

The Collapse of the Broker Protocol

By Joshua Horn and Benjamin H. McCoy

Introduction

Since 2004, brokers have enjoyed relative freedom of movement in changing employers. The genesis of this freedom can be traced to the Protocol for Broker Recruiting (the “Broker Protocol” or the “Protocol”), an industry-wide agreement between thousands of brokerages to refrain from suing one another when a broker leaves with client contact information. However, cracks in the Protocol are beginning to surface with some of the nation’s largest wealth management firms departing from it. Many fear a return to the days of old, when a broker’s change of firms routinely resulted in lawsuits by his or her former firm seeking injunctive relief. Such litigation inevitably led to a freeze in client assets and bred uncertainty throughout the industry. In this article, we walk through the beginnings of the Protocol, its benefits and drawbacks, the reasons firms are leaving, and the compliance implications of these new developments.



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What is the Broker Protocol and Why Was It Formed?

The Broker Protocol was formed in 2004 by large wire houses in order to stem the flood of lawsuits that was wreaking havoc on the industry. At that time, it was common for large brokerage firms to initiate litigation against departing brokers to stop them from taking clients and their attendant brokerage fees. Such litigation almost always involved temporary restraining orders and a freeze of client assets. In enjoining brokers, the firm could prevent, or at least delay, the brokers from contacting their clients. In the early 2000s, such disputes led to an outcry when clients were unable to access their funds while they were tied up in litigation.

As regulators circled, Merrill Lynch, UBS PaineWebber, and Smith Barney entered into the Broker Protocol. They were followed two years later by Morgan Stanley and Wells Fargo Advisors (then, Wachovia Securities). Eventually thousands of firms and Registered Investment Advisers (“RIAs”) joined the Protocol, with an estimated 1,700 firms participating today.

The Broker Protocol is aimed at protecting client interests by giving clients freedom of choice when their registered representatives change firms. To accomplish this, the Protocol forecloses liability on a departing representative and his or her new firm by reason of taking certain client information upon departure.

Specifically, a departing broker can transfer a client's name, address, phone number, email address, and account title. At bottom, the Protocol establishes a streamlined framework to protect client information while also providing departing brokers an opportunity to maintain the client relationship.

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The End of the Protocol?

In the fall of 2017, Morgan Stanley decided to leave the Broker Protocol. In doing so, Morgan Stanley indicated that most, if not all, of its brokers would be barred from soliciting clients for 12 months after leaving the firm. Shortly thereafter, UBS and Citibank announced that they also were leaving the Protocol.

Both firms indicated that leaving the Protocol was part of a broader overhaul in a business philosophy that saw them drastically cut back on recruiting senior advisors in favor of building up their in-house workforce.

Industry factors could also help explain why the larger firms no longer view the Protocol as viable. Since 2004, there has been a substantial increase in boutique and independent shops. The increasing exodus of brokers toward more independence can be attributed to a number of factors, including conflicts arising from the sale of "in-house" products, the advent of the fiduciary rule, and a decrease in the technological advantages large firms once enjoyed.

What Has Been the Effect of the Departures?

Not surprisingly, the large wire houses have initiated litigation against departing brokers. As noted above, such suits usually seek preliminary injunctive relief to thwart the exit of clients and firm information. In the typical case,

an injunction is sought until the merits of the dispute can be heard in FINRA arbitration.

For example, in December 2017, the District of New Jersey granted Morgan Stanley's request for a preliminary injunction precluding the departing broker from soliciting his prior customers or using any of Morgan Stanley's confidential information. See Order, *Morgan Stanley v. Fitzgerald*, No. 17-12866 (D.N.J. Dec. 13, 2017), ECF No. 19. In that case, Morgan Stanley had evidence that the departing broker was e-mailing clients the morning he resigned using information he obtained during his time at Morgan Stanley. See Compl., *Morgan Stanley v. Fitzgerald*, No. 17-12866 (D.N.J. Dec. 2017), ECF No. 1. Notably, the Court rejected Fitzgerald's argument that injunctive relief was inappropriate because the information he took would have been acceptable under the Broker Protocol.

Both Morgan Stanley and UBS have obtained similar results against other departing brokers. See, e.g., *Morgan Stanley v. Glazer*, No. 17-9107 (N.D. Ill. Dec. 21, 2017), ECF No. 14. As in *Fitzgerald*, the departing brokers took confidential customer information when leaving for smaller brokerage houses. See *id.* (noting that broker e-mailed himself a list of customers before departure). As reported by AdvisorHub, a majority of the brokers subject to TROs had to leave their new jobs as a result.

But there have also been successful departures where brokers have defeated attempts at injunctive relief. For example, Morgan Stanley withdrew its request for a TRO against Patrick O'Neill after he filed an affidavit stating that he had not taken any confidential information upon departure. See O'Neill Aff., *Morgan Stanley v. O'Neill*, No. 18-10602 (E.D. Mich. Feb. 26, 2018), ECF No. 9-2. In that case, there was essentially no documentary evidence indicating that O'Neill had taken customer information. Similar circumstances have resulted in numerous unsuccessful attempts by UBS at the state level.

In short, the former firms have been aggressive in enforcing the terms of broker employment agreements. While the results have varied, they generally turn on a simple question: did the departing broker comply with the employment agreement? In addition, most successful departures seem to occur where the new firm possesses the resources capable of fighting it out in court and before FINRA.

At this point, it bears noting that one major difference between the pre-Protocol days and now is the effect of this litigation on client assets. In the pre-Protocol day, the freezing of client assets during litigation between a broker and his former firm was a major issue. But that is no longer the case. Indeed, current FINRA rules – such as those relating to servicing standards, notice, and recordkeeping – ensure that in today's landscape client accounts will continue to be serviced and available. In short, the new wave of broker litigation will have little-to-no impact on customers themselves.

What is the Outlook Going Forward?

While the Protocol has lost some major players, it continues to exist with thousands of members. The mass exodus that many predicted has yet to occur and it is unclear when, if ever, that will happen. However, the sheer volume of brokers covered by the heavy hitters that have departed affects billions in assets under management. Indeed, in the immediate aftermath of exiting the Protocol, Morgan Stanley and UBS saw around 90 brokers covering \$12 billion in assets under management depart for new firms. For that reason, many are once again calling for regulators to get involved. Ironically, the threat of regulation was a major reason for the Protocol's formation in the first place. But given the change in the industry's landscape, regulation might be something that larger firms welcome as they adjust their business models accordingly.

The recent litigiousness of former firms – whether successful or not – has likely sent a message to their brokers to think twice about leaving. As noted above, TROs can be devastating. At the same time, however, the victories of departing brokers in court have provided a model for other brokers to follow. The true impact of the Protocol's demise on broker mobility will likely not be clear for a few years.

The Broker Protocol is aimed at protecting client interests by giving clients freedom of choice when their registered representatives change firms.

For firms recruiting from non-Protocol members, it is important to have a framework and policy in place to ensure that incoming brokers comply with their employment agreements and handle client information properly. It may also be necessary to increase the budget outlay for legal costs in order to assist the incoming broker in any litigation that might arise over his or her departure from the former employer. Nevertheless, there is only so much a firm can do because, at the end of the day, the onus is on the brokers to ensure that their departure meets the material obligations of the employment agreement.