

BANKING

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Fund Follies

With mutual funds, banks figure they aren't losing depositors, they're gaining investors. Most banks would do better buying their own CDs.

BY ALYSSA A. LAPPEN

Early in the afternoon on September 16, four General Accounting Office investigators strode out of the sleek new elevators at 125 West 55th Street and into the marbled eleventh-floor Manhattan headquarters of Richard Stierwalt, chairman and president of Concord Holding Corp. Set up in 1987 to serve as an administrator and distributor of mutual funds for banks, Concord now oversees \$36 billion in assets and generates gross revenues of at least \$30 million. That makes it one of the largest and most successful of the fifteen or so such firms purporting to shield an increasing number of banks that peddle mutual funds from the Glass-Steagall Act's prohibition against their underwriting and selling corporate securities.

But the GAO-men weren't raiding the place. The

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BofA's McGinty-Poteet: *"All [the bank's mutual fund] assets were earned the hard way, from scratch, with no converted pools"*



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Dreyfus's Genadry: *"We do not tout to the banking industry the potential of proprietary funds because we don't feel it is there"*



American Bankers' Association had invited the congressional watchdogs to pay a call on Concord with Stierwalt's blessing. Who better than someone on the front lines like Stierwalt to answer questions on the ABA's behalf about everything from the role of administrators like Concord, to the qualifications of the growing army of broker-dealers seated in bank lobbies across America, to the economic impact of the shift from deposits to mutual funds? After talking with many others in the bank mutual fund business, at the request of Henry Gonzalez, chairman of the House Banking Committee the GAO is scheduled to make its report to Congress later this fall.

The findings may or may not do much to allay the deepest, darkest concern nagging legislators and regulators — that a stock market crash will induce millions of unsophisticated onetime-CD-holders-turned-fund-investors to run for the exits (see box, page 42). But what the GAO report definitely won't resolve is an equally pressing concern: quite simply, whether the nation's commercial banks, as a group, have the financial — or intellectual — wherewithal to succeed in the ferociously competitive mutual fund business.

"By default most banks will not be successful," warns one observer close to the banking industry. If so, the pricey bank mutual fund experiment could precipitate a crisis of a very different sort from the one that regulators are trying to forestall: The lifeboat that many banks had hoped to construct of sturdy mutual funds could sink like an LDC loan.

No deposits, no returns

The pressure on banks to enter the mutual fund business is intense. Since 1980 assets in mutual funds have grown nearly twentyfold, to some \$1.8 trillion. The number is threatening to quickly overtake the \$2.4 trillion on deposit domestically with U.S. banks. And greenbacks have continued to pour in, at an annual rate of 20 percent so far this year. For stock and bond funds, the

growth rate is even higher, 35 percent.

Much of that money used to be on deposit in banks. If interest rates remain low, disintermediation can only worsen. To preserve their relationships with customers, most bankers feel compelled to get into funds. Thomas Howe, executive vice president and managing director of Fleet Investment Services, was more or less speaking for the entire banking industry at an Investment Company Institute conference last spring when he turned to Putnam Investments retail marketing head Stephen Gibson and declared, "We are not interested in giving our customers to a company like Putnam."

Even conservative banks recognize that it's in their interest to be in the fund business in one way or another. Says David Rosen, an executive vice president of rock-solid Republic New York Corp., one of the nation's best-capitalized banks: "Everything we do starts with client need, but we're not able to meet [all those needs] with the traditional liability bias that we tend to have. So we are offering [third-party] funds, particularly as an alternative to CDs that are maturing."

With the doors to many traditional lending businesses slamming in their faces, banks are following the lead of such pioneers as State Street Bank &

Trust Co. and Northern Trust Corp., whose businesses have long been largely fee-based. Already, an estimated 15 percent of net new money pouring into stock, bond and money market mutual funds — a record \$148 billion in the first seven months of this year — comes through banks. Some 125 banks sell their own name-brand mutual funds. The banks include many obvious money centers — from Citicorp and Chase Manhattan Corp. to Wells Fargo & Co. and Bank of America National Trust & Savings Association — as well as a host of jumbo regionals like NationsBank Corp., First Union Bancorp, First Chicago Corp., Fleet Bank and Shawmut Bank (see table above). The number of banks piling into proprietary mutual funds seems to swell every day.

