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Hungry RIAs Fuel Schwab's SMA Asset Inflows

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A healthy appetite for separately managed accounts by independent registered investment advisors (RIAs) is pulling Charles Schwab & Co. closer to the wirehouse brokerages, which are the industry's largest managed account sponsors.

Schwab posted 6.3% growth in the second quarter to hit $36.1 billion in SMA assets, outpacing the top four sponsors – Citi's Smith Barney, Merrill Lynch, UBS, and Morgan Stanley– that collectively saw their SMA assets shrink by 3.5%, according to Cerulli Associates. And Schwab's growth rate was highest among the top 25 sponsors Cerulli ranked.

Schwab's momentum underscores the potential many in the industry see for extending SMAs to independent advisors. And some observers say Schwab's success is critical to cracking open the RIA market even further for asset managers.

The company's growth stems from strong inflows – both advisors adding assets from new clients and other RIAs newly signing on to SMAs, says Jeff Carlin, Schwab's v.p. and national sales director for investment management services. He says Schwab's SMA inflows this year through July 31 totaled $4 billion, topping the $2.5 billion in the same period in 2007 by more than 60%. About $30 billion of the SMA assets come from RIAs using its platform, while the rest is sold by Schwab retail representatives.

Furthermore, the inflows largely come at the expense of wirehouses, Carlin says. Schwab held sixth place on Cerulli's list, trailing only the wirehouses – Smith Barney, UBS, Merrill Lynch, Morgan Stanley, and Wachovia. Smith Barney leads with $182.5 billion in SMA assets and Wachovia is fifth at $54.7 billion.

"I see us catching up," Carlin says. "We don't wake up in the morning saying, 'We're number six!'"

Schwab catching up soon is unlikely, says Jeff Strange, a Cerulli senior analyst. "It's still quite a bit of a gap – about $20 billion," he adds. "I'm bullish on their growth, but it depends on how much we see RIAs actually adopting separate accounts. It's going to be tough to crack the top five."

Strange says it's also difficult to align Schwab's growth with wirehouse declines. While RIA market boosters widely assert that wirehouse advisors and clients are flocking to the independent market because of turmoil and scandals at big-name firms, Strange says Cerulli's believes the "breakaway" trend is overstated.

Still, Carlin says 30% of this year's new SMA assets for Schwab came from "breakaway" advisors who left the brokerage world.

Carlin says Schwab's gains are real, pointing to the firm finally cracking 5% in SMA market share last quarter, when SMA industry assets contracted 1.4% to $722.5 billion. "It is a very positive place for us to be," Carlin says. "The five firms ahead of us have these enormous proprietary distribution channels, and no one else in the top 10 focuses as we do on the RIA space."

Schwab's penetration is hopeful for anyone targeting RIAs with managed accounts, says John Phoenix, CEO of Metamorphosis Money Management, or M3, a Denver firm offering specialized tax and transition management to help RIAs build SMA portfolios for wealthy clients. He also credits SMA growth at rival organizations such as Fidelity Investments and the Bank of New York Mellon's Pershing-Lockwood unit.

"Their overall growth is great for us, getting advisors exposed to managed accounts, even though our business focuses on advisors who are more familiar with managed accounts," Phoenix says.

Schwab is essentially the "800-pound canary in the coal mine" in efforts to expand SMAs to independent advisors, says Michael Stier, president and CEO of Adhesion Wealth, a Charlotte, N.C., firm that provides RIAs with performance reporting, portfolio accounting systems, and a managed account platform. It has $10 billion in assets under management or administration from RIAs.

Schwab isn't alone but clearly on a bigger scale than other firms bringing SMAs to independent advisors. Recent moves include last week's announcement by Boston-based FundQuest, a turnkey asset management program, that it added Fintegra Financial Solutions, a Minneapolis-based RIA with $140 million in assets, to an investment platform that includes SMAs. Earlier this month, Placemark Investments– an overlay manager supporting unified managed account (UMA) programs that incorporate SMAs – announced it was building a UMA for United Capital Financial Advisers, a national network of RIAs.

But while Schwab may be leading independent advisors to SMAs, it is not an innovator in developing platforms or programs, says Adhesion's Stier. "They are measured followers," he says.

Carlin says Schwab can claim to have been innovative in tailoring SMAs for RIAs when it launched its first platform in 2002, and following up with educational materials showing advisors how to use SMAs to compete with wirehouse rivals. But he doesn't dispute that Schwab doesn't always build from scratch.

“We listen to what advisors are wanting,” he says. “I’d be the first one to say that failing small and succeeding big has been a successful strategy for us. If we can’t be extremely impactful, there’s nothing wrong with being a fast follower.”

In that vein, Schwab isn’t committing to a timeline to develop a UMA, today’s hot offering as firms across the wealth management spectrum, including Smith Barney, have launched new programs. Industry-wide assets in UMAs, which combine SMAs, mutual funds and other investments into a single account, grew 7% in Cerulli’s second-quarter data.

Carlin says Schwab is “definitely in the exploratory phase” but has not decided, for instance, whether to build the UMA itself. “It’s still an evolving technology,” he says. “We want to build it to fit advisors specifically, make it dynamic and easy to use, and there is still work to be done.”

Schwab has about $26 billion across 2,600 SMA strategies from 926 managers on its dual-contract platform, where advisors directly hire managers. It has about $4 billion more on two SMA platforms with strategies vetted by its own due diligence team, which include than 250 products from 84 managers, Carlin says. Earlier this year, Schwab reported that it had added 50 SMA strategies to its vetted platforms.