

Omnibus Clearing Platform for Wealth Management Plans

Business Considerations ~ Business Options ~ Implementation Options



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Our Vision

We believe that digital advice and robo evolution will change the advice space the same way discount brokers changed the commission/brokerage space, with lower expectations and huge pressure on cost structure and digital delivery. Today's digital advice landscape is defined by complex and expensive adoption and integration, multiple systems and high minimums.

We're seeing a mismatch between product needs – asset allocation, digital business level APIs – and the product delivery (full-featured brokerage systems). Because there is still plenty of room for improvement, there is a focus on platform and infrastructure plays.

With a focus on the front and middle, only ETFengine is focusing on the back end clearing side of the equation. We recognize the need for a new infrastructure play that is built around a modern, product-focused and product-aligned clearing platform that is custom tailored for this space.

Our experience in building an investor system for mutual funds that encompassed over \$2.6 trillion in assets, 150 million accounts and over 60% market share demonstrated the success of a special-purpose platform with low operation costs. This approach was incredibly effective and widely adopted.

Independent advisors that need to keep up with the large financial players will require an expert partner that can move them into the digital advice space quickly and bring an open architecture with plugins already in place and a cost structure that doesn't kill their profit opportunity.

ETFengine is building a platform that is part of that equation, and we need to align with others who share our vision. We believe that there is a huge opportunity to expand that platform into a full product offering that is an open architecture, cloud-based, cost effective solution, including end-to-end capabilities, but that opportunity is not going to be available indefinitely.

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Introduction

The ETFengine omnibus clearing platform provides unique advantages for wealth management fee-based advisory accounts (wrap accounts) consisting primarily of ETF and no load mutual fund positions. These advantages translate into substantial operating cost advantages, revenue opportunities and a streamlined client service process. The omnibus clearing methodology is not available in traditional processing solutions for E-Advisory (Robo) products. This white paper will review the definition of omnibus processing, its business proposition and the options under which the platform may be implemented by also using your software. As a follow-up, we invite you to request our white paper which summarizes ETFengine's technical architecture and outline the creation of our advanced product features.

The ETFengine omnibus clearing platform supports these major concepts:

- A system designed to optionally use the UI and Middleware developed by the user
- A system designed at its core to support API access to all data and functions
- A system designed for industrial strength processing based on our prior work in omnibus processing
- Real time posting of trades upon order fulfillment
- Full Asset Allocation and rebalance capabilities
- Unified Management Account (UMA) wealth management functionality
- Hybrid service model (Internet and Advisor participating)
- Evolutionary path to full Omnibus processing - New accounts can be omnibus and others remain fully disclosed and converted over time.
- Full books and records including systems built to support compliance, oversight and visibility to all areas that are sensitive to regulation and control
- Portfolio models supplied from both external and internal managers
- Tax lot accounting and harvesting
- Multi-custodial capability allowing an investor to have accounts with different custodians
- Implementation option that supports both B2C services and B2B services
- And much more.

Created by omnibus recordkeeping experts, ETFengine's modern and innovative cloud-based clearing software offers a wide range of benefits. While ETFengine is a complete system that integrates everything from model management to account set-up, rebalancing, compliance and tax reporting, it also features many options for users to use their own software. With the ability to integrate with our system via APIs at many levels, users can "mix and match" functionality to meet their interests and needs most effectively. Customizing ETFengine to manage all of your accounts in one place results in substantial operating cost advantages, revenue opportunities and a streamlined client service process.

Omnibus Clearing Platform - What is it?

A definition of an “Omnibus Account” is an account held in the name of an intermediary (distributor, bank, custodian or trust company) acting on behalf of its customers as beneficial owners. In this case, the omnibus account holder performs its services on a non-disclosed basis. An understanding of omnibus recordkeeping starts with the question, “Who services the client and where are the client records held?” Please see Figure 1 below.

Omnibus recordkeeping of customer positions by an intermediary include transaction processing, tax reporting and shareholder communications. In the US, the Securities Exchange Act of 1934, rules 17a-3 and 17a-4, outlines these responsibilities. Omnibus record keeping is also referred to as sub-accounting. Simply put, an omnibus system must be capable of providing the same services to the investor as are supplied by the custodian.

‘Omnibus Record Keeping’ will be a key component in providing low cost digital advice because it eliminates major cost elements of the digital advice process flow.