Conservative bankers view this paper chase with a jaundiced eye. "There is too much mutual fund product out there," says Republic's Rosen. "You have to ask whether they will all survive. We're concerned, which is why we have not been so quick to throw out our own family of funds." Says another banker: "Those who have entered the business in its heyday will pay through the nose to build funds. We tend to have a shorter time frame on acceptable payback periods. We're not

THE BIGGEST NAMES

About two thirds of all assets in proprietary bank funds are in money market funds, and all but one of the top 25 bank funds are money funds.

Bank	Fund	Assets* (\$ millions)
Wells Fargo	Pacific Horizon Prime	\$12,939.4
PNC	Temporary Investment Fund TempFund	6,560.8
Northern Trust	Benchmark Diversified Assets	3,342.1
State Street	Seven Seas Money Market	3,241.2
NationsBank	Nations Treasury	2,906.7
Bank of America	Pacific Horizon Treasury	2,749.3
Wells Fargo	Overland Express Variable Rate Government	2,292.5
Morgan Guaranty	Pierpont Money Market	2,281.7
Barnett	Emerald Prime	2,192.1
Norwest	Norwest Cash Investment	1,949.4
NationsBank	Nations Prime	1,858.2
Bankers Trust	BT Institutional Cash Management	1,634.0
PNC	Trust for Federal Securities Treasury Trust	1,554.4

*Assets as of June 30, 1993.

IN BANK FUNDS

Bank	Fund	Assets* (\$ millions)
Boatmen's	Centerland Short-Term Diversified Assets	\$1,527.2
PNC	Trust for Federal Securities FedFund	1,489.7
National Bank of Detroit	Woodward Money Market	1,433.1
PNC	Trust for Federal Securities T-Fund	1,403.8
Boatmen's	Centerland Short-Term U.S. Treasury	1,229.9
Northern Trust	Benchmark Tax Exempt	1,189.4
Chase Manhattan	Vista U.S. Government Money Market	1,147.4
Northern Trust	Benchmark Government	1,137.0
Chemical	Hanover U.S. Treasury Money Market	1,116.4
PNC	Temporary Investment Fund TempCash	1,095.0
Banc One	One Group Prime Money Market	1,040.3
Bankers Trust	BT Investment Treasury Money	1,002.9

Source: Lipper Analytical Services.

looking at five or ten years. Inevitably the market changes, and those kinds of investment decisions turn out to be unwise."

When the current go-go days in mutual funds are gone-gone, as they eventually will be (even if the downturn amounts to a prolonged lull), banks that have built expensive fund infrastructures could be forced to bail out of the business — a proposition that promises to be costly in a shrinking market with few or no buyers. The alternative would be to somehow shift or cover expenses, perhaps by making risky loans. Which, of course, is precisely what the fund push was supposed to spare banks.

Even the most successful mutual fund purveyors among banks have found that the business is no surefire money-spinner. In nine years BofA has accumulated an impressive \$22 billion in funds under management, yet its profits from the business probably amount to no more than \$25 million annually.

Banks have chosen to be escorted down the proprietary funds path by several varieties of what one fund consultant calls fig leaves, institutions like Concord that profit by buffering banks from securities-law restrictions. The first sort is the anything-and-everything strain, which provides any fund-related service that

bank customers want, from account administration to money management itself. The most powerful of these is Federated Investors. The country's seventh-largest mutual fund manager, it has sold 80 percent of its \$66 billion in assets through banks. Although this quiet powerhouse is virtually unknown at the retail level, hundreds of banks work with some 95 retail and institutional Federated funds, both with the Federated and private labels. Buy BayBanks' BayFunds Shares — Massachusetts Municipal Cash Trust Fund, for example — and you will actually be buying a Federated-managed fund.

Private labels

In keeping with its low-profile modus operandi, Federated refused to talk to *Institutional Investor*. But according to industry sources, the company segued into the bank fund business through the bank trust departments its money market funds serve. Nowadays Pittsburgh-based Federated is also reportedly happy to create private-label funds for banks that want their own vehicles but don't want to manage the money, and to provide whatever type of funds its bank customers demand. Federated serves 24 banks in this fashion, according to Avi Nachmany, an analyst at Strategic

Insight, a mutual fund research house. For at least fifteen additional clients that want to manage money themselves, such as Shawmut and Boulevard Bancorp, Federated is glad to serve solely as an administrator and distributor. Other firms operating in this mode include SEI Corp., Boston Co. and Goldman, Sachs & Co.

