

The Future-Proof Firm: Navigating Broker-Dealer Trends

What does it mean to be futureproof? We think it means investing in systems and processes that position broker-dealers for success under a wide range of likely scenarios – which ironically also means being ready for the fallout from unlikely events.



Executive Summary

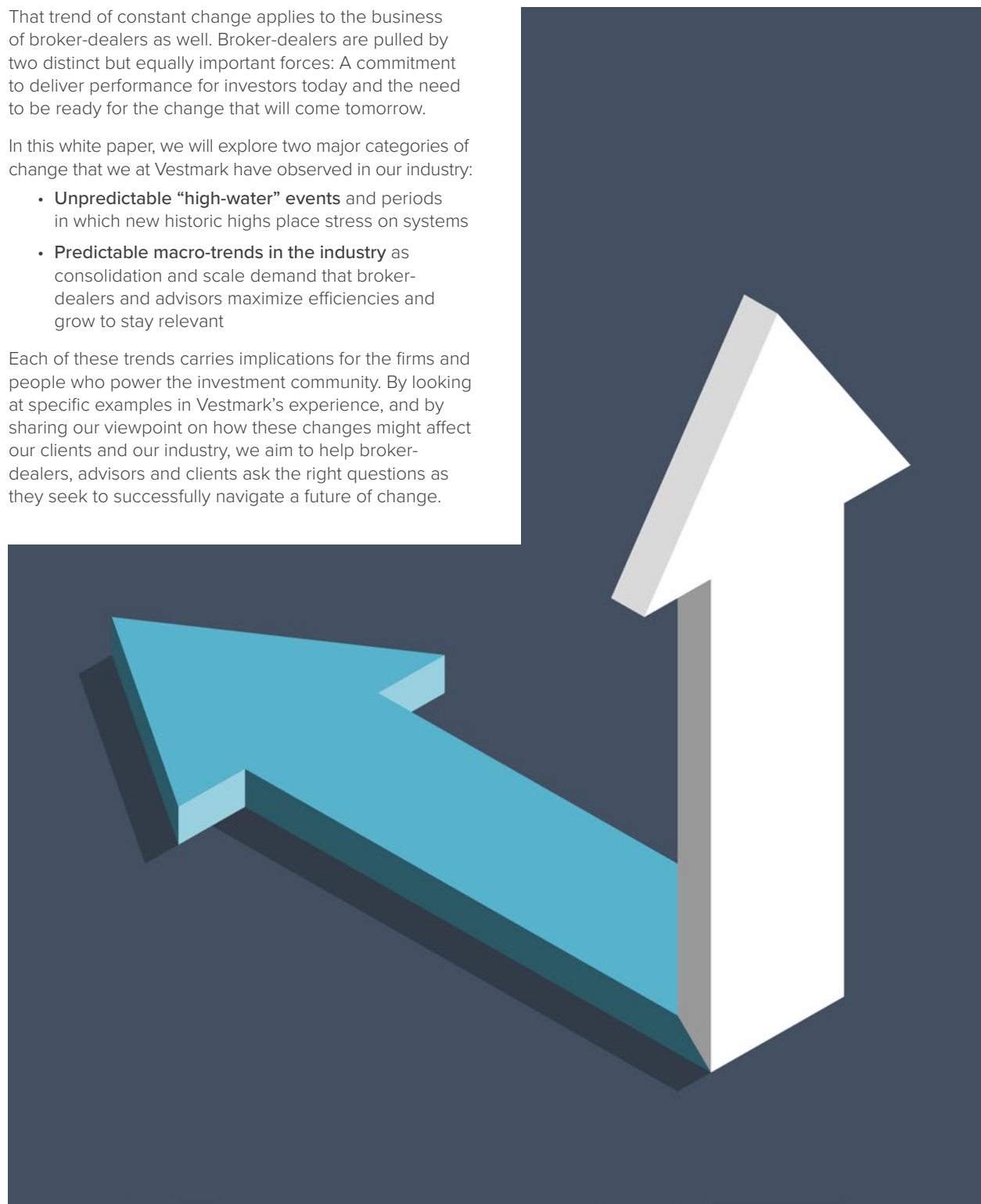
“Nothing endures but change.” It’s hard to believe that even the philosopher Heraclitus, when he wrote those words 2,500 years ago, could have imagined the pace of change we face today.

