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Snowden Lane Perspectives: Some Things You Probably Didn't Know About the Protocol for Broker Recruiting

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Rob spent 22 years at Merrill Lynch, in New York, Singapore, Hong Kong, and London. He was General Counsel and Chief Business Risk Officer of Global Wealth Management (GWM) and a member of the GWM Executive and Operating Committees. He previously held senior executive positions in International Private Client and the Asia Pacific Region. Rob started at Merrill Lynch in London (Europe, Middle East and Africa Region) and before that worked at the U.S. Securities and Exchange Commission. He has a BA from Franklin and Marshall College and a JD from George Washington University. He is Chairman of the Board of Centurion, the oldest organization in the U.S. dedicated to freeing the wrongly convicted, a former Chairman of the Board of the American Red Cross of Central New Jersey and a founding Board member of the Christina Seix Academy, a residential school for underprivileged inner city children.

In 2004, I participated with a relatively small group of business and legal people who originated the Protocol for Broker Recruiting (the Protocol). For 13 years since, and until co-founder Morgan Stanley departed days ago, the Protocol has enabled the efficient movement of Financial Advisors and clients between member firms. If the other founders exit, which seems likely, the Protocol may be threatened with extinction. Its demise will be a sad day for financial advisors and clients alike, but is not likely to re-set the clock to the way things were, or staunch the movement of advisors to the independent market place.

The circumstances that resulted in the Protocol's origin are not widely known. And while it's true it was driven by the big firms' desire to avoid the enormous cost of lawyers pursuing and defending recruited financial advisors, it was another issue altogether that triggered major competitors to initially consider forming a pact. I believe that without that catalyst, it's unlikely the original firms would ever have commenced discussions.

For those who remember back to 2004, Merrill Lynch, and other firms, found themselves deep in the swamp that was Elliott Spitzer's (then NY Attorney General) campaign against Wall Street. Recall that Spitzer used New York's criminal law, the Martin Act, as a club - and this was a time when corporations still feared that a criminal charge or conviction could threaten a firm's very existence. It's hard to overstate the concern within the big firms at that time. For example, at Merrill, we were charged with scrubbing the businesses, to identify and evaluate any business practices that might even remotely give rise to criminal liability.

A surprising one bubbled up from our review of the Global Wealth Management business, and it related to an obscure recruiting lawsuit in a Federal District Court. If recollection serves, a judge in the case had threatened use of another criminal statute, the Economic Espionage Act, against a firm that had recruited a financial advisor, on the theory that they were complicit in assisting their recruit to violate the law by bringing "trade secrets," (*i.e.*, client information), to the hiring firm.

Surprisingly, the threat of criminal liability was deemed real enough at the time to look to formulate a way around it, and the Protocol was conceived. Each of the founding firms took their own view on liability, but if one saw any threat, it was easy to understand it could be a significant problem due to the volume of recruits each firm handled and the largely de-centralized process by which recruiting was accomplished.

Morgan Stanley has apparently moved on from worry about criminal liability associated with recruiting, but in 2004 that risk was perceived. That risk, and the host of business issues that have been well discussed in the media, resulted in the Protocol's founding.

The regulators, and the Securities and Exchange Commission (SEC) in particular, loved the Protocol from the get go because it facilitated client choice and removed significant impediments to the free movement of clients from one firm to another. It's remarkable how difficult it can be for a client to move their account when the losing firm has legal protection to delay that transfer. Whether or not the regulators respond to the Protocol's demise if it happens, they should.

Internal discussions around joining the Protocol were fascinating. At Merrill Lynch, we knew, being hugely on both sides of the recruiting game, that the firm would save millions of dollars in legal fees not having to defend and sue financial advisors and competitors. Nonetheless, it rapidly became apparent there were essentially two points of view. Mostly, people were either "Free Traders" or "Protectionists."

Simply put, Free Traders believed that advisors would move or stay based on the strength of the brand, platform, products, services, culture and compensation. Advisors stayed with a firm because of those things, and because they felt part of a special community and had institutional pride.

Protectionists believed that if you opened the gates, there would be an exodus. Advisors would look to monetize their books at the first opportunity.

To some extent, both sides were right. It's fair to say that the Protocol helped fuel the soaring advisor recruiting packages over those 13 intervening years – and greased the skids for many advisors and clients to move.

But not everyone looked to the exits and it is also fair to say that the Protocol helped make firms better in order to retain advisors and clients, and to recruit new ones. It is impossible to refute that in a protectionist environment, advisors have less leverage and firms less incentive to look after them.

What wasn't anticipated was the financial crisis, and the wirehouses becoming banks. One consequence of that has been the gradual "homogenization" of the big firms. Twenty years ago, the wirehouses had markedly different personalities. Today, they seem, in many respects, indistinguishable from one another, particularly from the perspective of a financial advisor's daily work environment. Today, the primary reason for a financial advisor to move from one to another is money.

So, what are the likely consequences if the Protocol fades away? Certainly, a new litigious stance by Morgan Stanley and other large firms will chill recruiting. But I suspect it will mostly chill recruiting between the large firms, movement between which, since the crisis, was financially motivated anyway. I suspect it will be less inhibiting to those who genuinely care about their clients' best interests and seek independence. Overall, it will probably be temporary, as advisors and firms adapt to old rules in a new era.

Tactically, a lot has changed since 2004. Top advisors have fewer clients, and they have more ways of keeping contact with them, including texts, Snapchat, Facebook, LinkedIn, Instagram – none of which existed in 2004. It's a lot easier for an advisor's clients to follow an advisor without being solicited.

Morgan Stanley has sent a firm message to its advisors about who owns clients, and now will go into court and arbitration saying that client names are trade secrets, even though they weren't for 13 years.

About Snowden Lane Partners

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And what about all those who arrived with Protocol spreadsheets and brought their books to Morgan Stanley? And, of course, it won't take long before Morgan Stanley is again on both sides of the recruiting battle and wasting money like before.

So, the pendulum swings, and perhaps the free trade environment of the past 13 years will descend into protectionism. Or maybe one or two firms will stay a beacon of the free market. For sure, recruiting will not stop.

Maybe someone will even seek to invoke the Economic Espionage Act and firms will once again realize that we should make sure there is no confusion between client identities and trade secrets.