Next in the fig family come the administrators and distributors, folks like Concord, the Winsbury Company, Stephens Inc. and Furman Selz. They're in business to help banks set up proprietary funds as well as sell and administer them. It's no wonder that Concord's Stierwalt is anxious that the government not become overwrought by the latest, greatest fad in banking: He's making a small fortune off banks and doesn't want the Feds to butt

in. "Because of federal restrictions, banks have had to use third-party providers to distribute and administer their funds, and those [providers] are not new to the fund party," Stierwalt says from his perch behind an antique partner's desk, backed by a matching break-front brimming with nineteenth-century German beer steins. "They have provided a lot of professional guidance to prevent any fallout from the major market correction that the pundits predict." Such professional guidance costs the banks an average of 10 to 15 basis points out of their management fees.

Last, there are the pure marketers. Firms like Liberty Financial Cos., GNA Securities, Invest Financial Corp., Wall Street Investor Services and Marketing One provide the brokerage services to sell funds, not account administration. But even some of these players have wandered into fund management.

Banks are such fertile territory for mutual funds that even traditional fund families have been swarming into the bank market. Fidelity Investments now sells through more than 300 banks, and it is working overtime to expand those relationships as fast and as far as possible, both directly and through intermediaries. Of the \$200 billion Fidelity has under

THE BIG SCARE

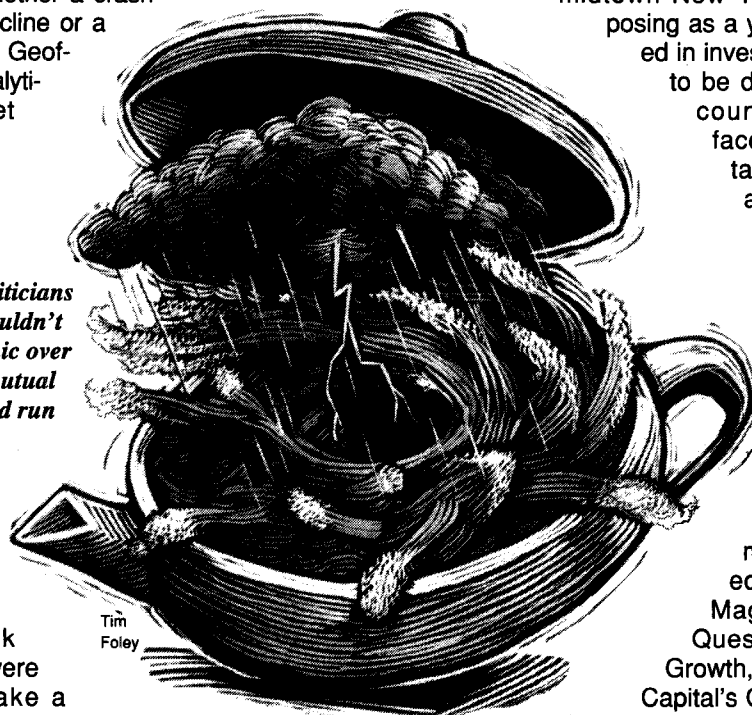
The prospect of a Great Mutual Fund Run by panicky depositors-turned-investors is generating almost as much official angst as health care. The worriers should pop a Valium and chill out.

Regulators and legislators, too, have been fretting very publicly about what will happen to bank mutual funds when the bull market takes a hard fall or tumbles into the kind of extended rolling bottom last witnessed in the early '80s.

"We don't know the savers' propensity to withstand a crash, or whether a crash would be a pounding decline or a gradual [retreat]," warns Geoffrey Bobroff of Lipper Analytical Services. All market cycles turn, adds bank consultant Joy Montgomery of Money Marketing Initiatives. "Then, some little old lady in Texas is going to make a big gafuffle and call her congressman."

The doomsday theory presupposes that after the fall not one but millions of little old ladies who'd hoped to escape the ravages of low-interest rate CDs will howl that they thought bank bond and equity funds were FDIC-insured and make a

*Politicians
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fund run*



massive run on bank funds, further deepening the market downturn. But even worse would be an ensuing barrage of lawsuits by tens of thousands of widows, retired postmen and orphans charging that banks and, ultimately, regulators failed to uphold their fiduciary duty by allowing them to invest in the fickle funds in the first place.

A trip to a bank just might allay some of these fears.

A curious reporter who recently walked into a midtown New York Citibank branch posing as a young mother interested in investments was surprised to be directed to a separate counter where a fresh-faced securities consultant politely grilled her about her investment horizon, goals and tolerance for risk.

