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BREAKING: Morgan Stanley to Pull Out of Recruiting Pact with Rival Firms

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On October 30, 2017, Morgan Stanley announced that it is withdrawing from the Protocol for Broker Recruiting effective November 3, ending over 13 years of relative peace in the securities industry recruiting wars. Other firms may follow suit. Therefore, broker-dealer and investment advisory firms should be prepared to update their recruiting and hiring practices, as well as review current policies relating to departing financial advisors.

Morgan Stanley, through its predecessor firm Citigroup Global Markets, Inc. (a/k/a Smith Barney) was one of the founding members of the Protocol in 2004. The original pact was signed by UBS Financial Services and Merrill Lynch, Pierce, Fenner & Smith, but was joined by virtually every major wirehouse firm, most of the regional and independent broker-dealers and hundreds of registered investment advisors. As of today, there are over 1,600 members of the Protocol.

The Protocol was implemented to reduce litigation costs related to hiring experienced registered representatives from competitors. Many, but not all firms at the time used non-solicitation agreements in an attempt to limit departing representatives' ability to induce clients to transfer their accounts to the representative's new firm. Very often, a broker's departure would result in litigation to enforce the non-solicitation agreement via a motion for temporary injunctive relief, expedited arbitration proceedings and a permanent injunction. The vast majority of these cases were settled, but not before significant attorneys' fees had been incurred.

The Protocol was also aimed at the then-prevalent practice of brokers taking client files and other documents from their old firm to their new one. Not only did the removal of documents and information hinder the prior firm's ability to compete to retain clients serviced by the departing advisor, but it also implicated privacy issues on behalf of the clients whose information was taken without their authorization. In addition, the practice drew scrutiny from some state securities regulators who were contemplating bringing enforcement actions against firms who participated in or turned a blind eye to it.

Accordingly, the members of the Protocol agreed that as long a registered representative left one Protocol signatory firm to join another and took only certain limited customer information with them—specifically, client names, addresses, phone numbers, email addresses and account types—neither the departing representative nor the new firm would have any monetary or other liability to the old firm by reason of taking the information or soliciting clients serviced by the registered representative.

The practical effect of the Protocol was to sharply curtail litigation among Protocol signatories arising out of their recruitment of one another's experienced financial advisors. However, the Protocol did not end all litigation arising out of broker transitions. Non-signatories to the Protocol continue to enforce their non-solicitation agreements against departing advisors who move to non-signatory firms, and vice versa. In addition, Protocol signatory firms can and do take legal action against departing advisors who violate the strictures of the Protocol. In addition, the Protocol does not curtail a member's ability to bring an action against the departing representative or the new firm for "raiding." There have been some multi-million dollar awards in recent years arising out of mass hiring situations, notwithstanding the fact that both firms involved were Protocol members.

Neither the SEC nor FINRA has officially approved the Protocol. In 2008, the SEC proposed amendments to its customer privacy regulation, Regulation S-P, which would have essentially codified the Protocol as an exception to Regulation S-P. The SEC never took action on the proposed amendment. However, neither the SEC nor FINRA has brought an enforcement action for violating Regulation S-P against a firm or an individual who complied with the Protocol when transmitting customer information. On the other hand, the SEC and FINRA have brought several enforcement actions against firms and individuals who did not adhere to the Protocol when transmitting customer information in the recruiting context.

Steps Financial Services Firms Should Take Now

It remains to be seen whether Morgan Stanley's action starts a stampede for the exits from the Protocol for Broker Recruiting. Nonetheless, it seems reasonable to expect litigation arising out of recruiting in the financial services industry to increase. All financial

services firms should review their current recruiting and on-boarding practices to minimize litigation exposure with new hires. In addition, all financial services firms should ensure that their policies and procedures relating to departing employees are up-to-date and that they are prepared to take swift action when departing employees violate those policies. KD stands ready to assist in reviewing and implementing your policies and procedures or to protect your interests in the event of a recruiting-based dispute.