Morgan Stanley to Pull Out of Recruiting Pact with Rival Firms

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(Clarifies in 7th paragraph that firm's exit from the Protocol is effective on Friday morning, not end of day.)

Morgan Stanley said Monday that it is dropping out of the Protocol for Broker Recruiting that large firms signed more than a decade ago, underscoring what it calls its "commitment" to spend money on retaining experienced brokers and training new ones rather than hiring them from rivals.

The Protocol was a revolutionary attempt by Merrill Lynch, Smith Barney and UBS Financial Services in 2004 to reduce litigation costs created by attempts to prevent brokers from calling their former clients. (Morgan Stanley joined the inter-industry pact in October 2006.) It allows brokers to move with five rudimentary pieces of client contact information after giving notice to their managers.

The Protocol has lost its protective punch for the big firms in recent years as more than 1,600 small broker-dealers and registered investment advisory firms have become signatories, allowing them to recruit from the bigger firms without fear of reprisal.

"[O]ver time the Protocol has become replete with opportunities for gamesmanship and loopholes," Morgan Stanley said in a news release.

"[F]irms have opportunistically joined the Protocol to make a strategic hire and then dropped out; firms have invoked the benefits of the Protocol when hiring while using non-Protocol affiliates to circumvent the Protocol when they lose talent; and firms have unilaterally made exceptions to the scope of the Protocol, undermining the objective of a universal set of rules. In its current state the Protocol is no longer sustainable."

The exit will allow Morgan Stanley “to invest more heavily in its world-class advisors and their teams, helping drive additional growth opportunities,” the press release said.

Morgan Stanley told managers on a conference call on Monday that the exit will become effective at the start of the day this Friday. Thereafter, any advisor jumping to another firm will be subject to a one-year non-solicitation ban.

“Morgan is taking the view that there is nowhere to go, and that’s not true,” said a 30-year veteran of the firm and its predecessors who spoke on condition of anonymity. “I think if it takes effect on Friday, you’ll see a lot of people leave on Friday.”

Rivals, to be sure, can’t hire brokers without doing weeks of due diligence on their production, compliance records and demeanor, said a complex manager at a large regional firm that has become a more aggressive recruiter as wirehouses pull back. “Unless they have been in the pipeline, any deal we offered would have to be heavily hair-cutted,” said the manager, who spoke on condition of anonymity.

The big question, according to recruiters and competitors, will be whether other large firms will follow Morgan Stanley, and whether it will bare its teeth by actually bringing lawsuits.

“it’s likely a matter of time before the other major players do the same,” said Louis Diamond, a vice president at Diamond Consultants, a recruiting firm for brokers.

The New York-based company and UBS, Wells Fargo Advisors and Merrill Lynch in recent months have become more aggressive in seeking court-imposed restraining orders to prevent brokers from contacting former clients by alleging that they were violating Protocol rules. The legal actions complement their decisions to pare back expensive recruiting efforts and also give managers and remaining brokers more time to try to convince their departing colleagues’ clients to stay rather than to follow their broker to a new firm.

Morgan Stanley’s decision to walk away from the pact may be mere saber-rattling, aimed at intimidating brokers concerned about the details of restarting their practices at another firm with threats of legal action, said some recruiters. But other recruiters, brokers and consultants said the effect on brokers’ mobility could be severe.

“It’s going to increase the amount of litigation and arbitration around the Street,” said Ross Intelisano, a plaintiffs’ lawyer at Rich, Intelisano & Katz in New York, who often represents brokers and customers suing broker-dealers.

Morgan Stanley’s size—its 15,700 brokers comprise the largest salesforce in the retail brokerage industry—and the consequences of its purchase of Smith Barney made it ripe to be a first mover in breaking out of the Protocol, several observers said.

The retention bonuses it gave to thousands of Smith Barney brokers in the form of forgivable loans, along with related promissory notes obligating brokers to repay unamortized balances if they leave before the loans mature, are poised to expire over the next few months. Removing that payback restraint likely worried Morgan Stanley at a time when its brokerage force has been contracting.

Without the protection of the Protocol, Morgan Stanley is betting that fewer brokers will leave.
