

Future-Proof

Your Independent Broker-Dealer



Independent broker-dealers (IBDs) today face perhaps the most challenging business landscape ever. This environment is making it harder for many firms to remain profitable and competitive.

Indeed, the number of IBDs has been steadily shrinking over the past decade. Between 2012 and 2021, there was a 21% decrease in the number of registered broker-dealer firms, according to the Financial Industry Regulatory Authority (FINRA). The number of firms fell from 4,289 to 3,394 during this time.¹

Because of this environment, registered representatives may be concerned about their broker-dealer's viability. And to attract new reps to your firm, you need to ensure a strong and growing business. Given the challenges and pressures your firm is facing, you may want to be thinking about ways you can future-proof your businesses to not just survive but to thrive.

What's driving the challenges?

Several factors are driving the challenges currently faced by IBDs:

- **Increased competition.** Broker-dealers are facing increased competition from alternative affiliation options such as independent and hybrid RIAs. And with greater numbers of RIAs operating outside the independent broker-dealer universe, the emergence of robo-advisors, and the aging of independent registered representatives,

the number of BD reps has been steadily declining over the years. Moreover, reps today expect much more from their broker-dealers, which can make recruiting more difficult, which, in turn, impairs growth. These developments are impacting the independent broker-dealer industry particularly hard.

- **Thinner margins.** Revenues are shrinking and expenses are rising. Smaller firms don't have the scale to negotiate better contracts with vendors, and they may find it hard to invest large amounts in technology and other infrastructure. With downward pressure on commissions, they are also seeing their profit centers shrinking. Thinning margins due to competitive pressures and commoditization of trading services are yet another factor, as is the growing demand for real-time processing.
- **Increased regulatory pressures.** Rising expenses associated with remaining compliant and managing regulatory changes has also been putting a strain on profit margins. Independent broker-dealers continue to experience heightened regulatory expectations for documentation, data transparency, and process consistency. Examples of new regulatory requirements

continued

abound. For example, regulators are paying closer attention to IBDs' anti-money laundering (AML) programs and ability to monitor and investigate suspicious activity. The SEC has also been reviewing the use of digital enhancement practices (DEPs) and other technology tools used by IBDs that influence client behavior and provide investment advice. This may result in new regulations designed to ensure that DEPs are consistent with acting in clients' best interests and might even require compliance as part of Reg BI. In addition, FINRA is implementing its new "bad broker" initiative in which it will issue a score for each IBD based on the number of risk-related disclosures it receives. Firms with low scores will receive a restricted status and must deposit a pre-determined amount in cash or qualified securities into a restricted account to cover future arbitration awards.

Given these challenges, it may make sense to take some steps to review and possibly evolve your business model.

The need for greater technology investment

Technology is playing an ever-greater role in how services are delivered across the financial services industry, so it's not surprising that future-proofing your independent broker-dealer business starts with investing in the right digital technology ecosystem.

A report by Cerulli states that technology (56%) is the most frequently identified factor that would influence a rep's decision to choose to affiliate with a BD. The report encourages IBDs to address the challenges they're facing by enhancing their value proposition and embracing technology.²

"Regardless of a BD's strategy and market positioning, it must recognize the role of technology in realizing this strategy," states the report. "To some extent, technology will provide operational efficiency — this is most essential to

The most frequently identified reason (56%) that would influence a rep's decision to choose to affiliate with a BD is its technology, according to Cerulli.



firms that wish to operate at scale or those that wish to be hands-off with their reps, essentially providing an operational platform.”

Technology frees IBDs to “spend more time prospecting or cultivating existing investor relationships,” states the report. “If this efficiency can be spread across thousands of representative practices, it can result in significant growth for the BD. Furthermore, these reps recognize the role of the BD in helping them build a more productive and efficient business.”

IBDs must figure out how to integrate new technology solutions into their existing tech stacks, the report adds. Technology should make tasks easier and improve outcomes, but if old and new tech tools don't talk to each other, the opposite can happen.

Future-proofing your business can also be expedited by moving to all-digital, automated technology solutions that will help drive productivity and improve cost-efficiency. To recruit new registered representatives, BDs must keep pace with current technology that's centered on both the client and rep experience. This may include technology for single sign-on, e-signature, mobile apps and built-in features like account aggregation, account reporting and fee billing.

