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Weather Any Storm

Digital Operations Make Broker-Dealers More Resilient

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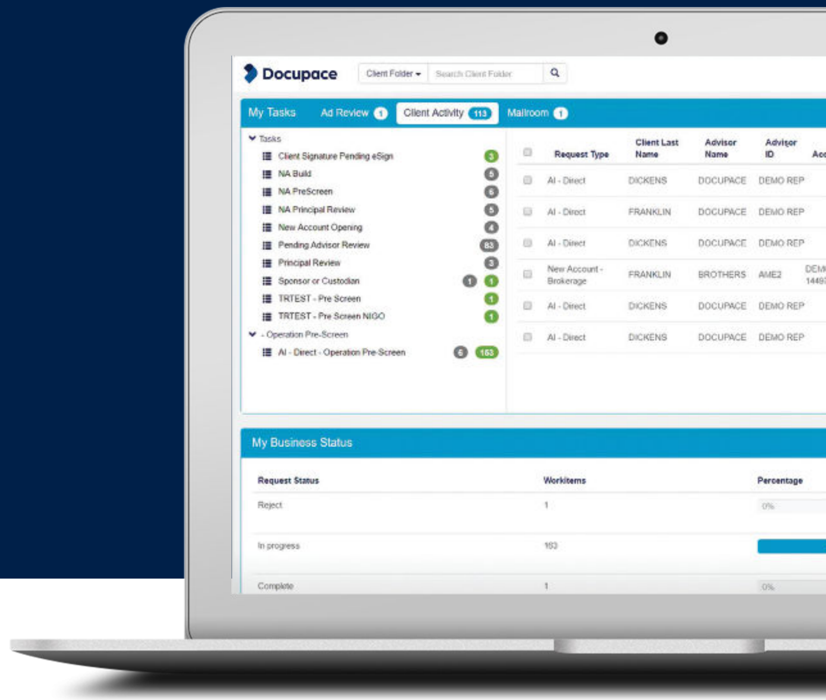


Introduction

The COVID-19 pandemic is unlike anything the wealth management industry has ever faced.

Between rapidly implementing social distancing measures and responding to economic downturn on a mind-boggling scale, the adaptability of wealth management firms everywhere is being tested. Business continuity plans — where they existed at all — are being reshaped and reassessed to meet these unprecedented challenges.

What can broker-dealers do to assure their survival in such an uncertain environment? For one, they can consider how other firms have survived past catastrophes, and incorporate those survival strategies into their own organizations.

Let’s take a look at an example of the kind of resilience that firms will need to survive this global crisis…and the next.

A Page from Recent History

September 10th, 2017—Hurricane Irma makes landfall in Florida. With winds recorded at 130 mph, Irma becomes the most intense hurricane to hit the continental U.S. since Katrina. By the time the storm dissipates, it's credited with causing $50 billion worth of damage.

At the time, Irma was the fourth-costliest tropical cyclone to impact the United States. However, it would be outdone later that same month by Hurricane Maria. These storms are part of a pattern of increasingly costly and frequent disasters. Since 1970, the number of high-impact natural disasters like fires and floods has more than quadrupled. In 2017 alone, the U.S. was affected by 16 natural disasters that each caused more than $1 billion of damage.

In the past, a disaster like Irma would have meant lengthy business disruption for Florida's wealth management industry. Broker-dealers located in evacuation zones would have been kept away from the materials they needed in order to conduct business, and many of those materials would have been damaged in the storm.

However, thanks to digital operations, many broker-dealers were able to withstand Irma without losing so much as a day of business. Raymond James picked up the operations from it's St. Petersburg headquarters at backup facilities in Memphis, Detroit, and Denver. Ladenburg Thalmann Financial Services Inc., parent company to five independent broker-dealers, was also able to temporarily relocate it's substantial Florida-based operation without any service interruption.

What gave these broker-dealers the ability to weather the storm? They all use digital operations instead of relying on paper-based processes. Improved digital capabilities have made them more resilient to even the most catastrophic hurricanes.

In fact, digital operations improve resilience to more than just weather. Digitally-enabled broker- dealers are more prepared to withstand surprises across a variety of risk categories, including cybersecurity, technological change, regulatory challenges, consolidation, and talent shortages.

