



## Multi-Discipline Accounts: Changing Focus to a Unified Delivery Platform

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## Overcoming Legacy Infrastructure and Implementing Multi-Discipline Accounts

In various venues—wirehouse sponsoring platforms, trust companies, independent sponsoring platforms, and money management firms—the Market Street Advisors Team has been studying multi-discipline accounts as a product for over a decade. Our essential thesis is that the industry should change its orientation from a product focus to a unified delivery platform which supports a variety of investment advisory products and services.

### Broad Product Description

The investment advice industry is in some general agreement about a better way that a combination of separate accounts with other investment products and services should be delivered to investors. However, there is virtually no commonality in terms and descriptions. Regardless of what the service is called: Multiple Style Portfolios, Multi-Discipline Accounts, Unified Managed Accounts, Multi-Sleeve Unified Managed Accounts, Unified Households, etc., the desired result is generally hoped to contain some or all of the following characteristics:

- Single Custody Account which supports ease of account paperwork and reporting.
- Sub-Accounting sleeves within the custody account.
- Ability to process various investment products and services in addition to traditional separate accounts:
  - ETF's
  - Mutual Funds
  - Margin positions
  - Derivatives
  - Securities held “beneath the line.”
- Ability to provide performance reporting at the security, economic sector, relationship and household level.
- Ability to facilitate either a passive or an active overlay function
  - Ability to apply client-directed and portfolio based restrictions across all sleeves
  - Ability to automatically rebalance across all sleeves.
  - Ability to tax “optimize” at both the sleeve and relationship levels.
  - Ability to intensify or minimize industry or economic sector bets at the sleeve level.
- Ability to aggregate client data from disparate custody systems and report on it.

### Fragmented Product Approach

Historically, the industry builds isolated delivery platforms that are product-centric. Often, the order of product delivery is this: first, the market is identified, second, the product is designed (often in a vacuum with heavy input from sales), and finally, systems and operations are consulted. This process can easily lead to a very sorry state of affairs. For example, mutual fund wrap platforms appeal to investors with roughly \$300,000 or less to invest. These platforms usually run separately from a traditional Separately Managed Account (SMA) platform that appeals to mass affluent investors with \$1,000,000 to \$5,000,000 to invest. This creates a lot of duplication of effort with attendant inefficiency. It is Market Street's position that the order of the product delivery steps should be greatly modified to become an iterative, consultative process involving all the interested parties.

### Legacy Infrastructure

We can cut to the chase by simply agreeing that the current product delivery platform in the industry is widely fragmented. Consequently, the investment advisory divisions at some firms have embedded within them widely disparate cultures, notions of best practices, technologies, operations, sales forces, etc. Couple these instances with an entrenched IT staff, and this is what is commonly known as a *legacy system*, but the problem is actually *legacy infrastructure*. It is superficial to blame product development problems solely on existing technology. Legacy infrastructure is much, much more than technology, and this is a major problem. Add in a

merger or two, and the situation approaches chaos. This is not an efficient way to deliver investment advisory services. Over time, pricing pressure, let alone client interests, will not allow this level of fragmentation. The owner of an Investment Advisory Platform can only ignore this reality at his or her peril. Some say that distribution in the separate account business is king, and distribution will always be important. However, distribution aside, the firms most likely to win the *product* race are those that are least beholden to legacy infrastructure. Consequently, the ranking of the potential beneficiaries are the inverse of what you would normally expect: consumer banks, family offices, private banks, independent sponsoring firms and wirehouses.

### The Market Demands a Unified Platform Not a Unified Product:

Market Street Advisors has consistently maintained that any investment advisory system must have the ability to accommodate the *complexity* of the institutional business, the *customization* required by the private wealth/high net worth business, and the *scalability* required by the wrap business.<sup>1</sup> Similarly, it is our persisting vision that the investment advisory platform must have the ability to support services that range from the needs of a consumer with \$50,000 invested in an ETF portfolio, the private wealth manager focusing on tax management, and the most sophisticated institutional investor. This is immediately feasible and can be efficiently delivered with current technology, but is a long way from universal adoption—primarily because of legacy architecture.

