

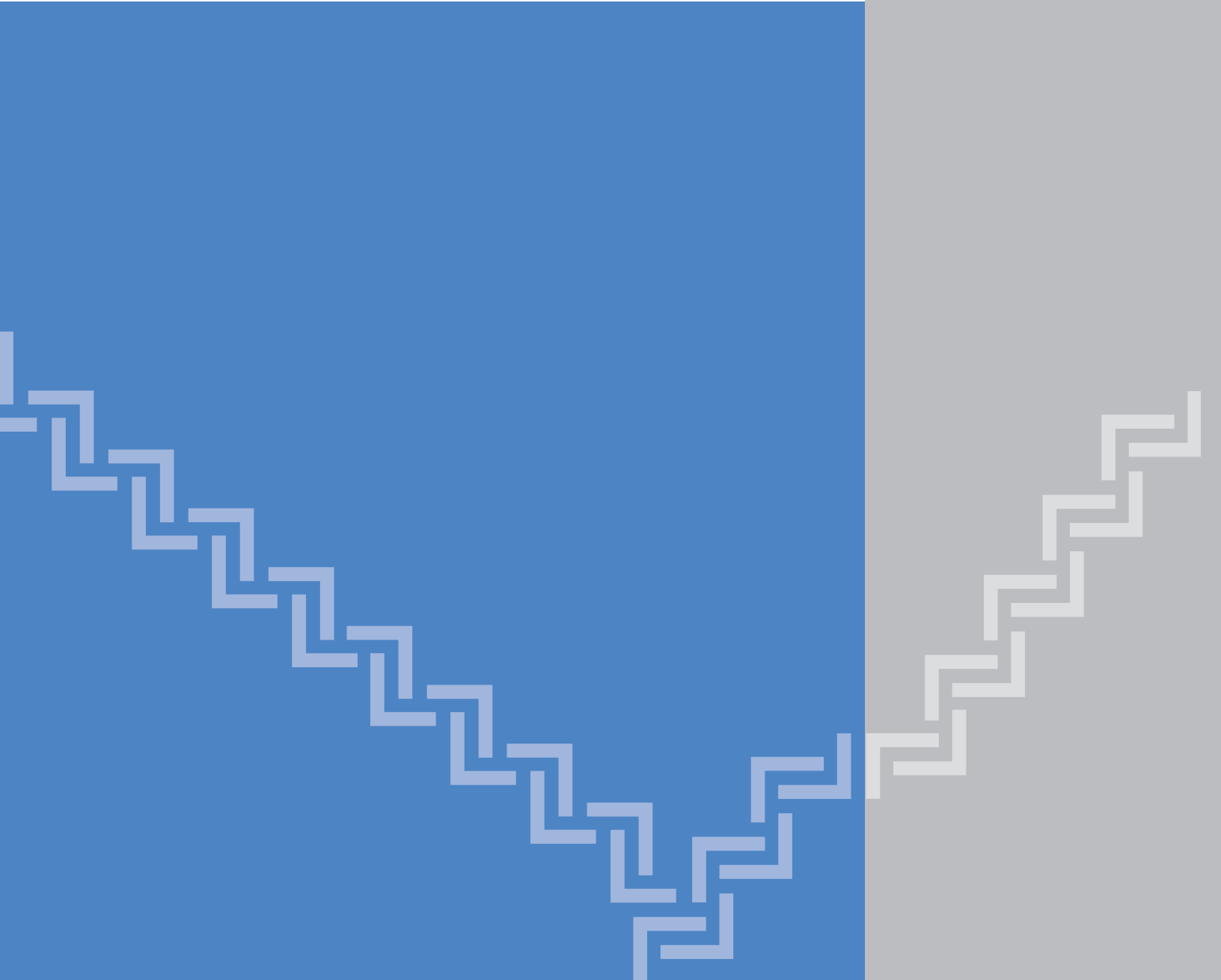


THE MONEY MANAGEMENT INSTITUTE



The State of Model Portfolio Programs

MMI REPORT
2007



Dover Financial Research, LLC is a boutique research and consulting firm, specializing in the financial services industry. For more information about the firm, please visit www.doverfr.com or call 781.461.0922.

The Money Management Institute (MMI) is the national organization for the managed accounts solutions industry, representing asset management firms, program sponsors and service providers. More information is available by visiting www.moneyinstitute.com or calling 202.822.4949.

