



Wells Fargo Upgrading UMA Platform to Add Manager-Traded Direct Indexing

By Nate DiCamillo | May 28, 2024

Wells Fargo is updating the tech powering its unified managed account, or UMA, platform to include manager-traded separately managed account strategies. The update is part of a plan to add direct indexing strategies to the menu by the fourth quarter.

Currently, the wirehouse offers direct indexing strategies only through its dual-contract separately managed account program, said Patty Loepker, head of investment products for the investment solutions group within Wells Fargo's wealth and investment management unit. By the fourth quarter, the firm will be able to accommodate manager-traded, third-party direct indexing strategies within its UMA platform.

The platform updates will allow direct indexers and other SMA managers on the platform more visibility into what tax lots are in every sleeve of a client's account, Loepker explained. Wells Fargo will anonymize securities held among the managers outside the direct indexing strategy, but the managers will be able to see if a security has a greater unrealized loss in another part of the portfolio than within their sleeve, based on the timing of each manager's purchase of the security.

This could help managers make investment decisions about specific tax lots, as well as helping to avoid wash sales, Loepker explained.

"The work that we're doing is making sure we can deliver all the tax lots for the clients' holdings of a specific security, and that the manager is in the best position to make a good decision around that specific investment," Loepker said.

Integrating direct indexing strategies into unified managed accounts offers clients more flexibility to reduce their overall tax bill. However, the necessary infrastructure between asset managers and wealth firms has lacked widespread implementation, several industry leaders said.

For instance, Merrill Lynch offers direct indexing only on its separately managed account platform because "it's a bit more straightforward to indicate how that strategy is meant to be deployed," said Stephen Patrickakos, head of managed investments for Merrill Lynch's investment solutions group.

Managers operating a sleeve within the UMA still don't have a view into what's happening in the other sleeves, increasing the chance of a wash sale, Patrickakos added.

"That's not to say it's insurmountable," he said. "In fact, it would be nice at one point to implement it in the UMA. But most larger firms like ours would call an overlay manager."



Typically, direct indexing strategies are traded by the direct indexing manager, and the UMA is overseen by an overlay manager who trades across every sleeve. When manager-traded direct indexing strategies are added to a UMA, the direct indexing manager and the UMA overlay manager must coordinate closely for both custom investment products to work together, said Marina Gross, head of Natixis Investment Managers' solutions group.

"That coordination gets even more complicated when it's a tax sensitive context," Gross said. For tax sensitive investors, managers must avoid wash sales, implement specific tax loss harvesting requests and manage tax lots carefully. This includes selecting shares to sell based on when they were purchased, Gross said.

The "easy route" is for wealth firms to add model-delivered direct indexing strategies to the UMA, but while that's "good for the platform, [it's] not so good for the investor," she said.

With model-based strategies, managers hand over trade instructions to an overlay manager. But that doesn't allow for much customization or tailored tax management – the key selling points for direct indexing.

"Model-based direct indexing strategies are very diluted," Gross said. "You give up a lot of the unique customization and advanced tax management when it's model-delivered."

Due to historical technology limitations, active equity strategies with a limited number of security holdings typically dominate UMAs. But adding a direct indexing sleeve offers clients more options for managing their investments, Gross said.

Franklin Templeton's O'Shaughnessy Asset Management has had conversations with wealth firms about walling off a sleeve of their UMA for direct indexing, but most wealth managers have yet to build mechanisms that automatically prevent a wash sale, said Roger Paradiso, executive chairman of O'Shaughnessy.

O'Shaughnessy is working to include manager-traded municipal and options overlays for its custom indexing product, a move that's not too dissimilar from trying to include a walled-off direct indexing strategy inside the UMA, Paradiso said. O'Shaughnessy communicates instructions to overlay managers through its custom index platform Canvas.

Blending direct indexing and the UMA helps the advisor justify the overall fees to the end client, said Barrett Ayers, president and CEO of Adhesion Wealth, an AssetMark subsidiary that primarily serves RIAs. Adhesion offers proprietary and third-party model-delivered direct indexing strategies.

"An advisor may say, 'why am I paying X number of basis points for an active manager when it's really hard to deliver alpha?'" Ayers said. "Instead, why don't I just go for a direct index in some of those efficient asset classes and get the fee way down?"



Incorporating direct indexing into UMAs may be the next frontier for these strategies.

“We think the UMA is the perfect vehicle to supercharge direct indexing, because it’s all inside of a single account,” Ayers said.

Adhesion is in the process of adding the first manager-traded direct indexing strategy to its UMA from a fixed income manager, Ayers said.

The fixed income manager will likely occupy 25% of an account and every morning Adhesion will reconcile its books with the manager and send it client instructions, Ayer added. As the firm implements this workflow, Adhesion will be able to do the same with boutique equity managers that trade niche products like micro-cap or nano-cap strategies.