of advisors at larger firms report spending at least five hours a week on investment manager research and portfolio construction, and 72% spend at least five hours on

portfolio monitoring. This is significantly higher than what was reported in 2012, which was elevated from what was reported two years before.

Because investment management can be technology-resource intensive, the 2014 research also asked advisors to estimate the time they spent working on technology. Almost half of respondents (46%) spend five hours or more. Here, too, the greater toll was reported by advisors from larger firms, 56% of whom spend five or more hours.

## Time Spent by All Advisors in 2014

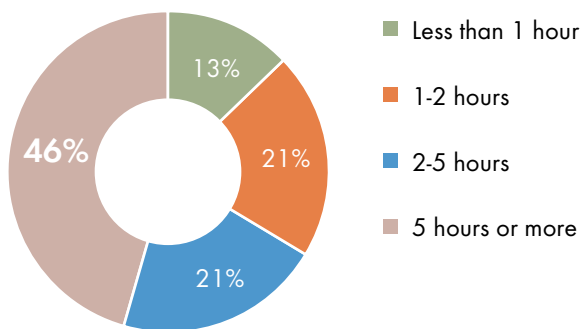
As a percentage of non-outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

## Working with Technology

As a percentage of non-outsourcing respondents



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014

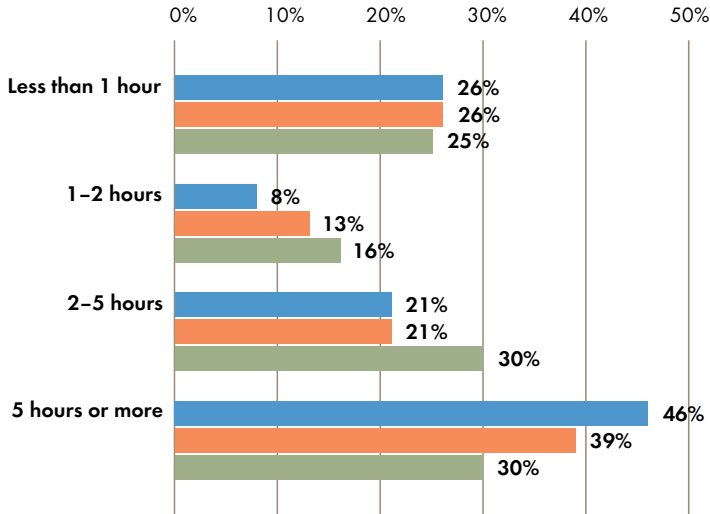


## Time Spent by Advisors from Larger Firms – 2014 vs. 2012 vs. 2010

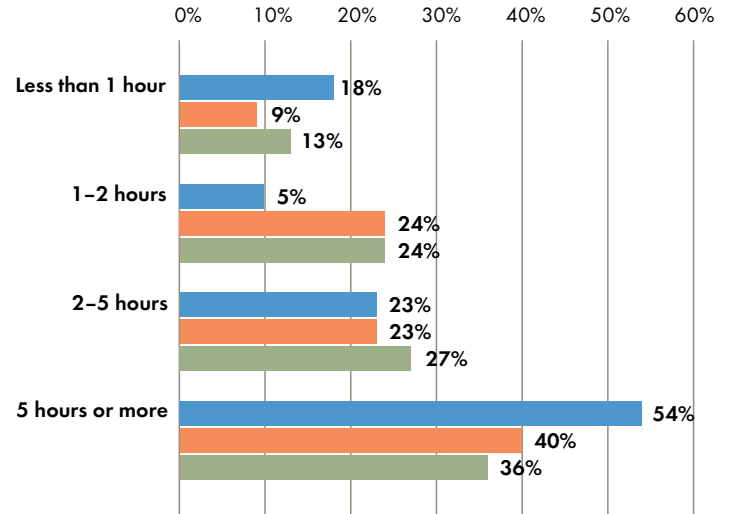
As a percentage of non-outsourcing respondents