After the reporter outlined her 25-year term for college savings and retirement needs and noted that she could stomach moderate risk, the consultant carefully proposed investments in respected names like Fidelity Magellan, AIM Charter, Quest for Value, Kemper Growth, AIM Weingarten and Capital's Growth Fund of Amer-

management, \$30 billion was sold through banks. "This is a very big market," says Nishan Vartabedian, Fidelity's executive vice president of bank services. "We have one priority [in this division] and that is to start selling to banks however and whenever they want [us] to." Not surprisingly, Fidelity expects sales through banks to continue to rise.

Similarly, Putnam today boasts that several hundred bank relationships produce a lofty 30 percent of its retail sales, or \$4 billion past year. "We have been addressing banks directly through a separate sales and service group for the last five or six years," says Putnam Investment's senior managing director William Shiebler. He adds that the dollar volume of Putnam funds sold through banks this year could reach \$6 billion. Other traditional fund families now widely offering

their brand names through banks include Franklin, Van Kampen Merritt, Capital Research & Management Co., Massachusetts Financial Services Co., Dreyfus Corp., Colonial Group and Oppenheimer Management.

As the established fund families know only too well, but bankers may have to learn painfully for themselves (if their record with LDC loans and real estate is any gauge), the competition in the mutual fund game is fierce. The heaviest fire on their flanks is likely to come from traditional mutual fund families, which have already become adept at using the banks to build their own businesses. As recently as 1986 the ICI was adamant about keeping banks out of the fund trade. Why share the spoils? The average fund family reportedly nets 25 to 30 percent per year, and well-managed boutiques can make much more. Then,

too, there was a concern that the banks would run so badly afoul of securities laws as to bring down the wrath of regulators on the whole industry, ruining the party for all.

But now traditional funds see clearly that bank lobbies are parqu岸ed with gold. Says Fidelity's Vartabedian, "Our research shows that bank customers have channel loyalty so strong that even if the customer's own bank did not offer a fund and the one across the street did, the customer would stay put." By putting their wares on a whole new set of retail shelves, traditional mutual fund families continue to raise their market share and profits at the expense of the banks.

Another compelling lure for established funds is the growing defined-contribution business. Most major mutual fund families have established 401(k) operations aimed at big corporate de-

ica — albeit with a front-end load.

What, none of the bank's own proprietary Landmark funds? The Landmark equity funds have not performed very well, the consultant said. When asked about tax implications, he recommended a couple of low-load variable annuities offered through Nationwide. "This is not like a CD, not like a bank product," he warned, handing over the disclosure form that Citibank, like most banks, requires all mutual fund investors to sign.

Admittedly, not all banks or bank advisers are likely to be so professional. Yet the worst-case scenario predicting a massive flight from bank mutual funds seems a bit far-fetched. Two thirds of bank fund assets are actually parked in money market funds whose value remains fixed at \$1 per share. Not your basic cut-and-run type money. Moreover, funds transferred from bank trusts — another big piece of the bank fund action — is also stable money from a group that tends to be made up of conservative long-term investors, not least because of handcuffs written into the tax code.

So regulators, despite all the Sturm und Drang, will probably go with the funds flow. Notes Robert Profusek, partner in charge of the corporate group at Jones, Day, Revis & Pogue: "History would show that until something disastrous happens, nothing will be done. It will take something cataclysmic for Washington to respond, and right now there is nothing anyone can really stand up and shout about. No bank has failed, no one has really lost money. There's not enough here."

So, not to worry. As for health care reform, where's that damned Valium?

financed-contribution plans. But adding business at the middle and low end of the market is an expensive proposition. Banks can help by providing easy access to companies with 50 to 2,000 plan participants, as well as to their top 500 clients.

In-house competition

All of this creates a dilemma for banks selling outside funds along with their own. Most feel they must offer third-party funds to ensure that they satisfy client needs and keep their noses clean. But they're also giving away business with each bank customer who buys a third-party fund. Banks never had that kind of in-house competition from national name-brand suppliers when they were managing commingled or common trusts.

A refrain heard often in the banking community is that banks are no strangers

to running money. After all, they've been serving as money managers to their well-heeled private clients for generations and to the commingled trust and pension markets for decades. And after ERISA passed in 1976, many banks began running such departments quite profitably, despite the fact that their managers often produced lackluster results.