Operational Concepts

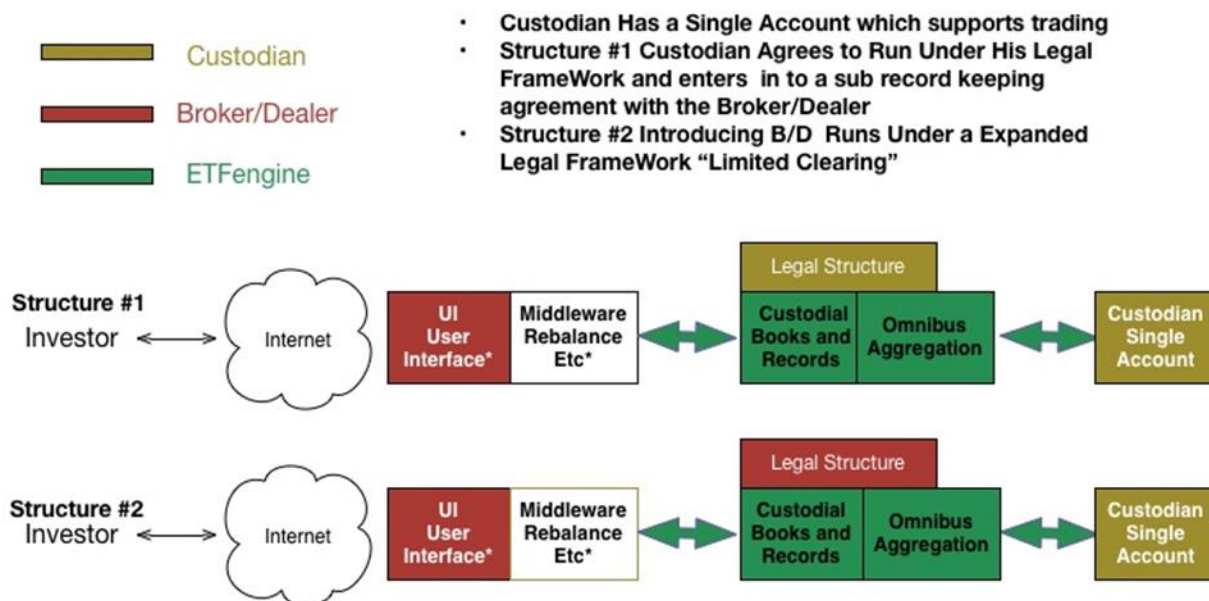
The operational structure for an omnibus clearing platform is shown in figure #1. In all cases a single omnibus account is held on the legacy clearing platform’s system. That account provides the omnibus trading system the capability to place consolidated orders. Presenting aggregated trades to this single account significantly reduces trade costs for the omnibus platform’s customers. The ETFengine omnibus platform aggregates client trades and once filled, allows ETFengine to de-aggregate the trades in real time to the client accounts. Many other capabilities exist in the ETFengine omnibus clearing model, including addressing the receipt and allocation of dividends and distributions to clients. The graphic in Figure #1 also depicts two legal structures that may be considered for implementation of the processes.

The following is a brief list of omnibus clearing capabilities:

- Automated trade and position Reconciliation of the omnibus account
- Multiple omnibus accounts to support different market strategies
- Aggregation & de-aggregation
- Our omnibus clearing layer has both omnibus and 1-1 capabilities during transition. The 1-1 one capability means our implementation strategy can be either revolutionary, or evolutionary
- Multiple aggregation trading during the day
- Error account processing for corrections and as-ofs
- Create Order files out and receive fill/confirmation files in multiple custodian formats
- Track partial fills
- Track trades by account, model and fund
- Cash management with automated settlement with custodian and account
- Multiple levels of trade edits

Figure 1

Clearing Model and Legal/Operational Structures



- Custodian Has a Single Account which supports trading
- Structure #1 Custodian Agrees to Run Under His Legal FrameWork and enters in to a sub record keeping agreement with the Broker/Dealer
- Structure #2 Introducing B/D Runs Under a Expanded Legal FrameWork "Limited Clearing"

* Note: UI and Middle ware can be supplied by Broker/Dealer and or ETFengine

The Benefits of Omnibus

The following summarizes the cost savings that can be obtained from the omnibus process:

- Trading in bulk and automation of trade crossing reducing trading costs. This is particularly useful when doing account rebalancing.
- Reduction of reconciliation expenses associated with having 'breaks' between your portfolio accounting investor records and the custodian records by having an interface to client records that you can control
- Operating in bulk for activities such as systematic purchases and redemptions
- Real time processing efficiency by posting the trade immediately after it is filled
- Cuts delivery and creation costs for statements as the custodian's costs for this process will be eliminated. Possible integration of tax forms with other year-end information sent to investors.

