

2011 BROKER-DEALER SURVEY: WHO'S LEADING; WHAT WORRIES BD LEADERS

Investment THE VOICE OF INDEPENDENTS ADVISOR

AdvisorOne.com | JUNE 2011

*Led by a visionary team
headed by Jud Bergman,
Envestnet and its advisors
are poised to lift off*

AGENTS^{OF} CHANGE

SALES OR SERVICE?
KEN FISHER RESPONDS

HOW FIRM OWNERS
ARE LIMITING THEIR
FIRMS' GROWTH

AGENTS OF CHANGE

JUDSON BERGMAN
CHAIRMAN, FOUNDER AND
CHIEF EXECUTIVE

LORI HARDWICK
EXECUTIVE VICE PRESIDENT,
ADVISORY SERVICES

BILL CRAGER
PRESIDENT

By JAMES J. GREEN
Photography by TOM MCKENZIE

Investnet has placed itself squarely at the crossroads of the major issues facing advisors. Its tools will help advisors tackle those issues, leading to growth for all

THESE ARE THE MAJOR ISSUES FACING ADVISORS IN 2011:

performing increased due diligence on investment products; adapting to a fluid regulatory environment; improving efficiency in the back office and directly with clients; finding alpha-producing investments at a time of slow economic growth and continued volatility in the markets; succession planning; deciding which business model—broker-dealer or RIA—to adopt; and providing holistic financial advice to clients on all their investments, not just those over which the advisor has control.

In each of those areas, Envestnet stands at the crossroads. Starting life as a turnkey asset management provider, the newly public company has built on its TAMP legacy, under the leadership of its founders—notably Jud Bergman—and Bill Crager to the point where it can provide a technology-based platform that allows advisors to address all those major issues in an efficient way. Its growth in revenue, advisors served and assets has been strong, but the company isn't finished with its growth plans and in providing the partnership services that advisors need to serve clients better, to be compliant, and to find best-in-breed money managers now and in the future.

As proof of its focus on the future, look at the hires Envestnet has made in the run-up to its July 2010 IPO and since it went public. People like Mike Henkel as co-head of Envestnet PMC, with a nonpareil research background from his days at Ibbotson. People like Jim Patrick, formerly of PIMCO Allianz who joined the company in 2009. People like Ron Fiske, formerly of Fidelity Institutional and Pershing Advisor Solutions, who signed up last year and manages relationships with custodians. People like Marion Asnes, the former editor in chief of *Financial Planning* magazine, also added to the executive team in 2010 as chief marketing officer. People like John Phoenix who formerly was CEO, of all things, of a Denver RIA firm. The additions strengthened the core of veterans like the aforementioned co-founders and notably Lori Hardwick, who runs Advisory Services. All of them are firm believers in the company's approach and proud of its accomplishments so far, but Envestnet is not resting on its IPO laurels.

For advisors, finding a deep comfort level with the people running a company is a prerequisite to partnering with that company. The people at Envestnet know technology, they know investing, they know efficiency, and they know compliance. Most of all, they know advisors and understand the issues they face. Envestnet is a force to be reckoned with, but as a custodian- and broker-dealer-neutral firm, it's not taking sides, though it's certainly prepared for the future.

WHERE IT IS, WHERE IT'S GOING

Bergman says Envestnet plans to organically grow its top line at 20%, growth that he suggests will be accelerated with

“selected acquisitions” that will be either financially accretive and provide access to more advisors in the current channels the firm serves, or strategic acquisitions of application providers that add to or enhance functions on its platform that will be “value accretive.” Bergman says “We expect to do one or two” of those acquisitions “in the coming year.” One acquisition that might be a sign of Envestnet's future acquisition plans took place last June, when the company acquired B-Ready Outsourcing of Landis, N.C., which has enhanced back-office data management and reporting services for Envestnet users of Schwab's Portfolio Center portfolio management software.

The company has about \$140 billion in total platform assets, and served more than 21,000 advisors on some part of its platform at year-end 2010, including more than 13,000 who have some degree of discretion over client assets, reports Crager.

Total assets on the Envestnet platform have grown from \$82 billion at year-end 2007 to \$140 billion at year-end 2010. AUM and assets under administration (AUA) have grown from \$29 billion in 2007 to \$63.7 billion in 2010. The company has increased its technology development expenses from \$4.9 million in 2008 to \$5.6 million in 2010. Growth is continuing in 2011. In first-quarter results announced May 5, Envestnet posted adjusted net income of \$2.8 million on a 35% increase in revenues to \$29.3 million compared to 2010's first quarter. Revenues from AUM and AUA increased 42% compared to Q1 2010, to \$23.3 million.

