CapVisor Associates, LLC

Research Report

The Cost of One-Stop Shopping: Making the Easy “Decision”

The Cost of One-Stop Shopping: Making the Easy “Decision”

Captive insurers frequently migrate growing cash balances into bank investment department fixed income or equity offerings, be they separately managed accounts (SMAs), mutual funds, or other vehicles. After all, the bank is an existing relationship and a trusted entity that presumably provides good service. For the captive’s Board, this makes the investment management decision simple and turnkey, consolidating reporting, accounting, and recordkeeping for the investment program.

However, what is the true cost of these de facto decisions made by the captive’s board? Have they executed their fiduciary responsibility prudently? Let’s examine the research.

Executive Summary: ***Convenience often carries a quiet price. Published research indicates that bank-affiliated investment platforms frequently experience performance differentials relative to independent managers due to structural conflicts and operational incentives. For a captive board, evaluating these turnkey solutions is a critical component of rigorous fiduciary governance.***

1. Summary of U.S.-Focused Academic Research

The strongest direct evidence comes from Hao and Yan (2012) in the *Journal of Financial and Quantitative Analysis*. Using a comprehensive sample of U.S. equity and hybrid mutual funds from 1992 to 2004, they find that investment-bank-affiliated funds significantly underperform unaffiliated funds. Depending on the risk-adjustment model, the average annualized risk-adjusted underperformance is **1.08% to 1.68%**. On a gross-of-fees basis, the gap is still **0.72%–1.44%** per year.[^1] In many cases, affiliated funds hold disproportionately large amounts of stock in their parent company’s IPO and SEO clients, and those client holdings themselves underperform. The authors attribute this to conflicts of interest in which the funds support the parent investment bank’s underwriting business at the expense of fund shareholders.[^1]

A major international study by Ferreira, Matos, and Pires (2018) in the *Journal of Finance*—which examined a worldwide sample showing roughly 92 basis points (bps) of underperformance for commercial bank-affiliated funds—explicitly analyzes the U.S. subsample.[^2] In U.S.-domiciled funds, the underperformance is less pronounced, and there is little or no relation between performance and measures of conflicts with the lending division. The authors attribute this to stricter enforcement of “Chinese walls” between lending and asset

management, as well as stronger investor-protection rules in the United States (a common-law country) compared with many other markets.[^2]

In short, U.S. evidence supports the underperformance of bank- or investment-bank-affiliated mutual funds relative to unaffiliated peers, though the magnitude appears smaller and less clearly driven by lending conflicts than in global samples. Most detailed U.S. empirical work focuses on equity and hybrid funds that predominantly hold domestic securities during the sample periods studied.

Executive Summary: ***When comparing bank-affiliated return patterns against top-quartile independent managers, the cumulative gap across market cycles becomes material. Captive portfolios benefit from a clear-eyed assessment of how median, bank-housed execution compares against specialized active management.***

2. Performance-Gap Estimates: U.S. Domestic Equity Context

Bank-Affiliated vs. Average Unaffiliated (U.S. Evidence)

- **Hao & Yan (2012):** ~1.08%–1.68% risk-adjusted (or ~0.72%–1.44% gross) annual underperformance for U.S. investment-bank-affiliated equity and hybrid funds.[^1]
- **Ferreira et al. (2018) U.S. Subsample:** Underperformance exists, though it is smaller and less consistent than the global 92 bps figure and is not strongly tied to lending-client overweighting.[^2]

A reasonable U.S.-centric range for bank- or investment-bank-affiliated versus average unaffiliated domestic-equity funds is therefore on the order of **~0.50%–1.50% per year**, with the higher end more characteristic of the investment-bank-affiliated sample in Hao & Yan.

Average Unaffiliated vs. Top-Quartile Managers

U.S. domestic equity active-manager universes show meaningful cross-sectional dispersion. Interquartile spreads (top-quartile minus bottom-quartile excess returns) are typically several percentage points annually (gross of fees) in large-cap and especially small-cap or specialized domestic strategies.[^3] Top-quartile managers have historically delivered positive excess returns relative to the median or benchmarks on the order of **1.00%–3.00%+ gross** across multi-year windows, though net-of-fee results, persistence, and statistical significance vary by period and risk model. Because the distribution of active skill is skewed, the top quartile sits meaningfully above the median.