That trend of constant change applies to the business of broker-dealers as well. Broker-dealers are pulled by two distinct but equally important forces: A commitment to deliver performance for investors today and the need to be ready for the change that will come tomorrow.

In this white paper, we will explore two major categories of change that we at Vestmark have observed in our industry:

- **Unpredictable “high-water” events** and periods in which new historic highs place stress on systems
- **Predictable macro-trends in the industry** as consolidation and scale demand that broker-dealers and advisors maximize efficiencies and grow to stay relevant

Each of these trends carries implications for the firms and people who power the investment community. By looking at specific examples in Vestmark’s experience, and by sharing our viewpoint on how these changes might affect our clients and our industry, we aim to help broker-dealers, advisors and clients ask the right questions as they seek to successfully navigate a future of change.



What do we mean by “future-proofing”?

The exact challenges and opportunities broker-dealers will face in the future are being shaped by what we do in the present. So “future-proofing” shouldn’t be taken as some kind of rigid, impenetrable armor that will withstand any assault. Instead, it’s about designing business strategies and systems that combine flexibility with raw strength to enable firms to ride trends, avoid pitfalls, and choose their best possible future.

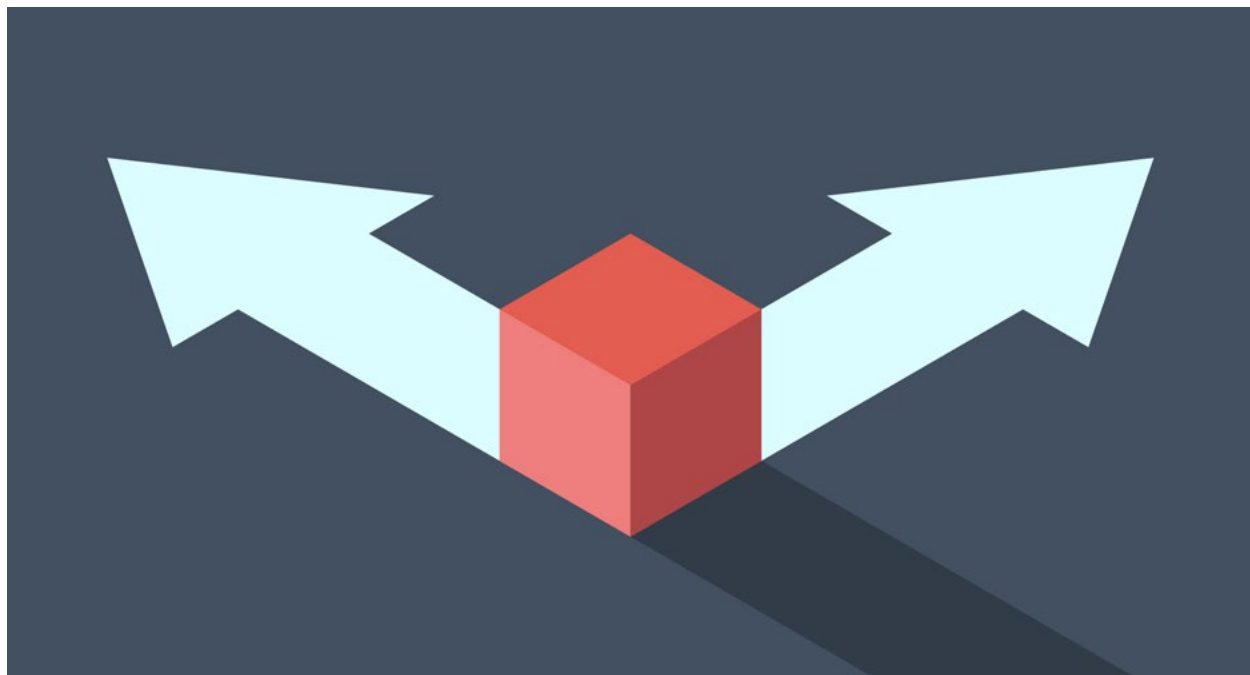
Walking the line between reliably meeting today’s needs and building future-proof systems can create tension, and key decisionmakers need to balance stability with proactiveness. Leaders face risks if they change to a new system that doesn’t deliver; but they will also need to answer for standing pat if their old system collapses, slowly degrades, or falls behind to the point that it can’t deliver the outcomes investors demand of their advisors today.