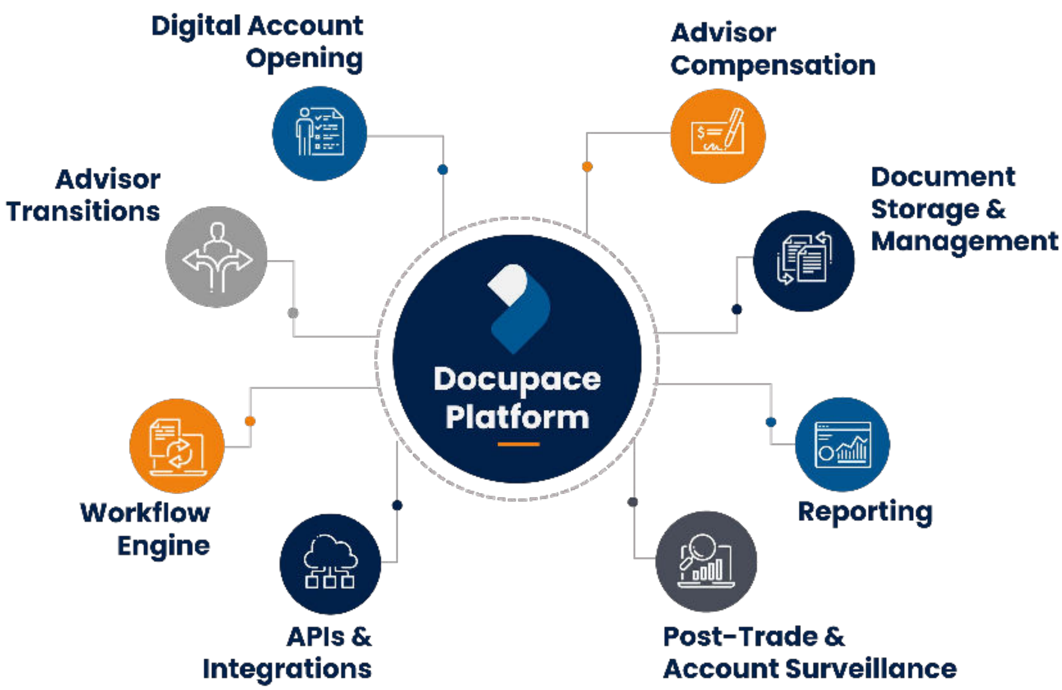
Going digital is a requirement for wealth management firms who are focused on achieving long-term goals. The more a firm relies on paper-based processes in any part of the organization, the higher its overall risk profile, no matter whether that risk is from a fire, a hacker, a hungry competitor, or a global pandemic.

In this whitepaper, we'll provide a brief overview of digital operations in wealth management, and go into detail about how digital technologies can shield broker-dealers and RIAs from various sources of risk.

What Do We Mean By "Digital Operations"?

When we talk about digital operations, we're speaking generally about any business process that uses digital technology instead of paper. Opportunities for digital optimization exist across offices and departments, from accounts payable to HR. However, in the wealth management industry, the highest-priority targets for digitization are typically:

- Document Management
- Client Onboarding
- Advisor Transitions



Document Management

Implementing a digital document management initiative means ending reliance on paper documents, fax, and mail. A comprehensive digital document management strategy includes plans for storage, access, and cybersecurity. The most advanced digital document management operations make use of off-premise cloud storage, a user-friendly platform for document search and recall, workflow automation, a broad suite of physical and software security controls, and a well- thought-out access and permissions policy.

Client Onboarding

The traditional client onboarding/new account opening and maintenance process is frustrating for clients, advisors, and back office personnel. Paper-based client onboarding requires the use of outdated fax and mail systems that limit visibility for advisors and create an administrative burden for broker-dealers and RIAs. In addition, not-in-good-order (NIGO) applications are common in paper-based systems. Digital client onboarding technologies replace these outdated systems, improving speed, compliance, and satisfaction in the field and in the back office.

Advisor Transitions

Recruiting the best advisors is a must for resilient wealth management firms. Unfortunately, regulations regarding the protection of client information make leaving one broker-dealer or RIA for another massively challenging for advisors. Digital advisor transitions operations can ease the burden on advisors, creating workflows that minimize business disruption while complying with all SEC and FINRA regulation

How Digital Operations Increase Resilience

Implementing just three digital operations strategies — document management, client onboarding, and advisor transitions — can make broker-dealers and RIAs more resistant to a wide variety of threats. In this section, we'll explore how these threats lose their power against digitally-equipped firms.

Global Pandemics

The COVID-19 pandemic is perhaps the greatest threat wealth management firms have faced in recent decades.

As global recession and widespread financial stress hit clients hard, advisors are under immense pressure to put them at ease. In many cases, in-person meetings will not be possible, and digital communication will be a core method for building and maintaining relationships.