### Platform Structure:

- Completion Account: The functionality mentioned earlier is desirable, if not necessary, to offering a robust investment advisory platform. However, we would add an additional accounting sleeve. We call this the completion sleeve. This sleeve would handle all cashing transactions. Also in this sleeve would be held the non-managed securities such as mutual funds and securities held “beneath the line.” This sleeve could also be a “margin” account and would hold derivatives that could be used to hedge the entire relationship.
- Overlay Management: Overlay management can take two paths—Passive and Active.
  - Passive: In the passive approach, tax sensitivity and rebalancing operations are a function of rules or “optimizations” written into the platform which are either applied automatically or made readily available under certain constraints, optimizations, rules, filters, etc.
  - Active: In the active approach, the automatic passive components can still be deployed, but overlay managers can take a much more aggressive role in the management of the investor’s holdings. For example, they could focus on true tax optimization based on individual client needs. They could hedge the entire relationship based on market conditions. They could much more finely tune the risk/reward relationship allowed by the client profile.
- Common platform for all services:
 

Although it is unlikely that a \$100,000 IRA rollover invested in ETF’s will require a hedging strategy, there is nothing to prevent the platform that provides an ETF service to also be able to support much more sophisticated relationships. This can be accomplished by an extensive role-based security technology that can easily block certain kinds of transactions from different kinds of relationships. Such rule-governed functionality could easily be controlled by the platform administrator. We envision that the total dollars to be invested would lock-in a certain product or service level that would affect the entire process—starting with the questionnaire, continuing through the range of products and services made available, and ending with the final proposal and subsequent implementation. However, the core operating platform would be the same for all products—although the look and feel of the presentation level to the different markets might be greatly differentiated.
- Models versus individually managed accounts:
 

Currently, the model based approach seems to be winning the “product” race. However, Market Street Advisors strongly believes that the platform should be agnostic as to whether the different investment sleeves are deployed by models that are driven by an active overlay manager or are individually managed by the investment manager. In any case, the platform should be able to support either approach.

### System Requirements:

- **Accounting Engine:**  
The system has to have the ability to account for a wide range of securities and conditions to include: ordinaries, derivatives, sophisticated fixed income vehicles and margin accounts.
- **Sub-Accounting Sleeves:**  
The system has to have a core accounting engine that is able to recognize multiple sub-accounts within one custody account. Without this basic functionality, the unified platform cannot run efficiently and will require major human intervention at almost any level of deployment. The efficient handling of sub-accounting sleeves is imperative to the efficient operation of the platform.
- **Open Relational Data Base:**  
Unless the platform's components are closely integrated and operating on one open, relational database, the ease of extracting information about the facts and transactions of the investment relationship will be significantly challenged. Data transparency becomes problematic.
- **Order Management System:**  
The order management system supporting this platform requires a level of sophistication to match that of the accounting engine. It has to be able to apply both client and portfolio based restrictions as well as handle automatic rebalance commands at both the sleeve and the household level.
- **Performance Measurement system:**  
Similar to the accounting requirements, the system has to be able to report performance on a variety of investment vehicles. Most importantly, it must be able to provide these reports at the sleeve, relationship and household level.
- **Flexibility:**  
Often, investment products are constructed and delivered in a vacuum. The old saw in the investment securities industry is that "stocks are sold not bought." However, you can only sell an investment service up to a certain point, but ultimately, the client will *buy* the service he or she prefers. Consequently, the very real possibility of being required to retrofit a product offering on the fly must be addressed by a system that is easily modified.
- **Knowledgeable Team:**  
Most importantly, a platform of this type must be built and maintained by a team of industry professionals who are knowledgeable in all aspects of delivering investment services. The team requires broad product and service expertise, knowledge of the required business applications as well as deep technological and operational experience. Without the right team, you will not be able to accurately size the project, deliver it in the projected time-frame and economically service it into the future.

### Summary:

The industry has been collectively groping toward a Unified Managed Account Platform for well over a decade. The impediments to its delivery have been and continue to be great. Current technology makes the delivery of the platform immediately available, but there are still many impediments to a successful implementation. However, the impediments are not technological in nature. Parochial inter-departmental interests are not trivial, of course, but legacy infrastructure is probably the biggest hurdle. The Unified Platform will not be attainable until an industry executive with the power, resources and vision is able to take control of the process and drive it to delivery.

<sup>1</sup>3/1/2004, *Senior Consultant*, "Not a Crisis but a Crossroad: defining the challenge in processing separate accounts," Part I of III, by Bevin Crodian