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PRESENTATION

Operator

Thank you for standing by, and welcome to the AB First Quarter 2017 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded and will be available for replay for 1 week.

I would now like to turn the conference over to the host of this call, the Director of Investor Relations for AB, Ms. Andrea Prochniak. Please go ahead.

Andrea L. Prochniak - *AllianceBernstein L.P. - SVP and Head of IR and Corporate Communications*

Thank you, Michelle. Hello, and welcome to our first quarter 2017 earnings review. This conference call is being webcast and accompanied by a slide presentation that's posted in the Investor Relations section of our website, www.abglobal.com.

Peter Kraus, our Chairman and CEO; John Weisenseel, our CFO; and Jim Gingrich, our COO, will present our financial results and take questions after our prepared remarks.

Some of the information we present today is forward-looking and subject to certain SEC rules and regulations regarding disclosure, so I'd like to point out the safe harbor language on Slide 1 of our presentation. You can also find our safe harbor language in the MD&A of our first quarter 2017 Form 10-Q which we filed this morning.

Under Regulation FD, management may only address questions of a material nature from the investment community in a public forum. So please ask all such questions during the call.

We're also live-tweeting today's earnings call. You can follow us on Twitter using our handle, @AB_insights.

Now I'll turn it over to Peter.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Thank you, Andrea, and good morning to everybody, and thanks for joining us today. Broader markets started the new year strong with a nice rally in equities and continued momentum in fixed income. But we're still dealing with secular and [cycular] issues that make growth difficult for active managers. I'll talk about these challenges today as well as what we're doing to position AB competitively in this environment.

Let's start with a firm overview, which is on Slide 3. Total gross sales for the quarter of $19 billion were up 23% from last year's first quarter, essentially flat with the fourth quarter of 2016. Net outflows of $200 million include a $2.8 billion [load] fee institutional investment-grade credit outflow and a $2.2 billion passive outflow across our channels. Excluding these outflows, net flows would have been a positive $4.8 billion. Period-end and average AUM were up versus both prior periods on strong market appreciation.

Our quarterly flow breakout by channel is shown on Slide 4.

Institutional gross sales of $2.5 billion were down sharply from last year's first and fourth quarters. We found that after rebalancing, following the election last November, our clients weren't as active in the first quarter of this year. Net outflows of $1.9 billion compared to net inflows of $1.8 billion in the 2 prior comparable periods. This channel is where we saw the biggest impact of the fixed income and passive outflows I just referred to.

In Retail, gross sales were our best since the second quarter of 2013, with $13.5 billion in total and positive net flows of $1.6 billion.

Asia ex-Japan fixed income sales were the largest driver of the sequential and year-over-year increases, though strength was broad-based across both regions and asset classes.

Private Wealth gross sales of $3 billion were down 6% year-over-year, but up 30% sequentially as clients became more active in the first quarter. Net inflows of $100 million were up $500 million in the fourth quarter of 2016.

Moving to Slide 5. Our long-term fixed income performance continues to be outstanding, with roughly 90% of assets in outperforming services over 3 and 5 years. Standout performers through the end of March include: Global Plus and TIPS Plus, top decile for the 1-, 3- and 5-year periods; Global Fixed Income, top decile for the 3- and 5-year; Global High Income, top decile for the 1-, top quartile for the 3- and 5-year. And on the Retail side; AB Income, the closed-end fund we converted to open-end last April to compete in the intermediate bond category, has performed at the top of the top decile across every major time period.

Slide 6 shows how our equity long-term track records continue to improve. Our percentage of outperforming active equity assets for the 1-year period improved to 42%, and that's through March; and at 83% and 65% of assets for 3- and 5-year track records, and those were improving as well.

Our Strategic Core strategies lagged the market increases during the most recent 12-month period, but they maintained top-decile 3- and 5-year track records. The same is true of U.S. Large Cap Growth, one of our top sellers in Retail during the quarter. And our Concentrated Growth strategies ranked in the top quartile for the 1-, 3- and 5-year. Strong relative performance like this positions us well to capture more flows.

Now let's talk about our client channels, beginning with Institutional on Slide 7. Two anomalies drove the first quarter's weak flow picture: historically low sales and the lumpy outflow I mentioned earlier. That said, our pipeline trends are more encouraging. The top left chart shows that not only did our pipeline of active services increase by $500 million sequentially, our average fee rate increased as well. That's because we added higher fee commitments in the first quarter, including $380 million to our Commercial Real Estate Debt fund and $200 million in customized multi-asset.