Accounts on the platform grew from 600,000 to slightly over 900,000 from 2007 to 2010, while advisors using



Envestnet grew from 11,000 to 21,000. Those advisors are independent and regional broker-dealer reps and RIAs. While Envestnet has benefited from the move toward independence in the advisor space, it has also abetted that move through its Web-based platform that accommodates the needs of existing advisors and the requirements of brokers moving from a captive model.

Another trend Envestnet is enabling is the move toward a fiduciary standard for all advice givers. When founder and CEO Bergman says “We take our fiduciary role seriously,” he’s talking partly about the Envestnet PMC investment platform through which an advisor can find “a trusted partner to the high-net-worth client as a co-fiduciary.” Beyond voicing mere support for a fiduciary standard, Envestnet has incorporated a fiduciary approach to serving clients directly into an advisor’s workflow through the Fiduciary Oversight Notes, or FONs, tool on its platform. The FONs, which appear as small blue notes on the platform, can be attached to any one of a number of actions taken on the platform, including buy orders or client meeting notes.

FONs can be added at the advisor’s discretion, or mandated by a broker-dealer depending on the action being taken. They then are archived, allowing a compliance department at a BD, or a visiting examiner from a regulator, to view them on demand. The content for the FONs was developed in partnership with the securities law firm of Sutherland, and end clients can get a report showing “what choices were made” about their accounts, says Crager, “and why.”

That feature encapsulates Envestnet’s approach: Not simply providing tools for and access to portfolio management and reporting and compliance, but incorporating those tools into the advisor’s workflow. That yields efficiency, provides scalability and fosters growth in an advisor’s practice, but also allows for better service to end clients.

Envestnet was founded in 1999 as a wealth management technology platform serving RIAs, then in 2001 acquired TAMP provider Portfolio Management Consultants, now Envestnet PMC, providing access to separate account portfolios, tools, analysis and reporting. The independent broker-dealer world



Keeping the Customers Satisfied

“THIRTY-EIGHT OF the top 50 broker-dealers use our platform,” boasts Lori Hardwick in an understated way, but “we’ve seen new interest from aggregator firms of break-aways.” Hardwick is Envestnet’s managing director of advisor services and an 11-year veteran of the firm, responsible for sales to broker-dealers and RIA firms, but also for onboarding advisors to the platform and training them to use its many features.

RIAs, she says, are an important part of Envestnet’s client base, and in fact the company’s roots are in the RIA world, while broker-dealers, “who didn’t trust us” at first,

she recalls, came later. “RIAs forced us to go to open architectures from the beginning,” she says, and after the company acquired Portfolio Management Consultants (PMC) in 2001, which had more than \$5 billion in assets, that “pushed us out of startup mode, and then the broker-dealers found us.”

What they found was an ever-changing platform which she says has more than 700 points of configuration, so what each broker-dealer or individual advisor sees on the platform is unique to each user. Moreover, the platform is upgraded quarterly, based in part on what current users suggest. Hardwick says she meets with advisors at least once a month personally. “Our best ideas,” she says, “always come from our clients; they’ve never steered us wrong.” Her group has an advisors’ council of some 20 RIAs and broker-dealer reps who gather for twice yearly meetings, and two-day “Alliance Conferences” with broker-dealer home office personnel that attract about 50 attendees.

Broker-dealers, she says, are looking for ways to “streamline their businesses, especially if they’re multi-custodian,” so the platform performs pre-population of paperwork. The home office also wants to “see where clients have signed off on risk tolerance,” and the platform informs them when a portfolio needs to be rebalanced. BDs are also warming up to the unified managed household (UMH) concept, she says partly because of the “sleeve-based accounting,” referring to single strategies within a broader client account, which Envestnet offers. “We’re the only one who offers that,” she says. “We didn’t offer a UMA until we had that capability.”

SMAs and UMAs are “more prevalent” in the independent broker-dealer space, Hardwick says, “now that everyone is recruiting from the wirehouses.”

RIAs now have their own division at the company, she says, headed by James Patrick, a former PIMCO Allianz executive and now managing director of advisor managed programs; and John Phoenix, the former head of a Denver-based RIA firm, Metamorphosis Asset Management, who is now a senior vice president of advisory solutions.

then took notice. “The investment world was changing,” recalls Crager of the environment in which the company was founded, and Envestnet’s strategy then, and now for that matter, was to explore how to provide the same technology and products to independent advisors that the wirehouses had. “In many ways, we’ve gone beyond” what the wirehouses offer, argues Crager. “We’ve evolved to where we’re empowering and enabling advisors,” says Bergman to both manage the wealth of high-net-worth clients, and “to win new business” from wirehouses.

