

Firms' Subadvisory Marriages Need Work

Article published on Sep 20, 2007

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While the number of subadvised funds keeps growing, managing those relationships isn't getting any easier.

That's because a number of subadvisors are institutional money managers that are unfamiliar with how retail products are sold. In some cases, there are multiple managers subadvising separate sleeves of the same fund, and they have no idea what the other manager is doing. This puts distance between the portfolio management teams running the money and the financial advisors selling the funds to their clients.

Firms that run private portfolios often view subadvised funds as just another account they manage, according to industry consultants. They typically aim to stay above the fray when it comes to distribution, marketing and communications. When they do participate in sales and prospecting efforts, they are often not recognized for their own brand, which provides a disincentive to engage.

"A good number of subadvisors don't want any part of marketing a fund to advisors," says Dan Sondhelm, partner and vice president at **SunStar**, a fund-marketing consulting firm. "They are in the business of managing money."

But as the institutional and retail worlds continue to converge, it may be incumbent upon both fund shops and their outside managers to get in sync in order to capture more assets. The gatekeepers or so-called professional buyers at retail brokerage firms have become much more sophisticated in recent years with their screening processes, and firms have embraced open architecture, reflecting a more institutional approach to retail sales.

Analysts at **Financial Research Corp.** are predicting that subadvised products will represent 17.3% of all long-term mutual fund and variable insurance assets by 2012. The growth of subadvised mutual funds is expected to remain modest yet steady, with market share rising from 13.3% in 2006 to 13.6% by year-end 2012. Assets held in subadvised funds have more than doubled to \$650 billion in 2007 from \$261 billion in 2002, according to **Lipper**.

Many fund managers turn to subadvised funds to ratchet up performance, gain exposure to a segment outside their expertise or defray capacity constraints in areas such as small-cap value, analysts say.

Despite the growing popularity of subadvised funds, there remain several ongoing and complicated challenges that could handicap the potential to grow assets, says Lisa Cohen, president of sales consulting firm **Momentum Partners** and a former managing director of product management at Evergreen Investments.

Subadvisors tend to have very little knowledge of the message the fund family is trying to deliver to its clients. "Aligning the sales pitch, including subadvisory, across the complex is crucial. But the stories don't always go together," she says.

One of the key things top-tier financial advisors need from fund firms is a speedy response to their concerns, especially when they're going to drop a ticket, Cohen says. "On the institutional side, there's not a strong understanding of the sales cycle in retail land," she says. Turnover rates in retail funds are significantly higher (96% versus 85%) than in the institutional space, where the sales cycle is on a 12-month basis.

With beefed-up due diligence screens in the retail channel, non-participation on the part of the subadvisor is going to hurt sales, and that's not good for either manager. "You're going to need the [subadvisor] portfolio manager to participate in the due diligence process to some degree," Cohen says.

RiverSource Investments, which employs a multi-manager approach on 12 mutual funds with \$8 billion in assets and 22 subadvisors, declined to comment in detail on the nature of its subadvisory arrangements, but Patrick Bannigan, the company's senior vice president of mutual funds, stated that "while RiverSource is responsible for marketing and sales, subadvisors will participate in certain sales efforts."

SunStar's Sondhelm says fund companies can manage their relationships better by specifying in the contract what their expectations are for the outside manager when it comes to its role in marketing, for instance.

Getting the subadvisor to make a time commitment for public appearances, conferences and television spots is equally important, he says. In addition, the fund complex can arrange an annual meeting with all its subadvisors, who can then familiarize themselves with the fund company and each other.

Cohen agrees that setting guidelines for subadvisors is a smart way to manage the relationship and ensure those assets stay within the complex for the long haul. In volatile markets, retail investors get jittery and want to hear from the folks tasked with managing their retirement savings.

In exchange for subadvisors' participation and more hands-on approach, some fund companies may want to reward them with more brand recognition during their public appearances.

"How much of a vested interest [the subadvisors have] in the branding of the funds makes a big difference in their participation," says Jeff Keil, principal of mutual fund consultancy **Keil Fiduciary Strategies**.