

Industry Insight

Omgeo OASYS for Retail Separately Managed Accounts (SMA)

BY: Andrew Clipper, Thomas Cottone, Patricia Sibilía, Citigroup Corporate and Investment Banking;

Kevin Arthur and Kevin Caulfield, Omgeo

Trade-aways, step-outs and other third-party settlements are becoming increasingly prevalent with the dynamic growth of the retail Separately Managed Account (SMA) industry while also inflicting margin menacing operational challenges for investment managers and sponsors. Fortunately, a new application of a proven technology has emerged to address these burdensome processing problems by adapting the institutional capabilities of Omgeo's OASYS for the retail SMA space. This innovation represents a significant advance in straight-through processing connectivity for the SMA industry that will increase operating efficiency, reduce errors and cut costs.

SMA industry growth

The retail SMA industry has shown dramatic and continued growth in assets under management in the last 10 years, over 20% annually.¹ This growth will continue as the mass affluent market increases (mass affluent HH's up 37% from 2003 to 2005²) and the baby boomer population approaches retirement, with the resulting rollover of approximately \$1.1 trillion in 401(k) plans in the next 10 years.³ Additionally, \$600 billion of 401(k) assets are expected to be in managed fee accounts by 2010,⁴ and over 40% of SMA net flows will be attributed to IRA rollovers by 2008, up from the current 25%.⁵ All of these factors will drive significant growth in the SMA industry, with total SMA assets projected to grow to \$1.5 trillion by 2011.⁶

¹ MMI/FRC

² Phoenix Marketing International's Affluent Marketing Service

³ EBRI/ICI Database; Citigroup internal analysis

⁴ Tiburon Strategic Advisors

⁵ Ibid

⁶ MMI/FRC

⁷ Matt Schott, Towergroup as quoted in American Banker, "Big Banks Outsourcers for Managed Accounts," January 30, 2006

⁸ FundFire, "Managed Account Industry Plots New Options Course," April 18, 2006

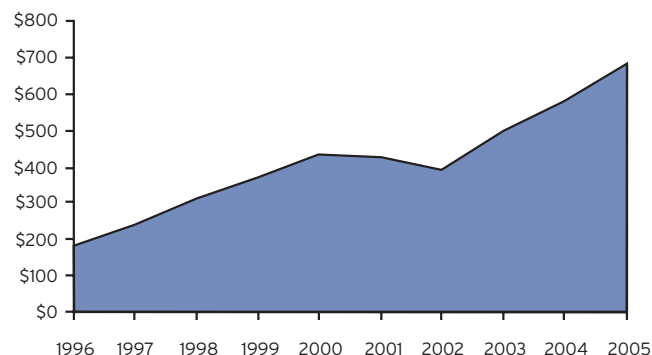
Growth accentuates operational challenges and risk

Along with this explosive growth comes operational inefficiencies, a myriad of manual processes and lack of communication standardization for transactions between investment managers and sponsors (primarily wire houses, broker/dealers, discount brokers, banks, RIAs). These operations costs put pressure on investment managers, as noted in recent articles:

"A decline in management fees has compelled many asset managers to look for ways to reduce operating costs. Technology and operations costs can consume as much as 45% of a manager's managed account revenues."⁷

"Industry officials say the SMA industry needs a standardized communications system if it wants to grow to an estimated \$1.5 trillion by 2011. With no common infrastructure in place, many managed account operations are run manually or are incompatible with other systems, creating inefficiencies."⁸

SMA industry assets under management (\$billions)



Source: Money Management Institute



This new adaptation represents a significant advance in straight-through processing connectivity for the SMA industry.

By not addressing the operational inefficiencies and cost burdens associated with so many of the manual processes in the SMA space, industry growth will undoubtedly be limited. One challenge centers on the often large number of sponsor programs with which an investment manager may participate and the resulting disparate and often manual communications of trade allocations.

Some investment managers participate in 50 or more sponsor programs, a number that includes banks, RIAs, regional broker/dealers, discount brokerages and insurance companies. Each sponsor may require separate connectivity and distinct internal processes, often with a heavy reliance on manual interactions. The operational risk of these multiple processes make daily SMA life a hardship for all parties, often eroding investment manager and sponsor margins in the process.

Historically, sponsors offered investment managers direct trading interfaces to their individual managed account programs. Investment managers most often execute orders through a sponsor's trading desk with the sponsor also providing custody services for investor accounts. However, problems arise in two areas when processing trade allocation and settlement:

1. An investment manager chooses to trade or execute away from the sponsor—which managers may do when coupling these trades with their institutional order flow in an effort to meet internal best execution requirements, or when accessing traders with expertise in a particular security type such as small cap, international or fixed income.
2. An investor specifies a custodian other than the sponsor where securities need to be settled in the regular way, following the institutional RVP/DVP settlement model at the DTCC (or the Federal Reserve for some Fixed Income securities).