- One client support center to service clients not two different groups with dissimilar emphasis. The omnibus service concept allows a support representative to correct and research issues without the friction and delays of a second support group at the custodian.
- Providing the capability to offset as of trade gains and losses for mutual funds.

The following are added revenue opportunities created from omnibus clearing:

- You can partner directly with a third party for your own cash sweep vehicle. Since you do the recordkeeping, any interest revenue share from this arrangement is higher than that provided by the legacy custodian for their sweep vehicles.
- Since you are doing the recordkeeping and tax reporting for retirement accounts (IRA, etc.), your portion of the annual custodial fee is much higher. As an alternative your client can receive a lower IRA custodial fee.
- Some fund families provide subaccounting fees to distributors of their funds. This subaccounting revenue can be as high as \$17.00 per position or up to 30 basis points.
- Since you can do the margin record keeping, higher spreads on margin interest should be available as you are providing the accounting services.
- Order flow control and processing is more in your control providing potential additional savings and/or revenue on flow payment.

Other efficiencies available in an omnibus processing structure include:

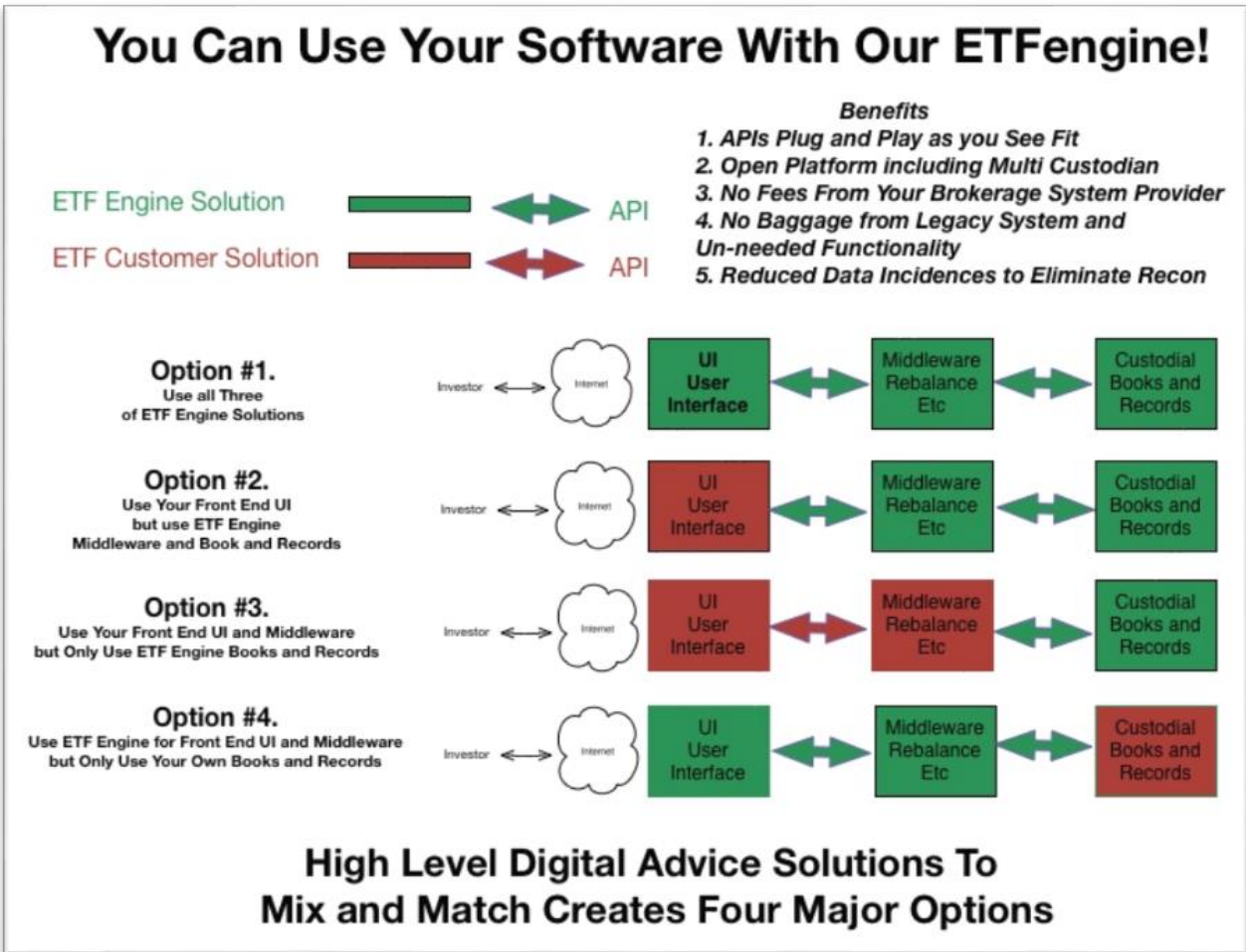
- Getting at the data with APIs everywhere on a system designed to provide them
- Using our single incidence of the investor data to eliminate any duplication of data issues that may be present in your current operational processes.
- Removing friction caused by the operational issues and delays that are inherent in a legacy brokerage system:
 - APIs, not Batch files
 - No longer needing file transport controls and processes
 - The number of ‘surround’ systems will be reduced through an open platform