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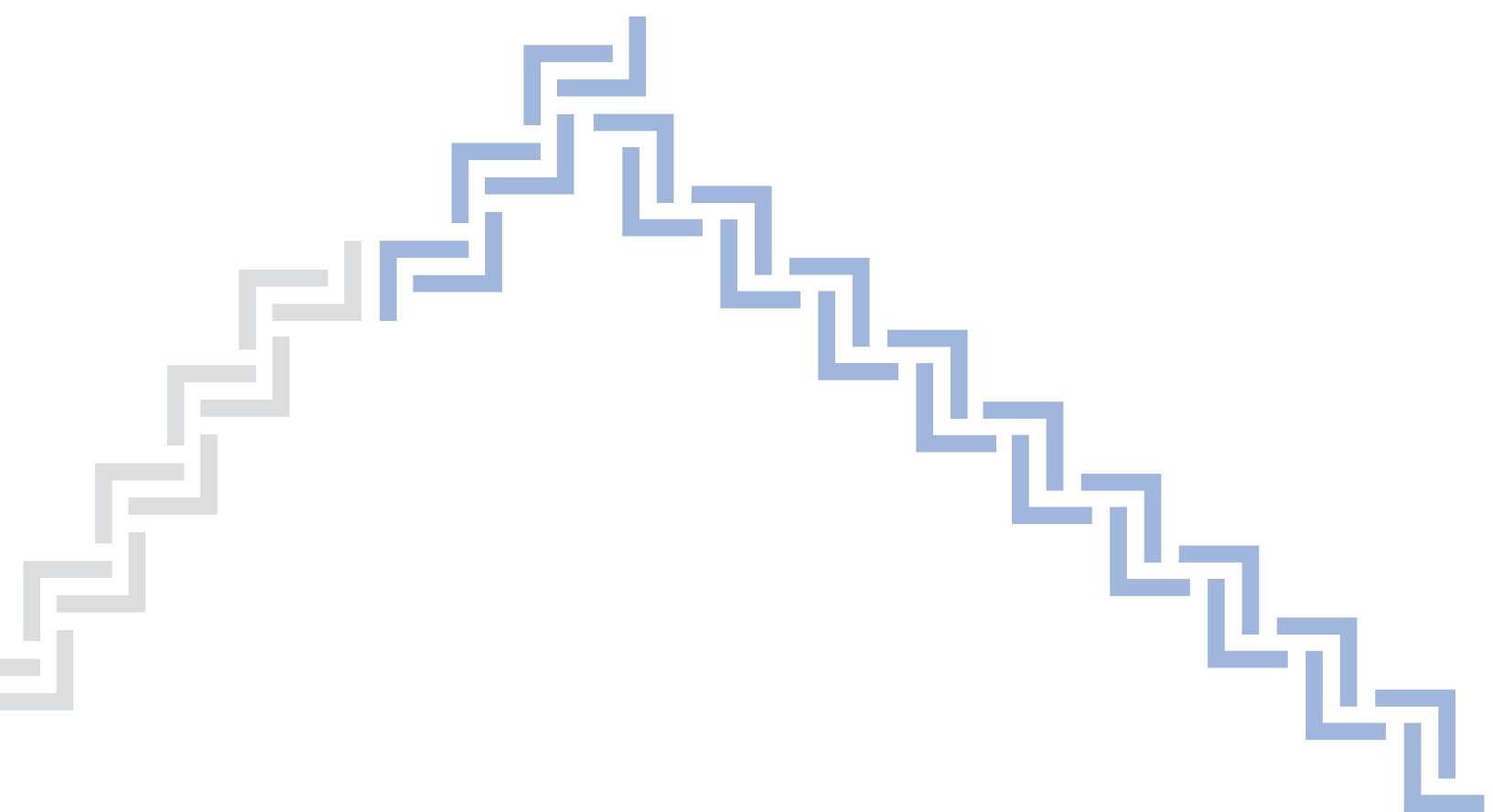
METHODOLOGY

The following research focuses on *model portfolio programs* within the brokerage industry. The data and analysis contained herein was compiled from numerous rounds of in-depth interviews and multiple quantitative surveys.

Qualitative analysis was derived from more than 60 interviews with executives representing the following types of firms: wirehouses, regional and independent brokerages, banks, overlay portfolio managers, service providers and asset management firms.

In addition, three quantitative surveys were conducted yielding the quantitative analysis found in this report. Data from these surveys have been compiled into a proprietary research database and represent the most comprehensive repository of information related to model portfolio programs.

Finally, MMI, in conjunction with Dover Financial Research, continues to lead the market in identifying and examining emerging trends that significantly influence the managed account solutions industry.



PREFACE

The Money Management Institute engaged Dover Financial Research, LLC to conduct proprietary research into the development and proliferation of model portfolio programs. The goal of this research is to provide an overview of the industry, to analyze the benefits and challenges associated with these programs, and to provide a prognosis of the direction in which the industry is heading.