But the rich, often content with capital preservation, are different from mutual fund investors, who demand competitive returns. For banks, funds represent a brave new world of perform or perish. Unlike trusts, funds compete openly for business, and their track records are published daily in newspapers nationwide. Fixed costs in funds are higher, and there is therefore pressure to grow funds under management quickly. Thus start-up funds invariably waive part or all of their management fees as an incentive for new investors to come aboard.

Banks will also have to ante up for top money managers or forget about success. "[NationsBank CEO] Hugh McColl probably would not object if a portfolio manager made more than he does for an outstanding year," says Lipper Analytical Services executive vice president Geoffrey Bobroff. "But there are many bankers who would object, which will be a problem." Add in the cost of daily valuations and 800-number telephone services or fees for third-party fund administrators or marketers, and pretty soon you're talking stiff overhead.

How stiff? It costs a minimum of \$25,000 in legal fees to set up even a simple money market fund, although complex funds can run more like \$150,000. Banks, however, sometimes use attorneys friendly to their institutions but unfamiliar with securities laws, pushing start-up legal fees as high as \$350,000 or even

\$500,000. For a modest family of five funds, in other words, start-up legal fees could run anywhere from \$750,000 to \$2.5 million. Then there are minimum expenses of \$150,000 a year for important items like ongoing legal advice, auditors, transfer agents, custodians, a board of directors and oh, yes, Securities and Exchange Commission fees — for funds with any net new sales to speak of — of 3.1 basis points.

Although the proliferation of funds might seem to suggest otherwise, barriers to profitable entry into this business continue to rise. Fidelity spent \$300 million last year on new technology alone. Sure, banks often use third parties that provide such services for them, but that only cuts further into their own margins.

Breakeven points vary depending on the type of fund, account size and number of services offered. But breakevens are highest and margins thinnest for commoditylike money market funds, which account for about 66 percent of the \$195 billion invested in proprietary bank funds. Warns one bank managing director, "You shouldn't start a money market fund if you think that maximum assets will be \$200 million, because it will never be very profitable."

Although a \$200 million bond or stock fund (whose management fees are higher) could be viable, such a fund would also be harder to build than a money market fund. And no matter how much money pours into a bank fund family, profits from the few funds that do well have to be averaged out over all of them. Even closing funds is expensive: Those that flop can cost \$150,000 and take six to eight months or more to shut down.

Bankers will be rudely surprised if they expect the front-end loads that have become nearly ubiquitous on proprietary funds to constitute pure, fee-based profit. What's left over after paying the brokers and covering marketing costs is often barely enough to meet internal overhead, says an analyst close to bank mutual funds. Those bank managers who see a pot of gold at the end of the proprietary fund rainbow are mostly hallucinating.

Despite the pitfalls, banks continue to jump into the mutual fund business, scrambling to set up their own proprietary funds like so many pinstriped lemmings. "Most banks will build their own, and that's a mistake," says Richard Leib, president of SEI Investment Services in Wayne, Pennsylvania. Leib, like most others in the bank mutual fund business,

has an ax to grind: His division of the \$250 million (revenues) SEI Corp. competes for bank customers for its own funds. But he has a point. "The securities business," says Leib, "is a very expensive business. Banks already have the branches in place, but they also have higher regulatory hurdles. And it takes years to figure out whether you have a decent money manager." Adds Elie Genadry, vice president of institutional sales at Dreyfus, one of the fund industry's lowest-cost producers: "It's aggravating. We don't go into banks and build up an income scenario that is totally ridiculous. We [work with] a few banks that have special needs and understand the economics of the funds, but we do not go out and tout to the banking industry the importance of success or the potential of proprietary funds because we don't feel it is there."

The consensus is that few bank mutual funds are actually growing — much less making money. "When banks say that they have sold this many [dollars in their] funds, they are fibbing," says Prudential Securities bank analyst George Salem. "They have used Hamburger Helper, in the form of [commingled] trust conversions. Moreover, they are not about to go out and convert the whole deposit base, because that will destroy their banks." According to Lipper, since 1985 about 13 percent of the assets now in proprietary bank mutual funds have come out of bank commingled trusts, the pooled funds through which banks manage retirement money for commercial and retail clients.

Fleet Investment Services, a division of the regional bank, launched its Galaxy family of funds in 1986, yet has managed to gather just \$4 billion in seventeen retail and one institutional fund. And two thirds of that came out of internal fund transfers. Fleet only began retailing its funds in 1990, but raised its complement of investment consultants to 100 this past summer in a bid to double assets to \$8 billion by 1995 — largely through retail sales. But to reach that target, Fleet will have to have tripled its retail sales starting in 1990. Given that the Galaxy funds are not yet growing by even \$1 billion a year, that goal seems optimistic.