While proud of its TAMP legacy, Crager says that approach provided due diligence and a technology platform in a “contained” way, that since then “Envestnet has opened up.” Crager says the firm is “neutral on product” as well as being “neutral on how those products are delivered.”

“Many broker-dealers think of us as a TAMP,” Hardwick says, “but they don’t realize” that Envestnet may well “be the solution to their hybrid advisor problem.”

CUSTODIAN NEUTRAL; PRODUCT NEUTRAL

One recent sign of that neutrality on the separately managed account front is the announcement in late April that Envestnet added an absolute return portfolio, called Crystal Strategy I, to its SMA platform from Brinker Capital, a putative competitor.

John Coyne, Brinker Capital’s president, says that Brinker saw the Envestnet deal as an opportunity “to expand beyond

“WE ARE IN THE BUSINESS OF FREEDOM, INDEPENDENCE AND EMPOWERMENT—THAT RESONATES WITH A CERTAIN KIND OF ADVISOR.”

—Jud Bergman

traditional distribution and to meet the needs of the broker-dealers” using Envestnet’s platform. It’s a changed world, said Coyne, noting that Brinker is in talks to put the strategy on the Pershing Lockwood platform as well, though he also said that “a few years ago, if you said those three names [Envestnet, Brinker, Lockwood; all competitors in the SMA space] in the same sentence, people would think you were crazy.” Envestnet, says Coyne, has done “a terrific job of creating one of the most dynamic platforms for SMAs.”

Another example of how Envestnet’s offerings are appealing to RIAs who want more efficiency in providing investment solutions for clients came in April. National Advisors Trust Co. (NATCO), the RIA cooperative trust company, signed a deal to provide its advisors with access to Envestnet UMA to create customized portfolio models for clients. In return, Envestnet advisors will gain access to NATCO’s trust and custody platform.

Advisors on the platform express satisfaction with Envestnet as well. Bill Bestgen, of Bay Financial Associates in Waltham, Mass., is a Commonwealth Financial Network rep who says he takes full advantage of the IBD’s association with Envestnet to screen SMA managers before subjecting it to his own rigorous due diligence process. “Envestnet has a minimum as low as \$100,000,” he says. “So a smaller \$1 million account or a \$1.5 million account can still get allocated across all asset classes properly.”

A TRUE HOLISTIC VIEW

Account aggregation has long been the holy grail of advisors, followed closely by the desire to grab a larger share of client

wallets. Envestnet downloads data from 52 different custodians every night, says Crager, and some of the company’s 500 employees in India reconcile and scrub that data overnight in time for the markets to reopen back in the United States. Envestnet is proud of its data integrity—“we ensure data is trade ready,” says Bergman. “We fix the breaks.”

Jim Lumberg, another co-founder who heads business development and runs the Vantage reporting program, says that “what we’ve done is to build out the pipes to whatever financial institutions” might be custodians or administering clients’ various investment and insurance vehicles, either through Envestnet’s own efforts or through ByAllAccounts, the aggregator firm. “We have more than 4,000 sources of financial data,” says Lumberg, “to help gain this holistic view of clients’ wealth.” Those institutions include major money centers, mutual fund companies and annuity sponsors, allowing advisors (with end-client authorization) to view assets held away in brokerage accounts and insurance products, in 401(k) and 529 plans and IRAs. “We don’t hold the data hostage,” Lumberg says, but instead give the advisor the ability to see all the client’s assets in order to better plan their overall investment strategy, and get paid for doing so. Providing such a holistic view and acting on it also showcases the value of the advisor to end clients; in the latest release of Envestnet’s platform, advisors can

make that aggregated view of a client’s entire assets available to that individual through a client portal.

SERVING THE BREAKAWAYS

“We’re getting significant net new flows from breakaway brokers,” Bergman reports, since breakaways face three major “threshold” needs that Envestnet and its partners can provide—a custodian; a “home for my license(s) that shares my values”; and “enabling technology” either on a desktop or from an outsourcer firm that can integrate key advisor applications. Among those firms are the HighTowers and Focus Financials of the world, he says. Just like at the wirehouses, Envestnet provides access to SMA managers, and through its data feeds, Envestnet can report on those assets “back at the [wirehouse] ranch,” says Crager.

Hardwick notes that brokers leaving wirehouses can retain their clients’ accounts at those wirehouses when using the Envestnet platform and still view those accounts. That is what made it possible for Envestnet to introduce last November a UMH—a unified managed household offering, though in May, Fiserv announced it would roll out a version of a UMH later this year.