For purposes of definition, *model portfolio programs* include any advisory program in which an underlying SMA manager provides its investment model (or models) to an overlay manager. Model-based delivery is another term used interchangeably with model portfolio programs to describe the way these programs operate. A hypothetical example would be an investment manager such as Neuberger Berman passing its investment model to an overlay manager such as Placemark or Parametric, or even Merrill Lynch.

Our research indicates that model portfolio programs benefit investors by providing an efficient way of delivering comprehensive, customized financial solutions in the form of a single account. Looking ahead, we believe these programs will be used to provide financial solutions to a wide swath of clients—ranging from mass affluent to high net worth individuals. In addition, sponsor firms that are able to perfect the development of these platforms by integrating alternative products, providing access to best-of-breed managers, unbundling pricing, and, above all, making it easy for the financial advisor to create customized portfolios will have a competitive advantage in the marketplace. As a result, model portfolio programs represent the next significant phase in the evolution of advisory programs.

Not all model portfolio programs are alike, however. They vary in terms of how they operate, from pure model-driven programs to those that provide flexibility with regard to trading and pricing. The overlay element of the program can play either a large or supporting role.

The transition to model portfolio programs will not happen over night. The obstacles standing in the way of widespread adoption of these programs—including the inability to seamlessly integrate pure alternative products, trading rotation issues, manager participation and advisor adoption—are substantial.

In the short term, these obstacles will thwart the growth of model portfolio programs. But as the industry overcomes the challenges and better comes to grips with the risks, model portfolio programs will represent a compelling solution for the financial advisor and will eclipse other types of product-specific programs, such as mutual fund wrap and SMA wrap. Therefore, we believe the future of these programs is bright.

INDUSTRY OUTLOOK

Both sponsor firms and asset managers believe that the UMA market segment will continue to grow. Consequently, model portfolio programs are also poised for expansion as they represent a meaningful subsegment of the UMA market.

Among asset managers, 29% of those surveyed ranked UMA platforms as their greatest growth opportunity—second only to mutual fund advisory programs at 46% (see Exhibit A).

Like asset managers, sponsor firms also viewed UMA platforms as critical to their advisory business. When asked about the future of advisory platforms, 75% of sponsors indicated that legacy platforms, with the exception of mutual fund advisory programs, will migrate to UMA-like platforms within the next five years (see Exhibit B).

The growing emphasis on UMA platforms and the shift away from traditional SMA platforms will clearly fuel the growth of model portfolio programs. To quantify the impact of this trend on the industry, asset managers and sponsors were asked to indicate the percentage of their retail SMA business that would convert to model portfolio programs. Sponsor firms were decidedly more bullish in their projections. However, both groups predicted a significant

shift in assets away from traditional separate accounts to model portfolio platforms over the next three to five years. Managers indicated approximately 17% of traditional SMA assets would migrate from retail separate accounts to model portfolio programs within three years, while sponsor firms predicted the number would be 36%. Looking ahead five years, asset managers were projecting a shift in assets of 28% and sponsor firms were expecting a shift of 48%.

In any event, the research clearly indicated that the shift toward model portfolio programs would be significant. All market participants need to be strategizing about their roles in this evolving environment.

EXHIBIT B. Sponsors' Vision for Advisory Platforms, 2Q 07

Sources: Dover Financial Research, Money Management Institute

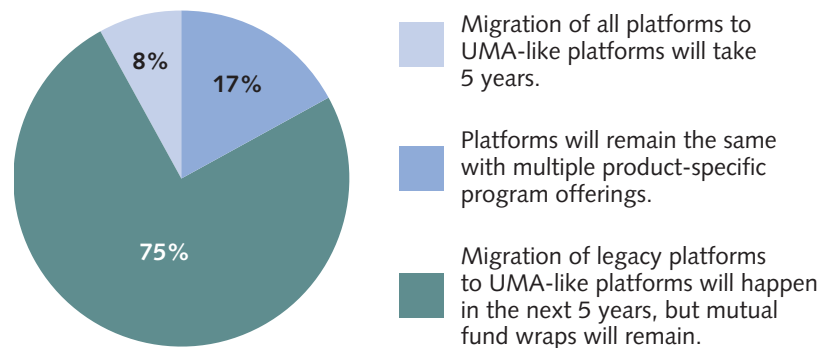


EXHIBIT A. Managed Account Solutions Market Segments Representing the Greatest Opportunity for Growth, 2Q 07

Sources: Dover Financial Research, Money Management Institute