Growing momentum in consultant advocacy, particularly for our newer services, has also been a big help. So far this year, one major global consultant has upgraded our Global Concentrated and Global Core Equity strategies to their highest rating.

Our Emerging Market Strategic Core Equity service, which ranked third percentile for the 3-year period through March, is getting closer scrutiny. And our new AB Custom Alternative Strategies, or CAS team, has been very well received.

Combination of strong performance and greater consultant support is contributing to the diversity of our pipeline as well. As you can see from the bottom left pies, our pipeline split by both assets and regions is much more equitable today than it's been in the past, when fixed income mandates from U.S. institutional clients typically represented the larger share.

Moving on to Retail on Slide 8. I'm very pleased with the momentum in this business which continues today. Not only were our total first quarter Retail gross sales of $13.5 billion our highest since the second quarter of 2013, our strength spanned asset classes and regions, with industry-wide gross sales of Global High Yield bond funds in Asia ex-Japan up again during the quarter. That region was AB's largest Retail growth driver.

We were very pleased with our first quarter U.S. Retail sales as well. Gross sales of $4.4 billion were up 22% sequentially and 10% year-on-year, and our highest since the first quarter of 2008. That's the chart at the top left.

We've focused for years on rebuilding our presence and regaining relevance with retail clients and are finally where we need to be with the breadth and performance of our offerings. Today, we have 57 Morningstar 4- and 5-star rated U.S. and Lux funds, nearly twice the number we had back in our pre-crisis heyday. And 78% of our total rated assets are in 4- and 5-star funds today. That's the chart at the bottom left. Our strategy is to parlay these strong track records into higher active mutual fund sales with the innovative new series of performance fee-based funds we just introduced in March.

As I've been saying for a long time, active managers need to level the playing field on fees and be more accountable for our performance if we're going to compete with ETFs. Our new series charges ETF-like management fees and a performance fee only if the fund surpasses benchmarks. If we can succeed with this new structure, and a big if, since it's early in the game, we think we can improve our competitive positioning and ultimately set a new industry pricing standard for active managers. We'll keep you posted on our progress.

Now let's go to Private Wealth, which is on Slide 9. I mentioned our double-digit sequential sales growth in the quarter and net inflows of $100 million. Our underlying flow picture was in fact better. We had 2 large outflows totaling $230 million that were not performance-related.

Targeted Services continue to be the momentum story for us. As you can see from the pies at the top left, we now offer 10 different services with total commitments of $4.7 billion. And client interest in these research-driven vehicles is only growing. New Targeted Service commitments in the quarter were $560 million, double that of last year's first quarter. That's a record for us in the quarter that did not include a new product launch, and our second-highest quarter ever.

Targeted Services accounts grow and onboard faster and tend to have significantly higher retention rates than accounts that do not include them. For example, Global Research Insights, a new concentrated equity service that's just about to hit its 1-year mark, has already attracted $560 million in commitments. Performance so far is more than 800 basis points above its bench.

Similar strong performance in our more seasoned Targeted Services is keeping clients in well past the lockup periods. That's not to say we're any less committed to the Bernstein core solution. Now more than ever, private clients need institutional-like investment management and risk controls.

Our model combines a core customized allocation by client, satellite services selected to augment return, income, diversification or a combination of the 3, and a dynamic asset allocation process designed to reduce portfolio volatility. It's an effective approach, particularly in less predictable markets. And because we manage these assets directly for clients, we can execute our investment strategies with a level of tax efficiency that others simply don't have. Private Wealth Management is an important business for us, and we are very well positioned today.

I'll wrap up our businesses with the sell-side on Slide 10. Both U.S. trading volumes and volatility declined markedly from the elevated levels we experienced in the fourth quarter, and our revenues declined as a result. What's more, industry-wide trading volumes continued to decline in both Asia and Europe, where revenues were pressured by the translation effect of a strong dollar as well. That's the top right chart.

We're seeing some clients beginning to allocate assets to Europe from the U.S, where valuations are high, though most remain on the sidelines in Asia. In the U.S., despite the low activity levels of both long-only and hedge fund managers, we continue to maintain a strong competitive position.

U.S. market share is volatile from month-to-month and the data's lagged, but you can see from the chart at the bottom left that Bernstein's share of U.S. volumes has been trending positively for the past 4 years.

