The 10th Annual Recruiters Roundtable

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Admit it.

You're glad 2008, the year from hell, is over. But will 2009 be any better?

There's endless uncertainty as we enter the New Year. The major firms in the retail brokerage arena are still adjusting to the wrenching changes in ownership structure caused by massive write-downs and losses stemming from the foreclosure crisis and tightening of credit.

Bank of America bought Merrill Lynch. Wells Fargo beat out Citigroup for Wachovia and its A.G. Edwards division. JPMorgan grabbed Bear Stearns, and Lehman Brothers, sadly, collapsed into bankruptcy. Goldman Sachs and Morgan Stanley have become bank holding companies. As the year wound down, and the economy seemed to be in freefall—the Dow had plunged below 8,000 and trillions of dollars in equity had vaporized—our panel examined what it all means, and what the future holds for financial advisors.

OWS: Let's start with Merrill Lynch. Are advisors happy with the Bank of America/Merrill retention package?

Bill Willis: No, they're not. I don't know if any broker's ever been happy with any retention package—but expectations here were considerably higher. Everyone is fairly disappointed, specifically those doing under $1 million in production.

Mindy Diamond: A lot of the sub-million-dollar producers were disappointed, but so were teams. The retention package [was based on] individual production. So a whole group of brokers said: "We did what you wanted us to do, which was to form teams. We've got one guy doing $900,000, another guy doing $800,000-but instead of being valued as a young, growing, fabulous team doing $1.7 million combined, you valued us each at less than $1 million, which means just 75% upfront and having to earn the other 25%."

Still, they're relieved to have been bought out by Bank of America—because their clients are relieved to have a deal providing financial stability. But [these advisors] aren't staying because they're in love with Merrill. They're staying because they're not sure there's a better choice.

Michael King: Most of the brokers over $1.75 million are staying. They get 100% to stay plus 50% for deferred comp, which gives them 150%. So if they can get about 250% realistically other places, it's 100% difference-but this way they don't have to take a chance. [BofA] did a very good job only with that group. The others are unhappy.

Steve Rosen: [BofA] gave the right people just enough to stay, but not [enough] to make them happy. In these market conditions, a lot of brokers are scared to move because they can't move their businesses. When producers doing over $1 million-especially [those doing] over $1.7 million with their deferred compensation—subtract [that level of business] from what they'd get from other firms, the bulk of them temporarily are going to stay put.

Most of the producers under $1 million just felt insulted; many of them are probably going to leave even with the market conditions.

Mickey Wasserman: The retention package reflects what all wirehouses are doing: Squeezing out third- and fourth-quintile advisors. They only want the $750,000-plus or $1 million-plus producers. The big question is: Where are the unhappy guys going to go?

Carri Degenhardt-Burke: [BofA President and Chief Executive Officer] Ken Lewis went on 60 Minutes and basically said he had 17,000 brokers who were being paid too much. That means that the payout is going to go down and life is going to be different. In behind-closed-door meetings, [the new management] had said: "Oh, yes, everything is going to be the same." That was basically a lie.

Rick Peterson: The sentiment of the Merrill brokers is that the retention package was not adequate for what they had been contributing. But there's more consternation on their part as to working for a bank in general. Lewis didn't help matters. When [60 Minutes] asked him if he had overpaid, he had a great chance to say, "Yeah, but we bought a great franchise." [Instead] he said, "We're going to wring $7 billion, $8 billion, $9 billion in savings out of this firm." That's the kind of mentality that brokers have been reluctant to accept from banks.

Rich Schwarzkopf: They want to reduce Merrill Lynch from 16,000 down to maybe 10,000 to 12,000 and make it a smaller, tighter firm. Of those eligible, almost 6,200 brokers accepted the package, but the "thundering herd" you hear is the brokers leaving-probably the largest migration of brokers from one firm in the history of Wall Street.

Danny Sarch: I can see Ken Lewis saying, "Wow, we bought Merrill Lynch," and they say, "Oh, you have to give a retention package to the brokers." I can see him saying, "Why?" Only because it's something that became expected. When I take my kids for pizza they expect ice cream afterwards. It's not written down anywhere-they just expect it.

Brokers expect to get a package. It used to be for interruption of business. But if Merrill Lynch is essentially going to be the same platform, where's the interruption of business? [That's] the culture clash that everybody has alluded to. A lot of these guys are prima donnas-they expected money just because they could get money.

If Bank of America tried to give 100% to everybody, it would've cost $12 billion. This was after they took $25 billion in government money. So they did as well as they could, taking care of the guys at $1.75 million and above.