Meanwhile, in the back office, even the most robust business continuity plans are being stretched to the limit by unprecedented disruption to everyday operations.

Trend Watch

For finance leaders in the U.S. and Mexico, the top concerns related to COVID-19 are financial impact (71%), global recession (64%), and effects on workforce/productivity (41%).

Source: How COVID-19 is affecting the asset and wealth management industry, PwC

For many firms, social distancing has meant a sudden shift to remote work, and increased technological frustrations as employees adjust to their "new normal."

If one thing is clear in the confusion, it's that remote work and its associated technological challenges must be built into your firm's business continuity plan. Digital tools offer much-needed flexibility, reducing the impact on operations during times of disruption.

The timeline for the pandemic remains uncertain, and periods of intermittent social distancing may be required for years to come. Additionally, many scientists agree that new pandemics will continue to emerge as a result of our hyperconnected world.

In other words, this isn't a one-time issue. Though the COVID-19 pandemic may be temporary in the grand scheme of things, it offers important lessons about adaptability and resilience that will still be relevant for the next global crisis.

The Elements

In 2012, Hurricane Sandy ravaged New York. The vault of the Depository Trust & Clearing Corporation was flooded, damaging the paper records of as many as 3.6 million securities. Over 8,000 boxes of FBI investigation files were damaged by flood waters. Thousands of homes and businesses were destroyed, along with countless financial records.

Trend Watch

$4 Trillion in assets will be at risk from climate change by 2030.

Source: Adapt To Climate Change Or Face Extinction, Forrester

These numbers are staggering, but it doesn't take a record-setting hurricane to illustrate the danger of relying on paper records. Fires, floods, pests, mold — they can all impact the integrity of paper documents.

If a fire burned through all of your firm's records, would you be able to bounce back? You might have insurance to help pay for the damages, but the operational challenge of moving forward without critical documents would be a nightmare. Tack on any regulatory consequences, and you have a potentially disastrous situation.

If a fire burned through all of your firm's records, would you be able to bounce back?

When implemented correctly, digital document management makes broker-dealers and RIAs nearly impervious to records damage caused by natural disasters. If records are stored digitally on secure cloud servers and properly backed up, the likelihood of a flood or fire destroying that data is minimal.

As we explored in the introduction, resilience to the elements is about more than just file integrity. Digital operations are a necessary component of any firm's business continuity plan; they're what enabled Raymond James to continue working in the face of Hurricane Irma, and the same would apply in almost any natural disaster scenario.

In a local business environment, closures due to natural disaster aren't necessarily problematic. After all, no one is out getting brunch the day after a major storm. However, due to the dispersed nature of the wealth management industry, it's not good enough for an advisor in California to have to turn away a client because of bad weather in New York. Digital operations help broker-dealers ensure national business continuity, and avoid potentially significant financial losses.

In addition, local advisors are likely to become busy in the weeks following a natural disaster. Clients who have been affected by the event find themselves in a new financial paradigm, and they may need to reallocate some of their funds toward emergency rebuilding or healthcare costs. Advisors must be available to these clients to make these transfers possible, which requires their broker-dealer to be open for business.

Theft, Sabotage, and Data Breach

It's not just natural elements that leaders at wealth management firms have to worry about; the human element is a source of anxiety as well.

Whether they're stored within your offices or off-site at a warehouse, the physical security of important financial information

Trend Watch

Global cyber attacks and data breaches are rising steadily, increasing by almost 100% between 2016 and 2017.

Source: Cyberattacks Doubled in 2017, Infosecurity Magazine should not be taken for granted. Doors can be broken down, locks can be picked, or, more likely, improperly secured records can be swiped from a desk or a briefcase. And unlike digital documents, which can be encrypted, just having access to paper documents gives bad actors everything they need to cause serious damage through destruction or alteration.

> Securing financial documents from thieves, disgruntled employees, or absent-minded filing clerks is much easier when those files are stored digitally in the cloud.

Securing financial documents from thieves, disgruntled employees, or absent-minded filing clerks is much easier when those files are stored digitally in the cloud. Permissions controls can be implemented to limit access to records to certain individuals. Encryption can be used to minimize the possibility of public disclosures. In addition, certain document management systems can ensure safety and compliance by storing documents in such a way that they're non-rewritable and non- erasable, complying with SEC and FINRA write once, read many (WORM) rules.

Technological Change

Artificial intelligence, robo-advisors, low-cost financial apps, blockchain, cryptocurrency — all of these technologies threaten to upend the traditional asset and wealth management structure.