So while the sell side continues to face unprecedented challenges and change, we feel we have certain advantages in navigating the uncertainty ahead. First and foremost, we have a differentiated research offering that clients value. This is particularly critical as we engage with them on the implementation of MiFID II in the U.K. and in Europe. We also have best-in-class trading capabilities and a unique ability to leverage our research insights on the desk. And we've expanded our trading operations to Zurich, Frankfurt and Scandinavia to make our full suite of execution services available in local markets. For these reasons, we're encouraged that as the new regulatory framework evolves, clients will continue to choose Bernstein.

Finally, I'll recap some of our recent strides in dealing with the current environment on Slide 11. We're delivering for clients with our investment performance in most of our fixed income and equity services, which is helping to drive flows to high-growth areas. We keep broadening our presence with new products and services across our client channels and around the world. We innovated for our clients during the quarter with our new U.S. Retail performance fee mutual fund series. And we employed continued expense discipline to increase our adjusted operating income, margin and EPU and produced a 55% incremental margin.

Looking forward, we don't know how the operating environment will evolve from here. Looking back, I'm proud of how we've managed our business and our financials so far in 2017.

Now I'll turn it over to John.

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO and SVP*

Thank you, Peter. Let's start with the GAAP income statement on Slide 13. First quarter GAAP net revenues of $765 million decreased 1% from the prior year period. Operating income of $166 million decreased 4%. And the 19.6% operating margin was 360 basis points lower.

GAAP EPU of $0.46 compares to $0.55 in the first quarter of 2016. Included in last year's $0.55 was a $0.16 net nonrecurring benefit resulting from the combination of a $75 million gain realized on the liquidation of our investment in Jasper Wireless Technologies and a $28 million noncash real estate charge relating to further consolidation of our New York office space.

As always, I'll focus our remarks from here on our adjusted results, which remove the effect of certain items that are not considered part of our core operating business. We base our distribution to unitholders upon our adjusted results, which we provide in addition to, and not as substitutes for, our GAAP results. Our standing GAAP reporting and a reconciliation of GAAP to adjusted results are in our presentation's appendix, press release and 10-Q.

Our adjusted financial results are on Slide 14. Compared to the same prior year period, first quarter revenues of $624 million increased 6%. Operating income of $151 million increased 14% and our margin of 24.1% increased 170 basis points. We earned or will distribute to our unitholders $0.46, up 18% versus the $0.39 for last year's first quarter. Higher base fees combined with flat non-compensation expenses primarily drove the improvement.

Revenues, operating income and margin all decreased from the fourth quarter of 2016 due to lower performance fees and Bernstein Research Services revenues and the usual first quarter sequential increase in our compensation accrual. We delve into these items in more detail on our adjusted income statement on Slide 15.

Beginning with revenues. First quarter net revenues of $624 million increased 6% year-on-year. The 9% increase in first quarter base fees compared to the same prior year period is primarily due to the higher average AUM across all 3 distribution channels, and to a lesser extent, higher fee rate realization, reflecting a mix shift from lower to higher fee products.

First quarter performance fees of $6 million compared to $1 million in the same prior year period had resulted from higher performance fees earned on our Select Equity Long/Short, CLO High Yield Bank Loans, Global Plus Fixed Income and Middle Market Lending strategies.

First quarter revenues for Bernstein Research Services decreased 10% year-on-year due primarily to lower client trading activity in the U.S. A stronger U.S. dollar contributed to our decline in European revenues. Investment gains increased year-on-year due to higher seed investment gains.

Moving to adjusted expenses. All in, our total first quarter operating expenses of $473 million increased 3% year-on-year. Total compensation and benefits expense increased 5% year-on-year with higher incentive compensation partially offset by lower base compensation.

Compensation was 50% of adjusted net revenues for the first quarter both this year and last year and compares to 44.6% for last year's fourth quarter.

Promotion and servicing expenses declined 11% year-on-year as a result of lower marketing, trade execution and transfer fees.

G&A expenses increased 3% year-on-year due to higher professional fees and foreign exchange losses versus gains in the prior period.

First quarter operating income of $151 million increased 14% from the prior year period as revenue growth outpaced expense growth. The first quarter incremental margin versus the prior year period was approximately 55%, reflecting our continued diligent expense management.