We can provide an operational analysis of your current processes and interfaces to your legacy provider. Once completed, ETFengine will create a pro forma comparison to aid in the evaluation of this alternative.

Flexibility

ETFengine contains a full stack of services to address a web serviced e-advice financial product. It provides the traditional front, middle and back end capabilities needed. More importantly, our stack can be mixed and matched to create a solution using your existing users’ interface and middle ware components. Figure 2 illustrates the four major options.

Figure 2

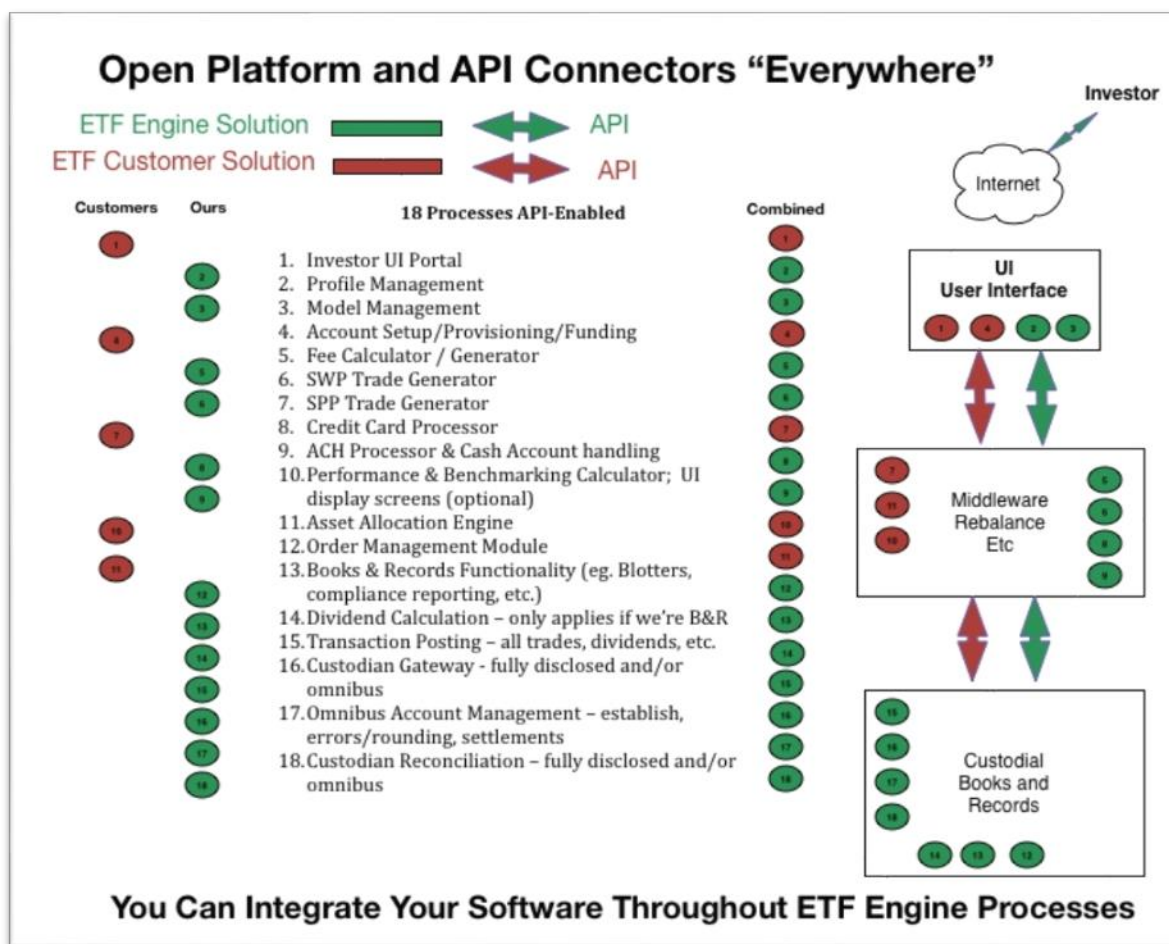


For example, in Figure 2, the clearing platform’s role in Option #3 is called the ‘Red-Red-Green’ option. You can keep your existing front end UI and middle software (the Red Blocks) and replace your current custodial back end with the ETFEngine Omnibus Clearing Platform (The Green Block).

The substitution process is much more flexible at a more granular level. See Figure 3. We could allow you to swap in or out several key pieces of our middle ware services. Generally, if you have an existing UI it would be used intact.

ETFEngine has a robust asset allocation API layer, so if you’re contemplating doing front end work or you need a more robust allocation middle layer, now would be a good time to contact us to understand this technology in detail.