2014 2012 2010

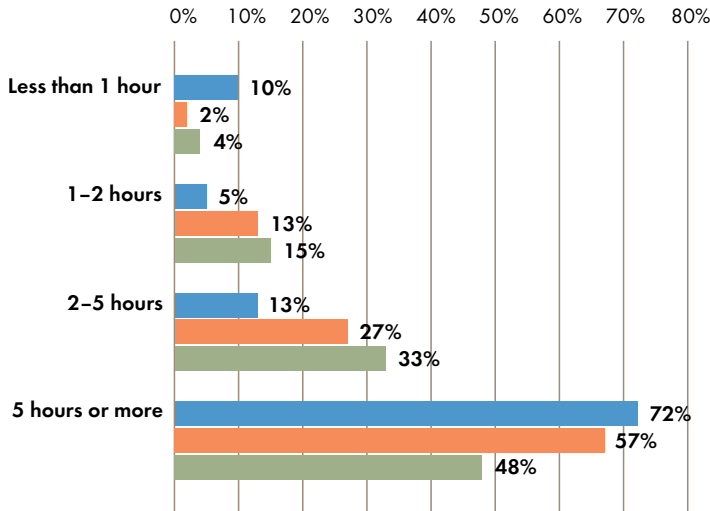
### Investment Manager Research




### Portfolio Construction



### Portfolio Monitoring



Source: "Investment Management Outsourcing: Impact on Clients," Northern Trust, 2014



**Q** At the completion of the survey, non-outsourcing respondents were invited to provide additional comments. A sampling follows.

- My ideal solution would be a firm that does trading/rebalancing according to our investment models. (*\$50 million and under RIA*)
- We like doing our own research and individual stock selection, among domestic equities, and some ADRs. What we outsource is fixed income and international, utilizing our own research to find competitive mutual funds. We like the greater control and flexibility, and our clients like that they can talk directly to the PM. **We also are very tactical, and like to be able to raise cash and get defensive quickly** (and our clients like this also!) Our returns over the past eight years have outperformed SPX net of fees as well. (*\$50 million and under regional broker-dealer*)
- If we could find a firm with similar philosophy as us but could offer the investments on a more efficient basis, i.e., lower cost, we would reconsider. (*\$50 million to \$150 million RIA*)
- **It isn't the cost, it's the solution.** We had outsourced money in the past and eventually it seems we outperform the standard by simply paying attention and remaining flexible. I don't know that outside managers can do that without knowing each client personally. Just building models with strict rules around each one and rebalancing or replacing once in a while may work for people who won't look at their money for 10 years but that's different than people with a 10-year time horizon for investing. (*\$50 million to \$150 million regional broker-dealer*)
- I enjoy the investment management process. Why would I outsource it? (*\$50 million and under RIA*)
- We have tried it in the past when we were with a major national wirehouse. We found the results did not justify the cost, and the additional administrative issues and unresponsiveness to individual preferences were definite negatives. (*\$150 million to \$500 million RIA*)
- If you were working with an outside supplier and their style fell apart, it would be hard to untangle yourself from them. If you completely control the investment decision, you can just make a different decision and re-allocate as needed. **I worry that I would become too distanced from the investment process and decision-making process.** I would rather make an investment decision and be wrong than rely on someone else to make the decision and have them be wrong. (*\$50 million and under RIA*)
- I like the concept but the tactical managers have underperformed. (*\$50 million to \$150 million independent financial planning firm*)



# Survey

1. **Does your firm outsource investment activities?**  
 Yes (goes to Q2)     No (goes to Q21)
2. **Which of the following investment management activities does your firm outsource? (Choose all that apply)**  
 All investment management activities  
 Specific asset classes/strategies  
 Investment manager research  
 Product selection  
 Compliance/Legal  
 Due diligence and ongoing monitoring  
 All investment management-related back-office operations  
 Specific investment management-related back-office operations  
 Other \_\_\_\_\_  
 None of the above (if selected, direct respondents to the 'no' track)
3. **How are outsourcing decisions related to Q2 determined? (Choose all that apply)**  
 Outsource all client accounts  
Typically outsource:  
 Larger accounts  
 Smaller accounts  
 New accounts  
 Legacy accounts  
 Equity strategies  
 Income strategies  
 Alternative strategies  
 Global/emerging market strategies  
 Complex portfolios  
 Less complex portfolios  
 Based on tax considerations  
 Other \_\_\_\_\_
4. **Does your firm outsource investment management activities using a turnkey asset management program (TAMP)? (Choose one)**  
 Yes     No
5. **Does your firm outsource to or partner with multiple firms? (Choose one)**  
 Yes     No
- 5A. **If your answer to Q5 was Yes, 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 provide? (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  
 Other \_\_\_\_\_
- 6A: **Do you anticipate broadening your firm's investment program initiatives to include any of the following programs? (Choose all that apply)**  
 Model-based UMA program  
 Model-based SMA program  
 Rep-directed hybrid program  
 Other \_\_\_\_\_
7. **In total, what percentage of clients' assets does your firm outsource? (Choose one)**  
 Less than 10%  
 11% - 24%  
 25% - 50%  
 51% - 74%  
 75% - 100%
8. **For how many years have you outsourced investment management activities?**  
 Less than one  
 One to two  
 Three to five  
 Five to 10  
 More than 10
9. **Which response best describes your explanation to clients about why you decided to outsource some/all investment management activities?**  
 Service enhancement: "We will be able to offer you the same level of services and technology capability as the very largest firms offer."  
 Alignment: "In our quest to make certain that your money works as hard as it can for you, we'll be in a position to hire some of the best money managers – and fire them when we need to."  
 Resource allocation: "Outsourcing enables us to leverage my time and expertise, and focus on your needs. Meanwhile, you can be assured that we have professional managers watching your money at all times."  
 Cost reduction: "We can pass savings onto our clients as outsourcing enables us to do more with fewer in-house resources."  
 Other \_\_\_\_\_
10. **When informing clients of your firm's decision to outsource, did you take advantage of any of the resources provided by outsourcing partners? (Choose all that apply)**  
 Presentations  
 Scripts  
 Letter templates  
 Wholesalers' availability to take part in client meetings  
 Other \_\_\_\_\_
11. **Overall, how would you characterize your clients' initial response to your firm's decision to outsource some or all of your investment management activities?**  
 Positive  
 Negative  
Comments \_\_\_\_\_  
\_\_\_\_\_