First quarter operating income of 24 -- operating margin of 24.1% increased 170 basis points year-on-year. On a sequential basis, 540 of the 750 basis point decline is due to the higher comp ratio.

You may have noticed that our first quarter adjusted operating income was $15 million lower than our GAAP operating income. The difference is primarily due to the consolidation of certain seed investment funds for GAAP reporting which increases operating income but has no effect on net income or EPU. Therefore, we deconsolidated the seed investment funds for our adjusted reporting, resulting in the lower adjusted operating income. All of the non-GAAP adjustments are outlined in the appendix of this presentation.

Finally, the first quarter effective tax rate for AllianceBernstein L.P. was 6% versus approximately 7% for the first quarter of 2016 and was lower than expected due to a favorable mix of pre-tax earnings from lower versus higher tax jurisdictions.

Going forward, we expect the effective tax rate to remain below 7%, based upon our current estimates of the percentage of pretax income we expect to derive from foreign jurisdictions and applicable foreign tax credits. We highlight these points and offer sequential quarter comparisons on the next slide of this presentation as well.

And with that, Peter, Jim and I are pleased to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Michael Carrier from Bank of America.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Maybe, Peter, first question. Just on the performance fee series funds, just wanted to get a sense, some of the feedback that you're getting and mostly on the distribution side in terms of the distribution channels, just given the new pricing structure and some of the competitive new aspects relative to you in the past.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Thanks, Mike. The -- first of all, we're engaged with a pretty significant number of distributors about how this should be described to their clients and what their interest is in actually distributing it to their clients in various different parts of their channel. I would characterize our engagement with our distributors as beyond a high level. Very different than any other product we've ever rolled out. Extensive discussion with both research, management and at the FA level. And we are, I think, approaching clearing all the blue sky hurdles. And within the next -- I would -- I'm making it a little longer just to be conservative, 60 days-or-so, my guess is that we'll actually be able to start to sell. So if you judge the reactions by the engagement level, you'd have to be positively inclined.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Okay. And just as a follow-up on maybe the, Bernstein, like, the Research Services. I guess 2 questions on that. One is, just given MiFID II coming online as we get into '18, just wanted to get your sense on how AB is looking at it in terms of the impact to, say, Europe versus outside of Europe. And then just given the weaker kind of trading environment that we've been in, just wanted to get a sense on how maybe the expenses working that business maybe relative to the buy side part of the business. Meaning when we see the lower revenues, do you have much lever on the expense side? Or will we see more margin pressure?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So I'll answer the second first. The expenses in the sell side business are quite variable. Of course, there are fixed expenses in every business, but compensation makes up a very large percentage of those expenses. And you also have brokerage and clearing costs, which you may note in the P&L, promotion and servicing's a little soft. That reflects the decline in activity. So if you were looking at the Bernstein P&L, I'd probably say that the amount of expenses that are variable in it versus the firm are actually larger. And so you have lot of flexibility in that P&L and therefore less margin compression possibilities in a decline. Look, that works in both directions, by the way. When revenues go up, there is less margin expansion. So you have a business that has actually pretty stable margins in lots of different conditions and a lot of variability in its expense. As it relates to MiFID II, we tried to give you a little bit of a preview of that in the comments. We're having very positive discussions with our clients in Europe. We feel good about where our competitive positioning is in Europe. I would say the MiFID II discussions outside of Europe, primarily in the United States, are limited. And we'll wait to see if that adjusts or changes. But for the present time, we're optimistic about our positioning in Europe and our competitive reality with regards to the legal changes that will become effective in January.

Operator

Your next question comes from William Katz from Citigroup.

William R Katz - *Citigroup Inc, Research Division - MD*

Just coming back to the new mutual funds that you had talked about. Within the feedback you're getting from the distribution partners, could you talk a little bit about specifically what attributes of the product they like? And then if you're getting a sense of where they may fund any allocation that could come from. Are there -- is this less passive coming into this book? Or would it be from other active?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So I think what excites most people when they see this revenue structure is 2 things. One, you adjust the paradigm from paying managers whether they perform or not to paying managers when they perform. And when they don't, the fee is ETF-like. That, I think, appeals to everybody from the perspective of putting the client first. And it also appeals to those from a fiduciary point of view. Not to say that fixed fees are not appropriate in a fiduciary sense, but it has a higher degree of sensitivity to what makes sense for the client. I think secondly, on sort of more nuanced level, I think the people like the fact that now managers are more highly incentivized to actually perform rather than just gather assets. Because if you just gathered assets and did not perform, the low base fee would not provide much compensation. And so you've really changed the relationship between the client and the investor in a way that is quite friendly to the client and puts a lot more pressure on having to perform. As it relates to where distributors think this will be funded, I think that's a little bit fuzzy. I'm not sure that people think it will come from one versus the other. I think it might come from both. I think it's probably too early for us to conclude on that one.