Figure 3



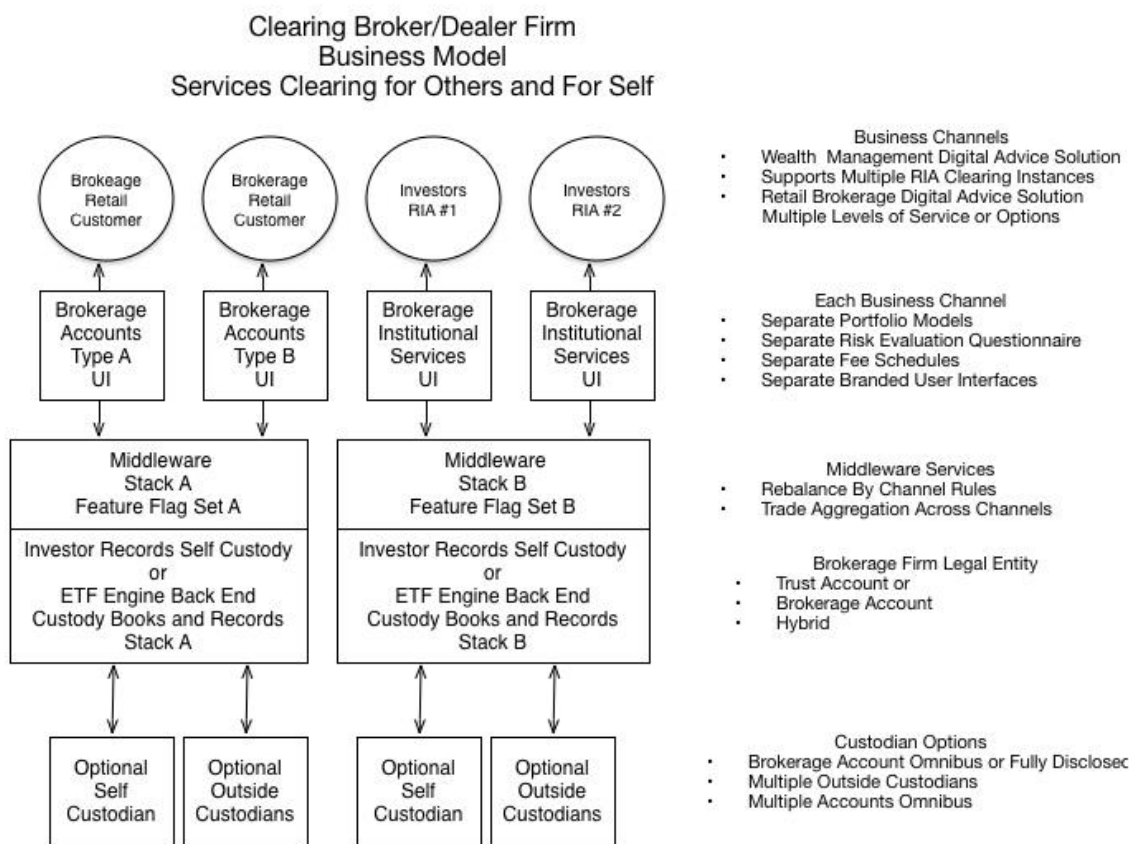
Implementation Options

Figure 4 below shows that ETFEngine supports both B2C implementations and B2B implementations. Our platform greatly reduces operating support costs when multiple incidences of the software are required to service multiple entities. We have created a solution for four separate business models and nine (9) different role participants allowing for separate UI interfaces. This solution is custodian agnostic and supports fully disclosed and omnibus accounts for each custodian.

The idea of many RIAs using a single incidence of the software while at the same time servicing a direct to consumer market is not normally anticipated in the first design of a system. Think of Schwab’s Institutional and Schwab’s Retail being serviced within the same support structure. **We have even anticipated that!**

The concept of separate portfolio managers for a single investor account is part of our platform. Figure 4 depicts some of the service options that are possible for a multichannel implementation using separate models, fee schedules, evaluation questionnaires and branded UI interfaces.

Figure 4



Compliance Concepts

The omnibus service has a complete set of the investor data, which is the primary books and records. A review of ETFengine’s compliance and regulatory systems and features is recommended. ETFengine’s suite is superior to most provided by current legacy systems, as we have created a much more auditable and controllable system than the typical backend legacy system. From the initial design, we created the transactional processes, as well as logging and messaging tracking used throughout the system, to support the regulatory oversight processes. Here are a just a few of ETFengine’s compliance capabilities:

- Audit trails on fees, money sources, trade, and price fulfillment by using our integrated transactional logging capabilities
- Account transactions identified with portfolio model, CUSIP and the ability to roll back from CUSIP level to model level reporting

- Integration with broker/dealer rep and state registration files that provides real time API interaction during work flows for new accounts and trading to assure proper compliance
- Testing record retention
- Maintenance of suitability and capture of suitability process (risk questionnaire) records for review
- AML services provided via API servicing
- Transaction tracking controls for reconciliation of cash and cash accounting, including outside funding sources such as ACH
- Omnibus reconciliation using mirror accounts and automatic rounding account accounts with full historical transactional records
- Error account transparency for trade corrections, and error account automation including support for net gain/loss capabilities for mutual funds