In the interest of its customers, Fleet

has broken from the banking pack by offering its funds with no front-end, level or back-end loads and with advisory fees and expense ratios that are in line with those of traditional fund families. "Loads provide a great incentive to sell," explains Peter Herlihy, marketing vice president at Fleet Investment Services. "But if your mutual fund business is based only on load selling, when the markets change it will be tougher to bring in assets." Galaxy wants to be able to move funds in good markets and bad. The catch is that this strategy will also double the time it takes Fleet to make any money on its funds.

The most conspicuous success in bank funds has been Bank of America. BofA's senior vice president in charge of mutual funds, Debra McGinty-Poteet, is

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admired in both the banking and mutual fund communities. Of the \$22 billion in assets in the bank's family of eleven Pacific Horizon mutual funds, built up by McGinty-Poteet during the past decade from a base of Security Pacific and, later, BofA institutional and retail funds, all but \$1 billion is invested in BofA's money market funds. The money funds have built a huge institutional business with other banks, trust departments, top 500 corporations and big municipalities nationwide. "All those assets were earned the hard way, from scratch, with no converted pools," boasts McGinty-Poteet. "We look a lot like Federated, and they are a competitor."

Yet after giving a healthy chunk of its fees to Concord for administrative services, BofA grosses only 10 basis points on management of institutional money market funds. That thin margin adds an estimated \$21 million — or about 1.4 per-

cent — to BofA's bottom line. Fees from managing other funds are what allow profits to creep up to perhaps \$25 million. McGinty-Poteet, then, is building a tidy, but hardly dazzling, profit center. But the time and effort it has taken BofA to get this far should sober other fast-talking contenders in the bank mutual fund sweepstakes.

15 percent hole

Still, Congress could give bank funds a boost. A bill before the House, H.R. 13, proposes to allow them to convert into funds their common trusts — those private pools of estate and other trust funds that are not tax-protected — without creating a tax liability for the investors. If the bill passes later this year as expected, an estimated \$170 billion in assets would probably shift into bank-managed mutual funds, giving the funds more ballast. At best, however, that infusion of cash would only buy proprietary bank mutual funds some time. Even in a bull market, the average fund suffers a formidable 15 to 17 percent annual attrition rate. To grow, therefore, bank funds must first fill that 15 percent hole every year.

Prospects would brighten markedly for bank funds if the current regulatory hurdles toppled. "Years ago, we interpreted Glass-Steagall as painting a bright line between banks and mutual funds, but that line has been fuzzed by a number of [federal] agencies and by the courts," says ICI executive vice president Richard Pogue. He calls for Congress to level the bank-versus-fund-company playing field. Such a move would lower bank costs by eliminating the need for fig leaf intermediaries (unless, of course, such middlemen could prove that they were actually adding value to banks' fund operations).

But sweeping deregulation is not likely, given the scrutiny bank funds have been getting from Congress, the GAO, the SEC and the Office of the Comptroller of the Currency of late. Mindful of the very real abuses that prompted Congress to pass Glass-Steagall 60 years ago, Congressman John Dingell fired off a series of letters to regulators earlier this year demanding to know just how high bank funds were flying and who was selling them. More to the point, Dingell also wanted to know if banks lend money to

affiliated mutual funds, or if bank funds buy securities from the banks' corporate clients so that the companies can use the proceeds to shore up flagging credit ratings — and thereby bolster the banks' loans. Without a relaxation of the regulations, few bank-run fund families can expect to make real progress.

"No one has had a runaway retail success," admits Robert Sherman, senior vice president of mutual funds for Shawmut's investment arm, although he has high hopes. His own bank has \$784 million in assets in eleven mutual funds, with \$650 million of that coming from commingled trusts in early 1993. Next year he hopes to attract \$450 million in new assets — an aggressive goal. Similarly, First Chicago has all but \$90 million of the \$1.5 billion in its First Prairie funds in three money markets. Even mighty J.P. Morgan & Co. has had trouble attracting new money to its funds, says a source familiar with the situation.