William R Katz - *Citigroup Inc, Research Division - MD*

Okay, and then my follow-up -- and I apologize, I did join the call a couple of minutes ago, it was a busy morning today. I noticed on the Institutional pipeline, that's there, but you mentioned that gross sales were less than half of 2016 quarterly average. Just a talk a little bit about was it just timing? What may have led to the softness on the gross sales for the quarter?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Well, we can't speak for everyone in the industry. But as it related to our experiences, there just wasn't any activity. I don't think that we really believe that, that's structural. I don't think that we think that, that's going to be pervasive. But in the first quarter of this year, activity level was just quite low. Now look, we know we're in a structural trend where institutions are allocating less capital over time. DB plans are shrinking, all that happening. So there's nothing new in that. But as it relates to this first quarter, I think all we can conclude is, for us, that the activity level for clients and organizations we talked to, which is most of the industry, was just very low.

Operator

Your next question comes from Surinder Thind from Jefferies.

Surinder Singh Thind - *Jefferies LLC, Research Division - Equity Analyst*

I'd like to start with a big picture question and just kind of the relative strength that we've kind of seen, I would say, industry-wide in fixed income kind of here in the U.S., even in kind of in this reflationary environment trade. With the Fed hiking a couple of times, I would have thought that the industry flows would have been at least a little bit weaker earlier in this part of the cycle, but they've actually held up really quite well. Or actually, they've been doing quite well. Any insights or things that you are seeing? Are we kind of already late in that rate hike cycle in the sense that it's been such a protracted period to kind of getting here, that we're kind of back to where maybe we should be in terms of more normalized flows for fixed income?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Well, I think, Surinder, it's a good question. I think you'll recall that we've said a couple of times, because we've been asked this a number of times, what is the impact of rising rates in a fixed income environment? And I think we've said that it does, one, depend on the speed at which rates rise. And if rates rise modestly as opposed to quickly, it has a different short-term effect. But it's not a bad thing when rates are rising. Firstly, yields are going up, and investors want yield. So that isn't necessarily a bad thing for fixed income, and I think we're seeing that. That was our expectation and that has been exactly what has played out. Now I think it has been somewhat more positive because the rate rises have been telegraphed, clear and slow. And I think that has -- that moderation has helped people stay in the fixed income instruments because the capital depreciation coming from fast rate rises is modest. So I think until investors feel that they have enough yield and they don't have to allocate that much in assets to get the income that they want, and that would be at yield levels that are much higher than where we are today, I think fixed income and yield-bearing securities are going to be in high demand. And that, I think, is the environment we're in.

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO and SVP*

The other 2 things I would add to are, look, equity markets have come a long way. People do need to rebalance to keep strategic allocations, which is going to tend to result in positive flows into fixed income, given what's happened to equity markets. I think our conversations with a number of our intermediaries make them somewhat cautious about equity valuations in the U.S. as well. So there is some hesitancy to be overexposed. And then lastly, the secular need for income is not going away.

Surinder Singh Thind - *Jefferies LLC, Research Division - Equity Analyst*

Understood. And then as a follow-up question, just on the performance fee products, obviously a very interesting proposition or value proposition to the investor. So when you guys were thinking about the various features of the product in terms of -- any color around how you guys determined maybe the range of the performance fees or maybe the reset time period? How those tradeoffs are? Or if maybe when you were thinking about it, is the expectation that most of the time, you'll earn kind of the base fee without the adjustments? Or how were you guys thinking about that?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Good question, Surinder. Number one, we wanted to be able to say to clients, "If we do not perform, you do not have to pay us for more than what you pay for beta." That was the key and most important assumption because that set how you would have to think about the fulcrum structure. So if you were -- if you believed that, that was the right philosophy for both the client and the investor, then the performance fee and the steepness of that fee will be driven by the fact that you are starting at 0 performance at 5 basis points. The rest of the structure's sort of self-defined because the fulcrum structure requires that you have as much upside as you have downside. And so we set, then, the fulcrum point, if you will, at what we thought was a reasonable expectation for performance for each of those products on a gross fee basis. So if a manager performed at the expected level, at their expected level, then they would get the expected fee, which was pretty close to where are in the market today. If they outperform, they did better. Underperformed, obviously. So that was our thinking. And in addition to that, we said we don't want to make this overly complex. We want people to be able to understand what the fees are at a moment's glance. Therefore, we said we want to set the fee every day, we want it to be clear every day and we don't want to use more than a 1-year calculation because that would make it simplest and it would reduce the amount of confusion over what year's performance am I paying for? In addition to that, once you make that decision, you then decide you need to reset it annually because, obviously, you're doing it on a 1-year basis. Again, simple, straightforward, clear.