- Accounting for investor fractional shares including cash account automation to assist in purchase and sale of fractional sales
- Daily reporting for net capital requirements and focus reporting

Whatever your compliance requirements, ETFengine can meet them.

Our History with Omnibus Recordkeeping

Our pedigree for creating major investor recordkeeping systems is unmatched. The omnibus processing engine our team created in 1986 was responsible for an extraordinary shift in the processing flows/concepts for participants in the mutual fund recordkeeping/servicing industry during the period 1990 to 2014. Over 3 trillion in assets and 200 million investor accounts were moved from the mutual fund transfer agency systems to the broker/dealer platforms by using the concept of omnibus accounting. This transformation allowed the broker/dealer to enjoy major operating efficiencies and cost/revenue benefits of over 2 billion dollars of annual relief to their back office processing costs. We have consulted internationally on the omnibus functionality we developed, and over the past seven years have been helping other firms to understand and adopt this recordkeeping concept.

The product our team developed in the 90s was also unique in its ability to include a fully advanced ETF/Mutual Fund wrap program processing capability that included full portfolio accounting features, including customized model portfolios, rebalancing, asset based fee generation and complete tax awareness for the client. The processing structure was unique in that the investor data had a singular copy for use by both the portfolio accounting component and the investor custodial component. As a result, the product maintained a fully functional books and records system that did not require a supporting clearing brokerage platform to mirror the accounts.

Nearly all of the major US retail brokerage and clearing services, including the four clearing brokers that service over 70% of the RIA market, use the omnibus system we created. We have long history of technology integrations and we understand how important it is to get it right. We understand in-depth 24/7 production risks. Our customers have always considered us tech partners, not just tech vendors

Based on our experience, we are uniquely qualified to meet industrial strength operating requirements that must address processing windows of hundreds of thousands of trades per day and postings of millions of dividend distributions in a nightly batch cycle. We have solved processing sensitivities to large volume investor processing rarely realized by even the largest custodial vendors today.

For more information, or to request a technical whitepaper, please contact ETFengine at sales@etfengine.com.