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Combined Implication: U.S. Bank Groups vs. Top-Quartile Independent Managers

Adding the documented U.S. affiliation gap (~0.50%–1.50%) to the typical spread between median active managers and top-quartile peers produces an order-of-magnitude estimate that U.S. bank-affiliated groups, as a whole, can lag top-quartile independent domestic equity managers by **roughly 1.50%–3.00%+ per year** (risk-adjusted, before fees, taxes, and implementation differences) in many market cycles.

Methodological Note: This figure represents a synthesized estimate rather than a direct head-to-head study of bank trust composites versus top-quartile independents. Actual gaps depend on specific strategies, time periods, risk models, gross vs. net returns, account constraints, and whether the bank entity is a commercial bank trust department, an investment bank affiliate, or a hybrid. While U.S. regulatory walls appear to mute some conflict effects seen internationally, practical performance gaps remain material.

Executive Summary: ***Institutional banking structures create unique human capital dynamics. Because large banking organizations operate under distinct compensation and career frameworks, top-performing portfolio managers frequently migrate toward independent boutiques over time, influencing the long-term composition of bank trust portfolios.***

3. Implications for Fixed Income (Bond) & Active Portfolio Management

While there is no single large-scale published academic study cleanly measuring bank-affiliated U.S. Investment Grade (IG) bond underperformance against top-quartile eVestment/PSN peers, a combination of structural market mechanics and qualitative practitioner evidence supports a persistent performance gap:

1. **Dealer & Inventory Conflicts:** Bank-affiliated desks face inherent pressures or structural considerations regarding internal debt issuance, affiliated underwriting syndicates, or secondary-market dealer inventory positioning.
2. **Execution & Pricing Spreads:** Captive and bank trust accounts may occasionally experience wider bid-ask transaction spreads compared to specialized institutional managers executing across competitive multi-dealer electronic platforms.
3. **The "Star Manager Flight" Talent Dynamic:** *A qualitative perspective derived from over four decades of institutional observation—including 27 years working alongside top investment talent inside New York City money-center banks.* High-performing portfolio managers who generate stellar 3- to 5-year risk-adjusted track records within bank

platforms frequently encounter strong economic incentives to transition to independent firms or boutique asset managers where compensation aligns directly with alpha generation and equity ownership. Because large banking institutions often maintain corporate compensation structures and administrative constraints, bank investment platforms can experience ongoing talent rotation—leaving certain portfolios managed by benchmark-hugging generalists or early-stage personnel while senior talent establishes independent practices.

Combined Implication for a Typical Bank Platform

Relative to the top quartile of independent managers reporting to institutional databases such as eVestment or PSN (the visible, higher-performing cohort), a reasonable order-of-magnitude expectation of underperformance is approximately **30 to 100+ basis points (0.30%–1.00%+) per year** in fixed income strategies (and wider in equity offerings):

- **Lower end (30 bps):** Assumes disciplined execution, low turnover, and minimal inventory bias.
- **Higher end (100+ bps):** Assumes persistent inventory preference, talent rotation effects, wider execution spreads, and less competitive security selection. Net-of-fee gaps are typically similar or slightly wider depending on institutional fee schedules.

Executive Summary: ***The numbers provide a clear baseline for evaluation. For a $20 million captive, settling for relationship convenience instead of top-quartile independent management involves a measurable cumulative wealth drag over a standard five-year horizon.***

4. Graphical Illustration: The $1.15M+ Opportunity Cost for a $20M Captive

To illustrate the financial impact of these return differentials, consider a typical **$20,000,000 captive insurance portfolio** allocated **20% to domestic equities ($4,000,000)** and **80% to investment-grade fixed income ($16,000,000)** over a standard **5-year strategic horizon**.[^4]

Applying the midpoints of the performance-gap ranges established above:

- **Domestic Equity Gap Midpoint (1.50%–3.00%): 2.25% per year**
- **Fixed Income Gap Midpoint (0.30%–1.00%): 0.65% per year**
- **Portfolio Weighted Annual Opportunity Cost:** $(20\% \times 2.25\%) + (80\% \times 0.65\%) = 0.45\% + 0.52\% = \mathbf{0.97}\%$ per year

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5-Year Cumulative Wealth Differential Table