BDs may want to pursue an open-architecture managed account platform that offers robust trading and investing capabilities and combines analytics from leading data providers. A future-proofed platform also includes sophisticated order execution features and post-trade processing applications. Your service provider's front-and back-office systems should be built to support high trading volumes in a real-time processing environment, as well as interface with multiple trading platforms and market data providers.

Proper scale and the right technology will be critical for achieving profitability in the future. Your technology ecosystem should provide technical and operational capabilities to enable scalability and improve collateral optimization. Robust processing tools that can scale, along with employee expertise to make sure that regulations are followed and customer assets are protected, are also keys to future-proofing your BD business.

Possessing technology that offers a frictionless experience is another key to future-proofing your firm. This includes turn-key and integrated platform solutions that level the playing field so everyone has the tools to access the markets and accumulate wealth.

A generational shift from older, retiring representatives to younger leaders and producers will play into the technology equation. The level of technological sophistication and capabilities may be a determining factor among next-gen financial professionals when it comes to who they choose as their broker-dealer. They will be looking for BDs with

technology that enhances client relationships, like planning software and mobile access to account information, along with self-service capabilities that make it easier for clients to save and invest their money.

As clients skew younger, this will also increase the importance of digital technology and capabilities for IBDs. It's projected that Millennials, who are already the largest segment of the U.S. workforce, will make up 75% of the labor force by 2025.³ These clients expect a holistic approach to financial

planning and a unified portal experience. Technology doesn't always have to be flashy; instead, it should serve to support what the representative brings to the table.

As the financial advisory industry moves toward a fee-based model, IBDs that can compete for and win high-performing representatives while developing the next generation of talent will be in the best position to grow. For example, 37% of reps at IBDs anticipate retiring within the next 10 years, according to a report by Cerulli Associates.⁴

Protecting clients' financial information and privacy from cyberattacks is also especially critical. Doing so will require the most relevant and up-to-date technology, along with a rapid and workable contingency plan in case a data breach does occur.

Data transformation challenges

Independent broker-dealers today receive and process data in a variety of formats from many different sources, including clearinghouses, fund firms, and parent companies. This data must be transformed into a consistent format so it can be processed through compliance and operations to populate locally managed books and platforms.

To recruit new reps, BDs must keep pace with current technology that's centered on both the client and advisor experience.

Many IBDs are struggling with the challenge of inputting non-proprietary product data into their systems and merging it with their proprietary products and brokerage account data. Artificial intelligence (AI) and machine learning (ML) technologies could help meet this data transformation challenge. For example, ML algorithms “learn” through human training. However, these technologies shouldn’t be oversold: Humans will continue to play a critical role in training and managing the algorithms.

These data transformation challenges could create new opportunities for IBDs in the future. For example, some regulatory compliance issues faced by IBDs have to do with the need to know more about clients and trading activities. Referred to as “know your customer,” or KYC, these efforts create new insights that IBDs can use along with technology to produce better advice. After all, this is one of the key differentiators for independent broker-dealers.

5 ways to future-proof your IBD

IBDs were historically the best choice for registered representatives who wanted to be independent but didn’t want to build an all of the advisory infrastructure from scratch. But the proliferation of advisory service providers, 1099 RIA platforms, and outsourcing partners have made the operation of an existing independent firm or launch of a de novo entity easier. This is forcing many IBDs to amend their playbook and evolve their business model to remain competitive.

Here are five ways to consider future-proofing your business:

- 1. Strive for economies of scale by seeking acquisition or affiliation targets.** As the IBD industry has evolved, efficiencies of scale have rewarded many IBDs with more revenue and higher profits. This has led to an emphasis on consolidation through merger and acquisition to take advantage of economies of scale. IBDs can build scale



through mergers and acquisitions with similarly sized broker-dealers. In addition, they may find acquisition or affiliation partners in RIAs who are looking for a firm to help manage complexities and share administration costs of operating a firm on their own. Your support infrastructure can help RIA firms who want to offer client's brokerage services, or those who want a turn-key platform, compliance, technology, in-house support, and the ability to conduct both advisory and brokerage business all in one place.

2. Allow representatives to create their own customized tech stack.

Registered representatives are accustomed to using proprietary tech stacks made available by their broker-dealer. But many now prefer to pick and choose vendors with technology that seamlessly integrates with their own technology. This allows them to be more flexible and choose solutions that evolve faster in the face of rapidly changing technology. Consider opening up your proprietary systems to third-party performance reporting, financial planning and CRM providers to allow reps to create their own custom tech stack.