Surinder Singh Thind - *Jefferies LLC, Research Division - Equity Analyst*

Got it. That's helpful. And then in terms of assuming that the product is successful, obviously, would the idea be to kind of -- is this basically what you guys, I think, believe to be kind of the magic bullet that might solve the active-passive problem at this point in the sense that if you could reset all of the fee structures just by the wave of the magic wand, do you think at this point in time, I know it's very early, but this is what you'd do with all the products? Or would -- or could this structure basically fit most of the products that you offer at this point?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So there is no magic bullet. I'm sure of that. I do think that this fee structure, if it becomes successful, will inform how most managers approach the market. And this is a flexible structure. People could look at this differently and have looked at it differently in the past. And as I've said numerous times, from a business point of view -- forget the client or the portfolio manager for a minute, but from a business point of view, an economic P&L point of view, is it better to be paid the same amount of money every day no matter what happens? Of course. Of course that's better. But if that's shrinking at 6% a year, it's not so much better. And so we view this as a revenue model that's more responsive to the client's needs, more appropriate in terms of what active managers really say their value proposition is. And therefore, if it grows at 6% a year, it's going to be a pretty attractive revenue model. And so I think if it turns out that this is successful and in fact it does grow, I suspect it'll be much more pervasive in not just AB's P&L, but in most managers' P&L.

Surinder Singh Thind - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And then one really quick, just a...

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Surinder, I just -- so let me just -- I'm sorry to interrupt. Just want to say one more thing. Two things you have to think about it in this model that is different than most performance fee structures that you see. The performance fee is not calculated on the beta, so it's not like a private equity type structure where you're calculating performance fees on your total return, including the beta. Quite volatile. Your mark it to market, it goes up and down. Here, it's calculated only on the alpha. Different value proposition. Secondly, it's an annual cap recalculation. Third, if you set this across a large number of products, some of which will perform and some of which won't in which is there is actual diversification, the volatility of this is far less than you might think just looking at 1 product and 1 performance fee. And I think that's the key point as you think about how does this model -- what's this model look like if it were to grow over time and be fully fleshed out.

Surinder Singh Thind - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And not to take up too much more of your time, but just one really quick question about the 2 loss mandates. They were $2.8 billion and $2.2 billion, was that right?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Yes.

Operator

Your next question comes from Alex Blostein from Goldman Sachs.

Alexander Blostein - *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*

Peter, wanted to go back to the MiFID II question for a second. You guys addressed how you're thinking about it from the sell-side perspective, but I wanted to hit for a second on how this may impact the asset manager, given kind of your global footprint, and I guess just as we're thinking about 2018, any implications for the operating margins would be -- we should be cognizant of when it comes to MiFID II in terms of whether you guys will be paying on the NAV, whether you'll be paying on the P&L. Any sort of updated thoughts about -- thoughts on that would be helpful.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Yes. So I think MiFID II is, from our perspective, not looking to have much of a impact on us on the buy side. There is, of course, the question that some clients might ask about, "Well, are you paying for your own research. Are you paying directly for research out of your GP or not?" We are not. We don't believe that, that is actually a sensible question in the -- from the perspective that we make a product as an active manager, we use research, we believe that's part of the process. And so you sort of can't pick out, well, let's not pay for that part of the process versus another part of the process. If there's a question about the overall fees that clients are paying, that's of course a discussion we have with clients all the time. But it doesn't make any sense to us to say, well, this one part of the ingredients that you put into your product, I don't like that ingredient, so I don't want to pay for that ingredient. That doesn't seem to make any sense. And I have found that view to be pervasive amongst both the industry and in many clients who also, sometimes, if they're managing their own money or using their transaction flow to purchase research as well and wouldn't separate that out.