“Future-proofing” for broker-dealers means balancing risk and opportunity in the most likely future state based on today’s trends, while simultaneously clearing obstacles that might inhibit future courses of action. For example, having a robust managed accounts platform might be the difference between whether or not you can satisfy advisor and investor needs during a period of high demand. Having data that is easily portable and a system that can effortlessly handle a large volume of transactions might be the difference between being an acquiring firm, the acquired, or a firm that withers away.

But that doesn’t mean “new” is always “better.” Even if a new solution seems superior to the way things have been done, it may not be ready for prime time. Any misstep while upgrading can have long-term repercussions on a firm’s reputation, as well as short-term impacts on investors and the bottom line. Just ask any firm who switches to new portfolio management solutions ahead of a major market event and then sees trades delayed by 30 minutes or more when the system is overwhelmed – as happened to some firms in the market meltdowns in the spring of 2020.

When we apply the concept of future-proofing to the broker-dealer industry, and consider that the future may take many different routes, what is needed is a managed accounts platform that can accommodate the many possible and likely futures for your firm – from one-time future events to gradual industry-wide trends; from change in response to outside factors to change driven by your own innovation.

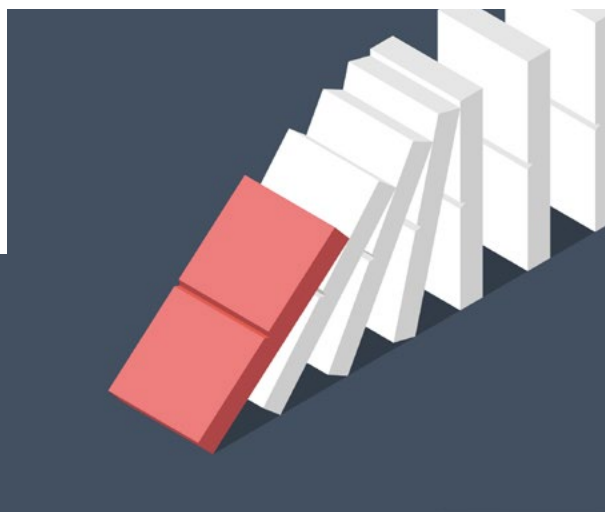
With that in mind, let’s look at two types of futures for which to prepare – the unpredictable future where events suddenly trigger market volatility, and the predictable future driven by trends towards scale and consolidation in the broker-dealer industry.