Jim Patrick, who is partly responsible for sales and product development to RIAs and institutions, says Envestnet is building the “infrastructure required to accommodate wirehouse reps” who are changing affiliations. Moreover, he says the firm is also “on the cusp of having a meaningful advantage in infrastructure, product, fiduciary and connectivity over the wires.”

ENGAGEMENT AND DUE DILIGENCE

So how does Envestnet make money? Advisors using the Envestnet platform have three different levels of interaction—Vantage, Paradigm and PMC—all of which are based on assets on the platform and all of which are customized based on the BD or RIA's desires (see sidebar "Keeping the Customer Satisfied" for more on the customization available to Envestnet users).

The lowest, least costly level of engagement is the Vantage model, for which Envestnet charges two to five basis points, and on which it delivers back office, billing and administrative services, as well as aggregated performance reporting and trading.

Paradigm, the second level, offers all the services provided under Vantage, but also what Bergman calls a more "industrial strength wealth management platform," for which it charges six to 12 bps, along with a full suite of reporting, research and analytics.

Envestnet PMC is at the pinnacle of engagement, charging 15 to 60 bps for what Bergman says are services "most like a TAMP and where the most competition is," mentioning SEI, Lockwood and Genworth as its main rivals. Offering customized investment consulting, PMC provides access to a host of managers and models, including home-grown strategies and jointly developed strategies, such as the recently announced PMC/Singer Partners Dynamic Fixed Income Portfolio, in concert with Brian Singer of Singer Partners. Bergman likens PMC to a high-end "bespoke suit," rather than an off-the-rack garment, though at each level of engagement, as mentioned, much customization is possible.

Mike Henkel, managing director, says PMC provides the "foundation for so much of the portfolio construction capabilities" on the entire Envestnet platform, and his team's job is to "create a palette of packaged products and analytical tools."

Returning to the neutrality theme, Brandon Thomas, a co-founder of Envestnet and CIO of PMC, says the firm is happy to serve both enterprise clients who want to limit their advisors' access to certain features, but provide full access to others. Some RIA clients, he points out, may start out doing their own research while using the platform's other features, but then start using PMC's research. The company's consultants,

Thomas says, perform extensive training of advisor users of the platform on everything from building portfolios to creating proposals.

As for due diligence on the more than 800 SMA strategies on the platform, Henkel said earlier this year that PMC has instituted a revised manager approval process that he characterized as "more quantitatively based and less analyst-driven," with the intent of providing more transparency to Envestnet PMC's internal compliance team. The approval process begins with Envestnet running a quarterly screen "on every manager in the Morningstar SMA database," followed by prospective managers filling out a 40-item questionnaire that ensures that "there's nothing materially wrong" with each manager—that their Form ADV and other registration documents are up-to-date and that there are no disciplinary actions in those records to give Envestnet pause. Once those performance and regulatory hurdles are passed, then Envestnet analysts "can say which of those managers they like, and why,"



The Relationships Manager

RON FISKE SAYS he first worked with Jud Bergman and Bill Crager 10 years ago when he was a managing director at Pershing to help build the clearing and custody firm's Managed Account Network (MAN) TAMP program. After a stint at Fidelity Institutional Wealth, Fiske joined Envestnet last fall as managing director of strategic partnerships, with responsibility for forging deeper relationships with the company's "fair number of important custodial partnerships," such as those

with Fidelity, Pershing, Schwab Advisor Services and TD Ameritrade Institutional.

The ever-ebullient Fiske says Envestnet has "become like the Times Square of strategists," where advisors can 'meet' the 40 strategists and more than 800 SMA managers on the platform. An acknowledged fan of Envestnet's leadership, Fiske says "Jud and Bill thought far ahead" on the fiduciary issue, and the development of the Fiduciary Oversight Notes (FONs) is an example, he says, of "allowing people to manage things in a consistent way." Moreover, with FONs "they made it part of the workflow" of advisors, as well as "memorializing" the reasons for the advisor's fiduciary-related decisions, allowing an examiner to easily pull up those notes from an archive. Since an RIA firm or a broker-dealer home office can dictate at which decision points those notes must be made, another constituency is happy: "Regulators," Fiske notes drily, "like the consistent application of rules." After all, he says, "some capabilities you don't want to think about; you want the exception report created" automatically.

One area that Fiske says the company is working on is holding a series of events with those SMA managers and strategists for RIAs on the Envestnet platform, along with a bigger event in 2012. Those meetings will help inform the advisors' due diligence on those money managers and models, but it will also become part of a continuing education initiative that Envestnet is building to provide scores of CE programs for both CFP and CIMA designations.