There is a lot to learn or understand about millennials, as they continue to show a preference toward simple, passive portfolios, alternative investments, and DIY asset management. However, these trends are not built into millennials' DNA. They are a reaction to shortcomings with current advising practices, which can be expensive and slow.

> **Trend Watch**
>
> **As of July 2019, Millennials are the largest segment of the adult population. Their numbers are projected to peak in 2033.**
>
> Source: Pew Research Center

As a perfect illustration, PwC points out that part of the reason millennials are attracted to robo-advisors is that processes like new client onboarding only take two or three steps, compared to 20 or 30 paper-based advisors.

By implementing digital operations initiatives like paperless client onboarding, esignatures, and client-facing web portals, broker-dealers and RIAs can bridge the gap between their advisors and the increasingly important millennial

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audience. There is still a lot to learn about these individuals' financial habits, and technology- focused broker-dealers are in a better position to adapt.
In addition, the simple truth is that technology in wealth management is only going to become more critical. The longer a firm waits to engage in digital operations, the more difficult it will be to make the leap. Implementing a digital operations platform that integrates with other paperless tools can put a firm in a position where it's ready and waiting for the next big thing, instead of always playing catch up.

Regulatory Challenges

SEC Regulation Best Interest (Reg BI) is just one recent example of increasing regulatory pressure in the wealth management industry.

With each new regulatory change, broker-dealers and financial advisors are challenged to incorporate new requirements (such as Form CRS) into their workflows, complicating their existing processes.

> **Trend Watch**
>
> **Around the globe, wealth management regulations are becoming increasingly complex, and increased scrutiny is being placed on client data security.**
>
> Source: Parting of the ways? Evolving Asset Management Regulation report, KPMG

Firms that still rely on paper-based document management and client onboarding have a simple option for reducing compliance costs. Digital client onboarding solutions have been proven to drive NIGO rates down into the single digits, and digital document management reduces the labor-hours and business disruption necessary to handle an audit.

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While regulations continue to shift and compliance costs remain high, making these changes could mean the difference between profit and loss for some broker-dealers and RIAs.

Mergers & Acquisitions

The industry is consolidating, and larger firms are systematically gobbling up small- and mid-sized independent broker-dealers and RIAs. However, the increase in M&A presents two major opportunities for digitally-enabled firms.

First, by drastically reducing administrative costs through the use of digital operations, some firms may actually free up enough resources to enter First, by drastically reducing administrative costs through the use of digital operations, some firms may actually free up enough resources to enter the M&A arena themselves. After going digital, it's not unheard of for broker-dealers to eliminate their call centers, downsize, or even move to areas with a lower cost-of-living. These changes can all help firms resist the temptation to sell, and maybe even acquire a few smaller firms of their own.

Mergers and acquisitions often create exodus events of high-quality advisors who don't want to go to work for their new parent company.

Second, consolidation creates an incredible opportunity for firms with digital advisor transitions operations. Mergers and acquisitions often create exodus events of high-quality advisors who don't want to go to work for their new parent company. These events are a gold rush for recruiters, who can use their tech stack and quick, painless advisor transitions workflows to attract the cream of the crop to their firms.

Talent Shortages

As technology becomes more important to the success of wealth management firms, the fight for good talent is going to become even more intense. Resilient firms will be the ones who can attract advisors and back office employees who will be able to innovate and grow along with the industry.

Trend Watch

Only **11.7%** of U.S. financial advisors are under age **35**.

Source: Babybust? Only 11.7% of financial advisors are under 35: Cerulli, Retirement Income Journal

Diversity and inclusion initiatives are bound to play a big role in deciding which firms get the best talent. After all, it's been proven time and again that diverse businesses are more innovative and better at capturing new markets.

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So where does technology come in? We've already covered how digital advisor onboarding can attract top-level advisor talent, but what about the back office?

Digital operations can introduce a number of new benefits for back office employees, including the ability to work remotely. When documents are stored in the cloud, advisor support staff are no longer tied to their filing cabinets. They can take their team's data on the go, giving them more flexibility and improving work-life balance.

This kind of flexibility can help firms meet their evolving hiring goals. When employees don't need to be in the office 9-5 every business day, the workforce can expand to include parents of young children and people without access to transportation, among others.

Conclusion

You can't know where the next big threat will come from or in what form, but there are steps you can take today to help your firm survive in spite of it — and those steps are less complicated than you might think.

Resilience isn't just about weathering the storm. The same digital technologies that can help your firm survive can also help it thrive. Decision makers are now in a position where they can simultaneously protect their firm from negative realities and take advantage of positive ones. Why wait?

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