OWS: Are Merrill and BofA recruiting at all or are they just trying to cut their ranks at this point?

Sarch: They're recruiting—but the contract to recruits was different from the contracts they were giving their own people in some significant ways. That was one of the things that drove them to make the contract less harsh.

King: They still want to recruit. They didn't miss a beat on that. Merrill's been recruiting the entire time. They're going to want $500,000 and above because I don't think they want the $300,000 person any longer. The big question remains: Will BofA change that culture?

Diamond: On *60 Minutes*, Ken Lewis said he'd always wanted Merrill Lynch. And, when it appeared that Merrill was in trouble, that was an opportunity. Clearly they're buying Merrill Lynch for the big boys, the million-dollar producers and teams. There is a message, loud and clear, to those $500,000/$700,000/$900,000 producers, individuals or teams:

Not only didn't you get a retention package—are they going to be investing in you? Are they going to be lowering your payout and trying to push you out the door? What's astounding to me is that many of them just feel happy enough to have gotten their 25% or 50%.

Sarch: Some Merrill brokers think this is all wonderful. They're feeling a sense of security [instead of worrying] about the horrible state of the markets [and how they're going to] keep their clients whole.

That said, name a mega-merger in any industry that, three years later, people say, "Boy, that was great-sure glad this happened." Nobody's been able to. So why do people think this is going to be that way? If you ask the legacy firms that make up Bank of America—from Montgomery Securities to Fleet to Quick & Reilly—those people aren't particularly happy and they don't have any of their own cultures remaining.

Willis: I disagree. B of A wants to keep everyone—they just didn't want to write a check that would be astronomical. They just paid as little as they thought they had to pay to keep everyone they had to. They feel like they bring something to the table that keeps that $300,000 producer there. Loyalty doesn't end in a day and people at Merrill Lynch are the most loyal workers on Wall Street. Many of them are willing to give this a try and see if the firm that they think is better than any other continues to be that way.

Degenhardt-Burke: Before this merger/acquisition, the typical Bank of America broker was doing about $400,000 in gross, which is totally different than the "million-dollar producers" that they want from Merrill Lynch. Their payout is around 34% or 35% versus a 45% payout at Merrill.

Schwarzkopf: I dropped BofA as a client because I found them incredibly bureaucratic, very difficult to work with. Merrill was bureaucratic and huge. It's like moving a whale. This is going to be terrible—two bureaucratic cultures coming together.

Diamond: There is sort of that paradox that they sent this odd message to the brokers doing under $1 million: "We're not that interested in retaining you, yet we're still recruiting brokers under $1 million and paying them a lot of money to get them." That begs the question: What does it mean for deals going forward? Will they only be paying megadeals to $750,000 and up? The BofA culture is not about paying big fat deals. Banks are all about looking for the lowest-cost provider.

Surprise, Surprise

OWS: What's the biggest story to catch you by surprise this past year?

Rosen: The resurrection of retail. Over the past couple of years, retail has been the stepchild. Now retail is the superhero. It's the only stable revenue stream. Instead of hearing spin-off talk, you're starting to see businesses being built around retail.

Sarch: How stark it is that corporate loyalty is just gone. These firms nurtured their people for years and years and years and years—and they destroyed that because of the mistakes at the top.

Schwarzkopf: The terrific growth of the regional firms has been the star, for this past six months anyway. These firms have benefited from all the implosions at the wirehouses and the national firms, which are a dying model. Some of the best brokers will move to regionals. Unfortunately there are only about a half a dozen really big ones—Raymond James, Stifel, RBC, Oppenheimer. In one year, Stifel increased its head count 30%—and that's without taking over another firm.

Willis: Biggest surprise? The utter collapse of the investment-banking business model. What we believed in, all of our careers, suddenly doesn't work anymore, be it Bear Stearns, Lehman Brothers, Merrill Lynch.

These were icons, firms that had been around forever—and suddenly they're either gone or changed or in most instances part of a bank and need to surround themselves by deposits and the Fed window to exist.

Peterson: After the financial meltdown this past year, there is so much angst on the part of investors, disgust on the part of the brokers, lack of loyalty to their firms for getting them into this mess in the first place—there's a flight to independence that I've never seen before. Linsco, the largest independent organization in the country, has become the fifth-largest brokerage firm in the United States. They told me the other day they've gone from three to nine internal recruiters to handle just $1 million producers and up. That's how many people are calling them instead of the other way around.

Wasserman: What caught me by surprise was the panic by the major firms, not realizing what they'd gotten themselves into. We're still running into mergers and acquisitions that look like they [were] put together on a napkin over a weekend.