One potential way around high costs could be through so-called hub-and-spoke funds (*Institutional Investor*, September 1992). This hybrid fig leaf was devised by Signature Corp. in 1988. Company founder Philip Coolidge, an entrepreneur from Mass Financial Services, now has 22 clients with \$24 billion in assets parked in 98 hubs. The system allows fund vendors, including banks like Chase and Citibank, to set up proprietary fund arms, or "spokes," in a variety of markets and then to plug them all into the same "hub" fund. For a fee Coolidge provides patented software, limited marketing assistance and the concept that he engineered. J.P. Morgan has implemented a plan creating U.S. spokes for American investors that link into existing foreign stock funds. Similarly, Bankers Trust Co. actively sells spokes into the retail, 401(k) and institutional markets that carry varying investment minimums and loads but which all plug into the same hub funds and money managers.

Investors in spoke funds theoretically will benefit from lower management fees and transaction costs, and hub advisers will pass along to banks — and their shareholder customers — the savings from the economies of scale that accompany large distribution. The system's partnership formula would also allow a bank

spoke to unplug its fund or funds without creating tax liabilities once it accumulates enough heft to operate on its own. The system functions like a Civil War-era rifle with detachable parts — detachment being the hoped-for goal. The drawback so far: Because the average hub still has only \$245 million in assets, bankers and other observers say that the real benefits have yet to materialize.

Other alternative marketing methods aim at different targets. Bankers Trust, \$8.5 billion of whose \$160 billion under management worldwide consists of mutual funds, hopes to expand its efforts in the 401(k) arena by offering corporate plan sponsors new choices. Through a joint effort with discount broker Charles Schwab & Co., Bankers will soon offer a selection of several retail BT funds, plus

hard slog. Consider Chase Manhattan. Impressively, the bank in six years has built the assets in its 24 Vista Funds from scratch to \$4.6 billion — up a rip-roaring 50 percent in the first half of this year alone. Chase wisely chose to compete head-on with other fund families through a large distribution network of financial planners and brokerage companies like Smith Barney Shearson, Alex. Brown & Sons, and Charles Schwab. Yet even here 64 percent of the bank's mutual fund assets are in the low-margin money market business. And so far only one Chase fund — Vista Growth & Income, with \$820 million in assets — has turned a robust profit.

One noteworthy exception to the nice-try-but-no-cigar pattern among banks is Wells Fargo. The California bank began its \$4 billion Overland

Express funds, sold wholesale through 400 brokers and other distributors in 1987, and then in 1992 opened its \$3.4 billion Stagecoach funds with a transfer of \$600 million in commingled IRA trusts. The Stagecoach funds, sold only in Wells branches, took off after a low-cost television advertising campaign last fall featured three Wells Fargo stagecoaches in a race up a steep incline, with the narrator noting that Stagecoach Funds had arrived. Thanks to handsome performance records and its effective,

low-cost marketing efforts, Wells

Fargo has already achieved annual net profits on its funds of about \$25 million — on a much smaller asset base than Bank of America's fund group.

Another success story appears to be evolving at Banc One Corp. The superregional plans to open 1,200 new investment centers at an estimated cost of \$15 million over the next two years. All will be located in its Banc One banks in twelve states. Before the end of the program, Banc One Investment Advisors Corp. plans to have 1,200 registered investment consultants pushing its 28 Group One funds as well as a full array of third-party funds. The funds already have \$5.4 billion in assets, although so far only \$300 million has come from retail sales. Banc One has had funds since 1984, but until the retail effort was established in late 1992, assets came solely from employee benefit, institutional and common trust accounts. Nev-

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200 others from assorted fund managers. This clever marketing idea will also crack open the IRA rollover nut by offering retiring defined-contribution clients a way to keep their pension funds with BT through one easy phone call.

NationsBank has launched a joint venture with Dean Witter Reynolds to boost the retail profile of the 28 NationsFunds it already has set in motion and the ten more to be rolled out before the end of the year. How better to quickly sell the Nations brand name than with a seasoned brokerage house as a partner? "The retail market will be a real engine for growth," notes Mark Williamson, mutual fund group executive at NationsBank. "But the retail effort is a newer part of the business, which is hard to get into, and Dean Witter already has significant infrastructure in place."

Yet even the most resolute up-and-comers in the bank fund business face a

ertheless, assets have ballooned from \$3 billion in late 1992.

Louisiana's smallish Premier Bank has likewise fashioned a thriving fund operation. By selling through both its own investment centers and other banks in Louisiana, Mississippi and Texas, the bank has boosted its Paragon Portfolio family to \$1.3 billion since opening the seven funds with \$550 million in transferred money in late 1989. The real coup for this bank, however, has been limiting low-margin money market funds to less than 18 percent of the total. The bulk is in equity and bond funds. Thus, Premier's funds net about 50 basis points — working out to some \$6 million, or a healthy 6 percent of the company's bottom line. Impressed with Premier's success, Banc One took out an option to buy the bank in 1995.