A Future of Black Swans and High-Water Marks

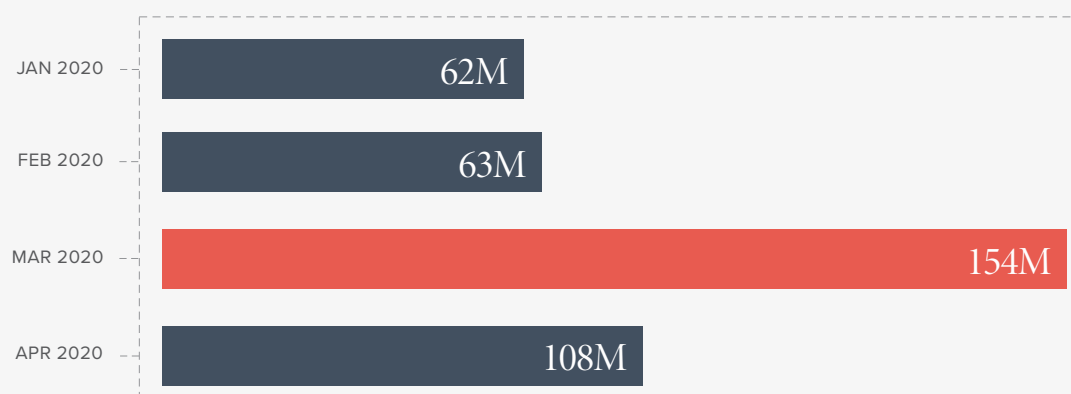
Nobody who has lived through the last two decades can ignore the impact of the unexpected. Markets can be roiled by all kinds of unpredictable events and can react in unpredictable ways, making it critical to have a system in place that can efficiently manage large swings in volume.

The coronavirus pandemic of 2020 provides a perfect example. The instigating event itself could be anticipated in the abstract, but until it emerged, its impact on humans started to be defined, and actors ranging from government entities to individual investors took action, its precise impact on the financial markets could not be fully understood.



Monthly Trading Volumes

A look at the VestmarkONE® platform's complex-wide monthly posted transactions for the first four months of 2020 shows the impact of a complex global event on transaction volume, which almost doubled from January to March as the market whipsawed in the spring.



SOURCE: Vestmark, Inc., Transactions Generated from Trading Sessions

Many of these transactions represented intraday trades, as investors and advisors sought to position themselves in the midst of tremendous volatility. Broker-dealers and their clients depended on real-time data and rapid reconciliation of accounts in order to know their positions minute by minute as they responded to developing events, and the trades they placed needed to be executed promptly to have the intended effect – even as millions of other trades were simultaneously placed. Of particular concern during this time were reports of the platforms of some large banks crashing or freezing.

Not only must a system execute trades efficiently under load, but the follow-up processing – auto-reconciling positions, transactions and taxlots, processing and posting dividends and corporate actions, calculating daily performance at the household, account and sleeve levels, and more – must also keep pace. In the events of the spring of 2020, in fact, trading challenges were compounded by the fiscal quarter end and expiration of many derivatives and futures that fell within this period, requiring additional load for reconciliation.

When future-proofing, firms want to make sure they deploy a platform that can keep up with an unpredictable world. The VestmarkONE platform was designed with integrated trading and accounting, empowering intraday trading, and was designed to scale up to meet any load placed upon it, allowing our clients to weather the events of 2020 without interruption.

WHAT THE FUTURE MAY HOLD:

More volatility

More record-breaking days, weeks and quarters, and more demands on your system. The triggers may be anything from unpredictable world events to regular market corrections, but as the overall size of the market grows, new highs in volume will be reached.

WHAT THE IMPLICATIONS COULD BE:

Direct and indirect impacts to reputation and business

- If your firm is reliably able to meet advisor and investor demands, this can offer reassurance and be used as a selling point.
- Using a platform with separate trading and accounting functions could leave broker-dealers operating in a knowledge gap, placing trades without an up-to-date picture of their position, with all the risk that entails.

WHAT FUTURE-PROOFING LOOKS LIKE:

Stress-tested solutions

Supporting a massively increased load to a system by choosing a platform that is stress-tested to work even under high-water-mark events, and that delivers real-time data and reconciliation.

VestmarkONE Platform Volumes by the Numbers

Largest trade volumes for a single client:

1.7M Daily
7M Monthly
47.3M Annually

Auto-reconciliation scale for a single client:

90.8M Taxlots Reconciled
in 2 hrs 12 minutes

Total VestmarkONE Platform transactions across all clients:

Nearly 500M daily

Sleeve rebalancing performance at volume for a single client:

559K Sleeves Rebalanced
in 17 minutes 49 seconds

SOURCE: Vestmark, Inc.