3. Bolster your regulatory practices.

With data quality a key issue, consider investing in new technologies to ensure a healthy and controlled process that includes end-to-end automation and completeness of source data. In addition, consider adding surveillance technology to improve your ability to monitor and investigate suspicious money movements to comply with anti-money laundering regulations.

4. Perform succession planning.

As representatives age, the industry has struggled with making business continuity and succession planning more accessible and less intimidating. Many well-capitalized broker-dealers have created in-house succession planning groups and lending solutions for acquirers at competitive interest rates, making the possibility of an internal sale more likely. This offers value to advisors who want to grow by acquisition.

5. Choose the right technology partner.

You need an adaptive, flexible technology partner that will enable you to keep pace with rapid market changes. Your technology must be constantly updated and maintained to reflect the latest industry developments and trends — otherwise, it could become obsolete and limit your ability to serve advisors and clients. To successfully recruit new reps, you'll want to ensure your platform keeps pace with current technology. This technology should be centered on improving both the client and the rep experience. Service and support are also critical elements of your relationship with a technology partner. Your partner should be able to customize technology solutions to fit your business' unique needs so you can scale, increase efficiency and manage costs. This will allow you to focus on growing your business and enhancing profitability. So look for a technology partner that offers relationship-based service; flexible clearing, custody and banking solutions; and value-added support services such as research, annuities and compliance and performance reporting tools.

Start planning now

The independent broker-dealer business is still a viable business. On average, 71% of all reps identify a preference for independent affiliation in the event they were to change firms.⁵ According to Cerulli, registered representatives are still moving to independent models for greater autonomy (62%), a higher payout (57%), and the ability to build financial value in an independent business (54%).

But the challenges faced by independent broker-dealers aren't likely to subside anytime soon. Take some time now to consider how you can future-proof your business in order to stay competitive and profitable in the years to come.

1 2022 FINRA Industry Snapshot report

2 Cerulli Associates, The Cerulli Edge – U.S. Edition, October 2017.

3 FirstUp, "Key Statistics About Millennials in the Workplace," October 6, 2021

4 Cerulli Associates, The Cerulli Report: U.S. Broker/Dealer Marketplace, 2021, The Pursuit of Scale.

5 Cerulli Associates, The Cerulli Report: U.S. Broker/Dealer Marketplace, 2022, Evolving Approaches to Advisor Recruitment and Affiliation.

Your Partner for Success

At Axos Clearing, we help turn business challenges into opportunities for growth. We provide broker-dealer firms with the technology and support to enhance their businesses and achieve higher and higher levels of success. Axos Clearing provides customized technology to fit your business' needs, helping you scale, increase operational efficiencies, and manage costs. Our flexible solutions include:

- **Clearing Services.** We have clearing and settlement capabilities for all domestic and foreign securities in equities, options, mutual funds, and fixed income products. Our global clearing capabilities include multi-currency settlement and reporting.
- **Relationship-Based Service.** We provide you with a dedicated client services team. The experienced professionals who support our firms have years of industry experience, and get to know you and your business fully, providing more personalized interaction and commitment to faster resolutions.
- **Flexible Technology.** We specialize in open-architecture technology solutions designed to provide the flexibility you need to meet the specific needs of your business.
- **Robust Product Offerings.** In addition to our core clearing and custodial capabilities, we're able to offer comprehensive financing options, access to global exchanges and cutting-edge broker technologies. Backed by Axos Bank, we offer financing and collateral management, global trade executions, lending, and syndicate capabilities. Our range of services can help you offer enhanced services to your clients and grow your business.

At Axos Clearing, we never stop thinking of new ways to help you grow your business and truly serve your clients.

For more information, email businessdevelopment@axosclearing.com, call 866-770-0218 or visit axosclearing.com.

Investment Products: Not FDIC Insured - No Bank Guarantee - May Lose Value.

Axos Advisor Services is a trademark of Axos Clearing LLC. Axos Clearing LLC provides back-office services for registered investment advisers. Neither Axos Advisor Services nor Axos Clearing LLC provides investment advice or make investment recommendations in any capacity.

Securities products are offered by Axos Clearing LLC, Member FINRA & SIPC.

Axos Clearing, LLC does not provide legal, accounting, or tax advice. Always consult your own legal, accounting, and tax advisors.

© 2023 Axos Clearing LLC. Member FINRA & SIPC. All Rights Reserved.