Operator

Your next question comes from Craig Siegenthaler from Crédit Suisse.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

I just had 2 follow-ups on the performance fee series. Number one, how does the fund work in a retail fee-based account where there's a distribution shelf fee? And I'm just thinking of the scenario where there's underperformance and there's a little economics to be spread between the distributor and base comp in the investment team. And then point two, can competitors launch its products with this -- a product with the same structure? Or do they need to license it from you guys?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So number one, if you are a manager selection business and you have a flat fee, let's just say 150 basis points, and you go out and acquire -- put managers on your platform. One is, you have a conflict. I mean, the conflict is you get paid 150 basis points and you're trying to find managers who will cost you the least so that you can keep as much of the profit as it reasonable for yourself. So when you look at this product, it is actually more complicated for you because the fee is variable. And you might actually say, "I don't want to put this product in that structure because that fee is variable and that creates variability around my income," i.e. the difference between what you pay the manager and the fee, the total fee. And I have said to distributors, "Look, there's a big opportunity here for you to actually change your model because you can now actually get away from that conflict and say I charge x for the advice and the manager selection and the capital allocation, and the managers over here pay -- you pay directly. And it's performance-based, 5 basis plus performance." Some manager selectors actually do use performance fees. I think the most -- I think the largest one in the market is Vanguard. And they -- and I think Fidelity does, too. And I think they've effectively done that. They accept that risk, that variability risk in their products. But I do think that this pushes on that form of manager selection process. And I frankly think it would be much better for the industry and the client if we unbundle or separate that, you remove the conflict, you pay for advice for one thing and you pay the managers for the other. And that's very clean, transparent, and from a fiduciary point of view, I think easier to understand. Your second question was?

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

Can competitors launch this? Or they need to license it from AB?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Yes. Yes. We did not -- we are not in the vein of trying to make money on our idea. We want the industry to adopt it. It's free. As they say, "Come on in, the water's fine." Anyone's free to file whatever prospectus they want with the SEC and replicate the service. Look, what we've said at the outset is we think the industry needs to change, think the revenue model needs to change. We're just voting with our feet.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

And Peter, on the concentrated equity funds, can you talk about how you manage capacity and liquidity in these higher active share sleeves? And I'm especially looking at Large Cap Growth just because it's ramped pretty quickly here.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So we have capacity limits for all of our services and we enforce them. And I think it's not more complicated than that, unless I'm missing the question.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

Is Large Cap Growth close to a capacity constraint?

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

No, Large Cap Growth has room.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

I meant the concentrated version.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

Concentrated version has room, too. And extremely good performance for both of them.

Operator

(Operator Instructions) Your next question comes from Robert Lee from KBW.

Robert Lee - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Most of my questions were asked, but I did have a follow-up on the -- could you talk a little bit about your SMA business? I mean, obviously that's one place in U.S. Retail where for a long time now that there's generally been, I guess, seen a somewhat better demand given the fee-based nature of it for distributors. So can you talk a little bit about your positioning there? How you would kind of size that book? If you feel like you have the right product offerings there? And your willingness or interest in kind of the whole model portfolio part of that business.

Peter Steven Kraus - *AllianceBernstein Holding L.P. - Chairman of Alliancebernstein Corporation and CEO*

So our key product in that space has been the Muni product, the nontaxable product. That has been a big success, continues to grow on many platforms, all Muni SMA trying to resolve the issues that financial advisers have of holding individual bonds under their current regulatory environment. And so that's, one, been an innovation; two, been successful; and three, continues to grow. And so we clearly embraced that part of the market. We're thinking about how we do that in the taxable space. And we've also been thinking about other ideas in equities space in the SMA market. But the SMA market has its limits, too, and the distributors like it, but they've got a much bigger non-SMA market that we continue to think we can grow in.

Operator

I have no further questions. Thank you. I turn the call back over to the presenters for closing remarks.

Andrea L. Prochniak - *AllianceBernstein L.P. - SVP and Head of IR and Corporate Communications*

Thanks very much for joining us today, everyone. I know it is a busy day, but our IR team here is to help you with any follow-up questions you may have. Thank you.

Operator

Thank you, everyone. This concludes today's conference call. You may now disconnect.