A Future with Fewer, Larger Broker-Dealers

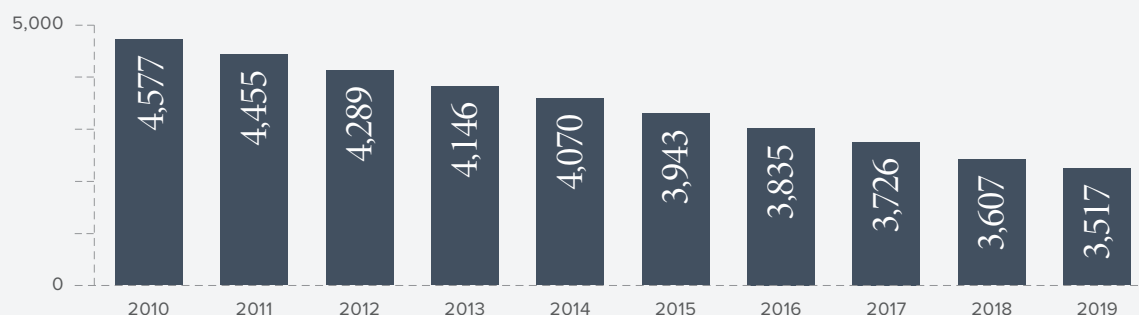
As the broker-dealer industry has evolved, efficiencies of scale have rewarded larger firms with greater profits. This has led to a pair of trends: consolidation through merger and acquisition, and an emphasis on organic growth by firms looking to stay relevant.

Vestmark has seen – and easily scaled to support – the effects of this trend on our own clients. Looking at four large national broker-dealers using the VestmarkONE platform, we have seen the number of accounts on the platform grow rapidly in recent years. One client saw a staggering 145% growth rate from 2018 to 2019 followed by a 30% increase from 2019 to 2020; another generated 67% growth over the past 2 years, representing a 29% annual CAGR. Assets under management, not surprisingly, is also on the rise; another client firm saw AUM spike 144% from 2017 to 2018. And this is only a snapshot of a sliver of the industry.

Size has become important to broker-dealer firms as the industry has shifted from commissions to fee-based services, narrowing margins and rewarding efficiency, which larger firms can better deliver. Compliance with increasing numbers of regulations also rewards scale – a large firm can centralize compliance, while smaller firms may find the cost of evolving compliance requirements prohibitive as margins shrink.

In whatever form upscaling takes, mergers and acquisitions or organic growth, broker-dealers need to be ready to manage more advisors, more accounts, more assets under management, and more simultaneous transactions and reporting. This starts with having a robust managed accounts platform that has proven under real-world conditions that it is able to handle the numbers involved.

23% Decrease in FINRA-registered broker-dealer and hybrid firms, 2010-2019



SOURCE: 2020 FINRA Industry Snapshot

WHAT THE FUTURE MAY HOLD:

A need to merge, acquire and grow

The number of registered broker-dealer and hybrid firms has dropped by almost a quarter in the past decade, due to pressure from margins and compliance costs. To survive, firms need to be able to get to and operate at a scale where they can be profitable..

WHAT THE IMPLICATIONS COULD BE:

Smaller, stagnant firms may be at a disadvantage

- Firms whose platforms can absorb or integrate efficiently with the system of another firm will be well-positioned for mergers and acquisitions.
- Firms looking to grow organically need to be able to offer standout service and efficiency so they can attract and retain advisors and investors.