**12. Has outsourcing some or all of your investment management activities resulted in a change in fees charged to clients?**

**(Choose one)**

- Fees have increased, but the firm has absorbed the increase
- Fees have increased, and the firm has passed the increase on to the client
- Fees have decreased, and there has been no change in the fee charged to the client
- Fees have decreased, and the client's fees have been reduced accordingly
- There has been no change in fees charged

Comments \_\_\_\_\_  
\_\_\_\_\_

**13. Has your firm's use of investment management outsourcing helped grow your client base?**

- Yes
- No

Comments \_\_\_\_\_  
\_\_\_\_\_

**14. Have you lost any clients as a result of your firm's decision to outsource some or all investment management activities?**

- Yes
- No

Comments \_\_\_\_\_  
\_\_\_\_\_

**15. 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
- Cost efficiency
- Superior back office technology and support
- Performance reporting
- Client profiling
- Production of client proposals
- Education and training
- Marketing support
- Practice management support
- Other \_\_\_\_\_

**16. 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 \_\_\_\_\_

**17. What's your level of satisfaction with your outsourcing solution? (Choose one)**

- Very satisfied
- Satisfied
- Dissatisfied
- Very dissatisfied

If you selected either Very satisfied or Satisfied as your response to Q17, please answer Q18

If you selected Dissatisfied or Very dissatisfied as your response to Q17, please answer Q19

**18. Which of the following has most positively impacted your firm's outsourcing experience? (Choose one)**

- Favorable investment performance
- Good reporting
- Strong client service and communication
- More time to focus on the business
- Expense
- Greater client satisfaction
- Other \_\_\_\_\_

**19. Which of the following has most negatively impacted your firm's outsourcing experience? (Choose one)**

- Poor investment performance
- Poor performance reporting
- Poor service and communication
- Time required to monitor
- Expense
- Decreased client satisfaction
- Other \_\_\_\_\_

**20. Do you have any additional comments about your investment management outsourcing experience?**

Comments \_\_\_\_\_  
\_\_\_\_\_



QUESTIONS TO RESPONDENTS WHO ANSWERED NO TO Q1.

21. Which best describes the reason that your firm does not outsource investment activities?

- 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 clients would not like it
- Our firm has not found a solution that supports our business
- Our firm is itself an advisory solutions provider
- Other \_\_\_\_\_

22. Which of the following best describes your firm?

- Our firm has assessed outsourcing and decided against it
- Our firm is currently considering outsourcing
- Our firm is not currently considering but has not ruled it out
- Other \_\_\_\_\_

23. 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 \_\_\_\_\_

24. 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
- Back office technology and support
- Performance reporting
- Client profiling
- Production of client proposals
- Education and training
- Marketing support
- Social media training
- Practice management support
- Recruiting support
- Other \_\_\_\_\_

25. 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
- Social media training
- I don't use any outside help for these
- Other \_\_\_\_\_

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

	1 hour	1-2 hours	2-5 hours	5 hours or more
Investment manager research	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Portfolio construction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Portfolio monitoring	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Working with technology	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

27. Do you have any additional comments about investment management outsourcing?

Comments \_\_\_\_\_

THESE QUESTIONS ANSWERED BY ALL RESPONDENTS.

Are you associated with any of the following?

- Independent financial planning 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 - \$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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