Horizon	Bank Platform Portfolio (4.00%/yr)	Top-Quartile Independent Portfolio (4.97%/yr)	Annual Spread Gain	Cumulative Opportunity Cost
Year 0	$20,000,000	$20,000,000	$0	**$0**
Year 1	$20,800,000	$20,994,000	$194,000	**$194,000**
Year 2	$21,632,000	$22,037,402	$211,402	**$405,402**
Year 3	$22,497,280	$23,132,661	$229,979	**$635,381**
Year 4	$23,397,171	$24,282,354	$249,802	**$885,183**
Year 5	**$24,333,058**	**$25,489,187**	**$270,946**	**$1,156,129**

Over a 5-year strategy cycle, compounding this **97 bps annual drag** results in a cumulative opportunity cost of **$1,156,129** (nearly **5.8% of initial principal**). For a captive insurer, this differential represents capital that could otherwise support risk reserves or corporate surplus requirements.

Executive Summary: ***Fiduciary governance requires active verification. Captive boards can move beyond default administrative convenience by requesting objective performance data, ensuring that relationship banking aligns fully with long-term stakeholder value.***

5. CapVisor Takeaway: Beyond "One-Stop Shop" Convenience

For a captive board, routing cash balances and fixed income portfolios to a relationship bank offers immediate administrative ease. Yet institutional reality demonstrates that turnkey convenience can involve a meaningful opportunity cost.

Bank asset management platforms often navigate structural headwinds, including talent retention dynamics and internal desk priorities. When high-performing portfolio managers transition to independent firms, bank trust departments may find themselves relying more heavily on benchmark-oriented generalists. Combined with execution spreads and administrative structures, the all-in performance drag can accumulate across fixed income and equity allocations.

The Fiduciary Imperative:

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Under the Prudent Expert standard, captive boards benefit from regularly reviewing whether relationship-based solutions are delivering competitive risk-adjusted returns relative to broader institutional alternatives.

How CapVisor Quantifies Your Opportunity Cost:

There is no substitute for empirical data. CapVisor can seamlessly ingest your bank's actual performance composites or representative account data into our institutional manager universe. This enables a rigorous, objective peer comparison against top-quartile independent managers—adjusting for duration, credit quality, and sector exposures—to reveal the exact opportunity cost of using your bank as a one-stop shop.

Footnotes, Sources & Modeling Assumptions

[^1]: **Hao, Q., & Yan, X. (2012).** "The Performance of Investment Bank-Affiliated Mutual Funds: Conflicts of Interest or Informational Advantage?" *Journal of Financial and Quantitative Analysis*, 47(3), 537–565. Based on a pure U.S. sample of domestic-focused equity and hybrid mutual funds (1992–2004), documenting 1.08%–1.68% annualized risk-adjusted underperformance and 0.72%–1.44% gross-of-fee underperformance. [^2]: **Ferreira, M. A., Matos, P., & Pires, P. (2018).** "Asset Management within Commercial Banking Groups: International Evidence." *Journal of Finance*, 73(5), 2181–2227. Documents ~92 bps global annualized underperformance for commercial bank-affiliated funds while noting a milder, statistically less consistent gap in the U.S. subsample due to stricter regulatory Chinese walls and common-law investor protections. [^3]: **Institutional Active Manager Dispersion Benchmarks:** Derived from multi-year cross-sectional interquartile return spreads observed across institutional U.S. domestic equity universes (e.g., eVestment and Informa PSN institutional databases), where top-quartile active managers typically outperform median peers by 1.00%–3.00%+ gross annually across rolling 3- to 5-year cycles. [^4]: **Simulation Modeling Assumptions:** (1) Initial portfolio value of $20,000,000 allocated 20% to U.S. domestic equities ($4,000,000) and 80% to U.S. investment-grade fixed income ($16,000,000), rebalanced annually; (2) Equity return gap set at 2.25%/yr (midpoint of the 1.50%–3.00% synthesized range); (3) Fixed income return gap set at 0.65%/yr (midpoint of the 30–100 bps range); (4) Weighted portfolio return differential equals $(0.20 \times 2.25\%) + (80\% \times 0.65\%) = 0.97\%$/yr; (5) Baseline bank portfolio nominal compound annual growth rate (CAGR) set at a conservative 4.00%/yr ($r_{\text{bank}} = 4.00\%$), yielding a top-quartile independent comparative CAGR of 4.97%/yr ($r_{\text{top}} = 4.97\%$); (6) Assumes annual compounding with zero interim cash inflows or outflows.

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Note that dollar opportunity cost varies slightly with the underlying nominal baseline rate due to compounding cross-terms, though the 97 bps annual return spread remains constant.