WHAT FUTURE-PROOFING LOOKS LIKE:

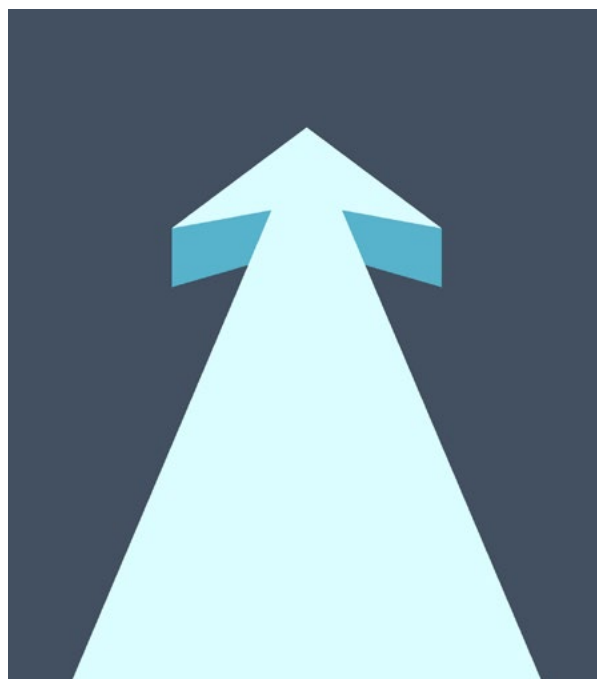
A solid foundation for scalability

Strategic future-proofing means having a platform that can enable a seamless integration with the systems of others in the event of mergers or acquisitions, or one that can support a firm's plans to develop and deploy unique offerings to attract new business.

Instead of asking if it can add some hundreds or thousands of new accounts, firms should ideally be able to answer in the affirmative if asked to double their accounts tomorrow – because if a merger happens, it might be a requirement.

A firm that wants to grow organically by attracting more advisors and helping those advisors each support more investors not only needs to be able to address scale, but needs flexibility to create their own unique, value-added system so they can offer advisors (and by extension investors) an experience and support they can't get elsewhere.

When future-proofing, firms want to make sure they deploy a platform that can keep up with an unpredictable world. The VestmarkONE platform was designed with integrated trading and accounting, empowering intraday trading, and was designed to scale up to meet any load placed upon it, allowing our clients to weather the events of 2020 without interruption.



VestmarkONE Platform Scale by the Numbers

Total assets managed for a single client to date:

\$325B

Total number of sleeves managed for a single client to date:

4M

Total number of accounts managed for a single client to date:

1.3M

Total accounts managed using the VestmarkONE platform:

4.5M

Total assets under administration on the VestmarkONE Platform:

\$1.2T

SOURCE: Vestmark, Inc.

Conclusion: Future-Proofing Starts Now

There isn't a broker-dealer in business today who can afford to be complacent. While there is no shortage of technology partners ready to promise great performance tomorrow, it's smart to start by evaluating what they can do for you today.

It's also important to look for a partner whose support goes beyond technology. Broker-dealers benefit most when they have a platform partner who is not just looking to sell a solution, but who will work with them to tailor the solutions to their needs, help them anticipate future areas of concern and design solutions to cover those potential situations.

When those events occur, whether in the form of a COVID-19-style perfect storm of business disruption and market volatility, or as a result of a long-planned merger, it's also important to consider the people behind the platform. In the spring of 2020, many firms saw their platform service disrupted as the outsourced support teams were ordered to work from home. Vestmark had developed plans to future-proof itself that included the possibility of working from home – plans that were seamlessly executed.

By extension, our clients have future-proofed themselves by choosing a service partner that had also prepared for an unpredictable future.

Vestmark has built its reputation by serving the needs of many of the world's largest broker-dealers, easily cresting all the heaviest volumes and demands thrown at them by their millions of investors. At the same time, Vestmark has remained committed to smart, scalable innovation, with a focus on efficiency and creating modular solutions so that broker-dealers can integrate individual components of the VestmarkONE platform's technology into their own best-in-class systems.

We are confident that we have a solution that can help future-proof your firm – whatever that future may hold.



Find out how Vestmark can help you future-proof and scale your wealth management business without compromise.

Call (781) 224-3640 or visit www.vestmark.com.



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