Tough guidelines

Transforming depositors into investors could be fraught with perils, for banks as well as depositors. The exercise, after all, tampers with the banks' enduring franchise: perceived safety. Moreover, wary regulators are poised to pounce. No wonder bank executives are bending over backward to keep their fund solicitations squeaky clean — and to educate customers to the risks. Listen to BofA's McGinty-Poteet: "We are very conservative. The SEC is no pushover, but the OCC certainly isn't either, and having both of them [watching us] makes us keep all the i's dotted and t's crossed."

BofA contends that its customers get what they need — not what the bank wants to sell — because it markets third-party funds alongside its own eleven Pacific Horizon offerings. In fact, three quarters of the funds BofA sells are not its own, though its margins over time are better on its own brand. Chase Manhattan appears equally interested in protecting itself by protecting its customers. Says chief investment executive Leonard Spalding Jr., "We believe that in the long run clients will appreciate that we're not trying to stuff our own product down their throats." This from a bank whose Vista Growth & Income Fund has achieved a handsome 27 percent average annual return for the past five years, making it one of the best performers in its category.

Nonetheless, banks' avid pursuit of fund profits could ultimately create exactly the kind of problems that regulators fear most. Despite the banks' ostensible good intentions, isolated problems have surfaced as bank funds have moved into the mainstream. For instance, several banks have sought to capitalize on their identity as banks by giving their funds names similar to their own. That could engender not totally unintentional consumer confusion between FDIC-insured deposits and unguaranteed securities or mutual funds. For example, Banc One calls its funds Group One and NationsBank funds are dubbed NationsFunds.

Comptroller of the Currency Eugene Ludwig fired off tough new guidelines to banks last summer. Federally regulated national banks must refrain from offer-

cent proprietary bank funds. Having been unable to create income via proprietary funds, they are slapping loads on them and limiting the number of [outside] funds they make available." A few banks, he says, refuse to sell any funds but their own. Others have kicked out traditional fund families whose products have track records better than those of their own funds. Bank fund consumers increasingly can find themselves dealing with high-powered sales organizations.

The wisest, or at any rate the most prudent, route for many banks would be to leave the driving to third-party fund families, except where the banks have highly successful market niches. "It is an oxymoron to say that a regional or a local bank can sell sufficient funds to make [it] a viable presence," says a fund-business veteran. "T. Rowe Price, Fidelity, Put-

nam, Capital Research and the like have built a national trade with brand names known in every state. How can you take a bank with only so many states and make it a major player?" By selling third-party funds, banks can have the best of both worlds: providing the funds that consumers are clamoring for and collecting ready-made — albeit one-time — fees in their 68 to 72 percent take from front-end loads.

Once, insurers thought they, too, could clean up selling mutual funds. At the height of the 1960s, several tried to elbow their way into the booming funds business by launching proprietary funds. "It was not an immediate bonanza for all the players," a long-time fund-industry observer notes dryly. "They tried to make it in the business with in-house talent and weren't successful until they bought outside talent or other organizations." Those that have succeeded did so largely by acquisition. Marsh & McLennan Cos. bought Putnam; New England Mutual Life Insurance Co. bought Loomis, Sayles & Co., Capital Growth Management and Investment Trust of Boston; Sun Life Insurance Co. of America bought Mass Financial; Liberty bought SteinRoe. But many more companies, including the Travelers Corp., Cigna, Mutual of Omaha Insurance Co. and Trend America, eventually sold out or considerably lowered their expectations.

Many banks may have to do the same. ■

"The most prudent route would be to leave the driving to third-party fund families."

ing any investment products with names identical to their own, disclose clearly in all ads and sales literature that such products are not FDIC-insured and separate tellers from any bank staffers accepting investments. When the SEC recently caught the Bank of California overpricing some fallen bonds it held in one of its tax-exempt money market funds, it quickly issued a cease-and-desist order, and the bank responded with lightning speed. Although the breaches of the rules to date hardly seem like the precursors of widespread disaster, the implications are a tad worrisome: Where one bank's asset management arm fails to mark its securities to market, there are likely to be at least a few others.

Another alarming trend is surfacing. "Banks are beginning to put in quotas to see that their own funds grow and become profitable," says one fund executive. "I know of a dozen or so banks that require their fund brokers to sell 50 per-