That's not all. At Envestnet, Fiske says, he likes being "with people who want to figure out how to get things done, instead of why it can't be done." The company's leadership, he says, "still play like they're down two touchdowns and time is running out."



From Media to Investnet

WHEN MARION ASNES was considering a career change, she would have had many options in the advisor universe. As the highly respected editor in chief of *Financial Planning* magazine, she knew all the major players in the industry from covering those firms for the magazine. She also formed plenty of solid connections with advisors who partnered with those major players and knew what they were really like. So why did she choose Investnet when, arguably, she could

have received a warm welcome at a host of other companies? “There’s integrity, confidence and urgency” at the firm, she said in an April interview, six months after joining Investnet in its New York offices. “This is a very ethical company that’s doing right by advisors.”

She further argues that “everything about the future of financial advisory requires scalability. What Investnet can do for you as an advisor is to embody your process, taking a complex activity and turning it into a workflow.” That embodiment—“your process, your workflow, memorialized in the software”—will make you scalable, she says.

Asnes says she spent years as a journalist “focusing on learning advisor needs. So instead of writing about, I joined a company that is doing something” about meeting those needs.

Her new colleagues return the compliments. “As you get older,” says Ron Fiske, the former Pershing and Fidelity advisor executive who joined Investnet at about the same time as Asnes, “you want to work with people like Marion.”

allowing those analysts, he said, to do “real analytical work.” (*Henkel is a regular commentator on AdvisorOne.com, exploring new frontiers in portfolio construction.*)

A separate level of engagement is a licensing deal in place for six clients of long standing for whom Investnet has done customized technology for Vantage- and Paradigm-level services.

NEXT STEPS

Considering the number of advisors on its platform, from across the advisor business model spectrum, considering the high-net-worth clients those advisors are serving, and considering the neural data network on the platform, you could easily speculate where Investnet might go next. If you guessed advisor investment benchmarking, you’d be right.

As we went to press, Investnet was planning to add to its platform an advisor benchmarking tool that will allow advisors on the platform to compare how well their investment strategy has performed against other advisors on the platform or against the outside strategists. The tool will begin with 36 months of data, and permit shorter- or longer-term comparisons against individual managers or similar investment strategies. You could also see how, sitting at the crossroads of so many advisors with

similar desires for growth and efficiency, an advisor matchmaking service could be in the offing, taking advantage of Investnet’s custodial and broker-dealer neutrality, but also of its account aggregation capabilities.

Then there are those acquisitions that Bergman mentioned are likely. Investnet has made at least one outside investment: taking a minority stake in HighTower Advisors, the fast-growing Chicago-based firm led by Elliot Weissbluth that has attracted a number of high-profile breakaway brokers into its multi-custodial independent advisor partnership. Bergman says that at the time of the investment, HighTower was the only firm with a business model of attracting high-end advisors focused on serving the high-net-worth client, plus “we liked the management very much.” More firms with similar models have since emerged, he says, and Bergman says it would be “highly unlikely” that Investnet would make a similar investment now.

He recalls that last year “we went public to gain public currency” and returns to the “empowerment” argument: “We want to increasingly empower the advisor to manage wealth holistically,” noting that that includes managing clients assets in insurance vehicles and 401(k)s.

“Our profitability strategy,” says Bergman, “is all about scale. Our competitors have outsourced,” their technology platform, but “we said we’d build it ourselves.”

Cragger says Investnet’s offerings “speak to the way the advisor is evolving.” The advisor is more focused on risk management, finding income and alpha-producing investments with the need to report on all those investments at a challenging time.

Investnet faces competition from both the TAMP side and the reporting side. In an illustration of how the industry is evolving, some of those same competitors partner with Investnet and promise to deliver similar efficiencies, investment manager access and enhanced reporting, including RIA custodians. But Bergman is unperturbed. “We are in the business of freedom, independence and empowerment—that resonates with a certain kind of advisor.” **IA**

Group Editor in Chief **Jamie Green** can be reached at jgreen@investnet-advisor.com.

(#22939) Adapted with permission from Investment Advisor magazine. Copyright 2011 by Summit Business Media, LLC. All Rights Reserved. For more information about reprints from Investment Advisor, contact PARS International Corp. at 212-221-9595.

The information expressed herein is for general and educational purposes only and is not intended to constitute legal, tax, securities, or investment advice. The information provided is based on currently available information as of the date of this writing and may be subject to change at any time without prior notice.

Investnet is a registered investment advisor with the SEC and engages in the business of providing investment advisory and multi-product online technology services and products.