Estimated number of industry accounts (millions)

Year	Estimated Accounts
2001	1.66
2002	1.84
2003	1.89
2004	1.93
2005	2.17

Source: Money Management Institute

Sponsors process trade-aways, or step-outs, but often reluctantly due to the associated processing pain involved with booking account allocations manually. In today's SMA environment, an investment manager may trade away on an across the board model change involving thousands of individual accounts across dozens of sponsors. The trade-away usually occurs in a large block to an outside institutional broker who settles with the sponsor(s) and outside custodian(s). The executing or trade-away brokers, while not concerned with account breakdowns, have to settle the block trade to ensure securities are properly delivered to multiple sponsor(s)/custodian(s) for street side settlements.

That settlement, however, only details the block traded, not the thousands of underlying accounts represented by the trade. The investment manager needs to communicate this underlying account detail directly to the sponsor/custodian. Unlike when the investment manager trades directly with the sponsor, where the system may automatically book the trades to the underlying accounts, a trade-away often means the sponsor will manually enter these allocations.

This new adaptation represents a significant advance in straight-through processing connectivity for the SMA industry.

Prospective solution: a case study

With the volume of trade-aways increasing in recent years comes a corresponding increase in manual work often creating an onerous burden on the sponsor. This was a challenge faced by Citigroup Global Markets in processing trade-aways on behalf of investment managers in Smith Barney Consulting Group's SMA program.

Citigroup Global Markets handles 5 - 6 billion shares from SMA transactions per year⁹ and sought to automate the input of these trade-away allocations into its back-office system. They examined existing institutional protocols to achieve this result, including Omgeo's OASYS product and other industry standard protocols, which are used widely in institutional trading for communicating trade execution, allocations and settlement (STP). Omgeo OASYS processes over 45 million electronic allocations each year for non-retail institutional trades for over 400 investment managers and over 400 broker/dealers. Why couldn't investment managers and brokers realize the same efficiency from electronic STP via OASYS in the institutional world for the SMA world?

Around the same time that Citigroup Global Markets began discussing a custom solution with Omgeo, Citigroup's Global Transaction Services launched a new product for investment managers in the SMA space, known as Asset Manager Solutions. It is now a leading end-to-end operations platform for investment managers who manage SMAs. Asset Manager Solutions had an automated STP system that communicated allocations to the sponsors, often utilizing custom built interfaces, but wanted a scalable, best-in-class service, offering features including a single connection point with an established dealer community and automated/ electronic communications with the executing broker and sponsor.

Citigroup's Global Transaction Services approached Omgeo in an effort to outline the growth opportunity in SMAs and discuss ways to reduce the burden and cost on sponsors incurred in either manually processing trade-aways and step-outs or building custom interfaces to handle allocations. With its large existing base of allocation connectivity, Omgeo embraced the opportunity to serve the growing SMA market and design a solution to help with a growing industry challenge. The complexity came in designing the system to properly identify retail SMAs versus traditional institutional accounts in the allocation message between the investment manager and sponsor, while also ensuring the solution is a cost effective means of electronic communications for all parties.

A design team from Global Transaction Services and Omgeo developed a distinct series of acronyms for the investment manager and sponsor, system tags for the SMA trades, a new acronym for Citigroup's Asset Manager Solutions as an operations service intermediary and a pricing mechanism to suit the managed accounts industry. This system allows sponsors to economically receive allocations from investment managers serviced by Citigroup's Asset Manager Solutions.

Citigroup pioneers solution to operational SMA challenge

The Citigroup/Omgeo SMA allocation protocol went into production in 2006 and is now at a growing list of sponsors whose investment managers use the Citigroup Asset Manager Solutions operations services platform. While there are other methodologies that can be utilized for allocations, the Citigroup/Omgeo solution allows the SMA industry to quickly deliver allocations using an industry standard protocol already in production at over 800 broker/dealers and investment managers. It is also delivered in a cost effective manner, without costly development or delays to either sponsors or managers.

⁹ Citigroup Global Markets data

Global Transaction Services
www.transactionservices.citigroup.com

© 2007 Citibank, N.A. All rights reserved. Citi and Arc Design is a service mark of Citigroup Inc., used and registered throughout the world.

226542 GTS24095 9/07

