



Patrick J. Burns: I'm not sure the SEC or FINRA has the stomach for a return to the days of heavy litigation.

Broker protocol may be endangered by complexities as membership starts to explode

Merrill Lynch, LPL and Ameriprise create addendums to once-sacred truce; they may spark an unfavorable trend

Brooke's note: The broker protocol has always had the air of something that was too good to be true as a no-fault truce between brokers and the broker-dealers that they defect from. A broker is happy that it allows him or her free passage to independence or a new employer. An employer is happy because it keeps the broker from conspiring with clients ahead of time. But considering how precarious the balance of this compact is, it was hard to imagine that broker-dealers wouldn't seek to tweak the deal. This article is about how the first signs of this inclination on the part of broker-dealers is starting to occur and what it means to the industry. As an added note, the broker protocol list, with firm names and dates of enrollment, is published [here](#).

As the number of firms joining the Protocol and using it to recruit top producers swells, three big companies have put limits on the extent to which the no-fault poaching truce applies to them.

Though the restrictions have so far been fairly minimal, the number of signatories and the addendum letters by Merrill Lynch, LPL and Ameriprise are raising questions in some lawyers' minds about whether the Protocol may eventually become difficult to use.

"You have such an explosion of members, it's become unwieldy," says Thomas B. Lewis, a shareholder of Stark & Stark, a Princeton, N.J.-based law firm that counsels financial advisors. "What's happening now is that there are certain companies that are trying to limit their exposure under the Protocol, which makes it even more unwieldy."

Potential problem

That's a potential problem for RIAs and breakaways, because the Protocol has been the legal conduit by which registered reps have been departing from large firms, including the wirehouses. The Protocol has been simple to use, but if a small RIA had to look at all of the existing letters and decide if they applied to his or her situation, the effort involved could put a damper on the use of the Protocol.

"Take this out a year from now: what if there are 50 or 100 side letters?" says Patrick J. Burns Jr., a lawyer in Beverly Hills.

The Protocol was originally established by three firms – Smith Barney, UBS and Merrill Lynch – as a way to avoid the expensive litigation that went along with brokers switching from one big firm to another. The Protocol lays out the rules by which a broker is permitted to solicit clients.

Over the years, more and more companies have joined the Protocol, and it's now being used by breakaways who want to become independent, and by RIAs who want to entice breakaways to their firms.

List of broker protocol signatories

RIABiz obtained a copy of the list of signatories, which is maintained by Wachtell, Lipton, Rosen & Katz of New York. The list is posted at the bottom of this story. Joining the protocol is as simple as sending an e-mail to Wachtell. Once a company is a signatory, it regularly receives a copy of the list of all the companies that have signed on.

Here's a copy of the list of [signatories as of 12/21/09](#)

In the three months since RIABiz last wrote about the Protocol, more than 40 firms have joined it, bringing the total to more than 405. Between the beginning of October and December 21st, the time period covered by RIABiz's copy of the list of signatories, the number jumped from 364 to 407. Just a little more than a year ago – in November of 2008, there were only 118 signatories.

The pace shows no sign of abating.

"It's still a real crush," says Rob Ross, an associate with the Hamburger Law firm. He notes, however, that there may be a tipping point. If the Protocol becomes inconvenient for a big firm, one may pull out altogether.

FINRA, SEC and employment-related litigation

However, Burns says the collapse of the Protocol would likely draw regulators' attention. FINRA and the SEC have both said the Protocol is an agreement between companies, and thus is not their concern. That could change if employment-related litigation surged again.

"I'm not sure the SEC or FINRA has the stomach for a return to those days," Burns says.

Ameriprise

Ameriprise was the first, in June of 2009, to add a letter of addendum, which was sent to all the members of the Protocol. Its letter appears to exclude from the Protocol, under some conditions, advisors who are becoming or joining Ameriprise franchisees, though the company didn't return calls to clarify its meaning. See the letter [here](#)

Merrill Lynch/BofA

In December, Merrill Lynch issued a letter excluding from the Protocol the Bank of America advisors who were being merged into Merrill as part of BofA's acquisition of the big wirehouse.

According to Lewis, the Protocol is worthwhile for a company that is luring advisors to its platform. In essence, a signatory gambles that it will gain more advisors than lose, and so have no-fault truce will pay off for it. For small

companies, it almost always make sense – big companies aren't actively trying to recruit from small companies. For big companies such as wirehouses, joining the Protocol is more of a judgement call.

At the time that it decided against joining the Protocol, and indeed explicitly excluded the BofA advisors from being covered by it, Bank of America was losing more advisors than it was gaining.

“There's no real reason to join the Protocol (in that situation),” Lewis says.

See the letter [here](#)

LPL

On Jan. 3, LPL Financial clarified its participation in the protocol with a letter, as well. It says that in cases where it has a relationship with a bank or credit union, it will not stand in the way of the bank or credit union enforcing restrictive covenants against employees or independent financial advisors.

A spokesman for LPL, Joseph Kuo, further clarified the letter by saying, ““LPL Financial recognizes and respects the relationships that banks and credit unions have with their customers and members. Therefore, LPL has clarified its participation in the Protocol to state more expressly that financial institutions and their associated advisors with whom LPL Financial has written agreements are excluded from the protocol.

“Importantly, this recent clarification is limited to only financial institutions – such as banks and credit unions – and their associated advisors that LPL Financial serves.”

See the letter [here](#)