Diamond: It was all shocking. We thought, when Bear [Stearns] collapsed, that was extraordinary. Turns out, Bear was the lucky one.

King: The biggest thing is the lack of stability. Everything is topsy-turvy. Everything you thought was-is not anymore. But brokers are beginning to say they have some value and they don't have to be frightened because if something happens they can go somewhere else or they can stay in place.

Degenhardt-Burke: Six months to a year ago, everyone was talking about Citi and how that bank model is broken and how [Smith Barney] would have to be spun off. But, in the course of the last four months, everyone has had to go to a bank model. Merrill has been forced into it. Morgan Stanley. Goldman Sachs, for goodness' sake.

A Tale of Two Structures

OWS: Is the bank-holding-company structure for Morgan Stanley and Goldman going to be a different, more broker-friendly culture than the one that's being set up with Bank of America and Merrill?

Degenhardt-Burke: [A] bank holding company is totally different than Merrill Lynch being bought by Bank of America. That's going to change their world forever. Look at Smith Barney and you see the bureaucratic mess that happens-people are going to have their livelihoods affected by not six tiers of management...but by 16 tiers.

Diamond: There's a huge distinction that needs to be made between a bank-owned wirehouse or brokerage and a bank holding company. At Morgan Stanley, for example, [Chairman and CEO] John Mack fiercely fought not to be bought by a bank but to retain that independent, investment-banking wirehouse culture because retail is king in the firm. Retail brokerage is really what saved a lot of these firms. If BofA comes in and really begins to mess with the comp structure for Merrill brokers, they'll leave. They've got a million other places they can go.

Schwarzkopf: It's a mystery why anyone stays at a wirehouse now. In the past 10 years, the wirehouses sowed their own destruction by training everybody to become asset-gatherers and fee-managed businesses. The books used to be 30%, 40% equity. No more. Now equity's 10% or something. Everything is managed, so it's a very easy transition to go to LPL or any other big independent and get a 90% payout and other things.

Sarch: The big firms have a tremendous branding problem. Some of the best "name" franchises in this country are Merrill and UBS and Morgan Stanley and Smith Barney and Citi. We can all say their tag lines. One of the things that used to pull investors in was a firm saying, "This is our business. We're smarter than everybody else." Now the investor is saying, "If you're so smart, how can you have lost billions and billions of dollars?"

Diamond: There's no question that there's been tremendous brand erosion. But no matter what, names like Merrill Lynch and Morgan Stanley and UBS still resonate.

Peterson: The bulk of the [investor] movement has simply been to cross the street—maybe for the perceived safety of another brand name.

But another dynamic [involves] the ultra-high-net-worth (UHNW) community-$25 million or more in investable assets. [These people] used to have positions with Goldman, Lehman, Credit Suisse, Bear Stearns and other firms. A lot of them have [been clients of] family offices-and remained loyal to brokers who left to start their own family offices.

And how do UHNW clients choose their advisors? Something like 58% turn to their UHNW friends and ask whom they invest with. It feeds upon itself. I know of one [family office] that's gone from $2 billion to $11 billion in the past 12 weeks alone.

Willis: For the first time, the real high-net-worth, very successful broker is going independent-usually as an RIA rather than going through a broker-dealer. He's turning around that advisory model that he was taught over the last 15 years of the brokerage firm, and using it in his own business model.

Schwarzkopf: Yeah, the numbers show where the UHNW money is going. By far, Charles Schwab is blowing everybody out, with over $1.5 trillion. The average new financial consultant at Schwab—just the average guy!—has $100 million in assets. They hired two Merrill teams recently. One had $5 billion and $20 million in production and another one was $5.2 billion. They're hiring some really big people. They've got 5,500 reps now. That's where the big money is going.

Diamond: This year, the transition packages offered to wirehouse advisors were tremendous. If you assume that everybody's deferred-comp accounts are way, way down, then going to another wirehouse is the most plug-and-play [option]. As the deals come down at the wirehouses, it'll be interesting to see if more of these "breakaway brokers"—what the independents are calling these disenchanted wirehouse advisors—go to either independent broker-dealers or RIAs or RIA consolidators.

Wasserman: This year's trend—the UHNW advisor opening up a multi-family or single-family office—is going to create more competition. With the economy, there are going to be fewer high-net-worth families out there. [Some advisors will be] going out of business because they don't have a lot of clients to choose from.

OWS: Where you do you see the deals going for advisors?

Wasserman: Deals in general are going down.

OWS: Do you all agree with that—are deals declining?

ALL:[in unison] Yes!

OWS: How far down?

Degenhardt-Burke: On average, it's about 20% to 25% lower than what they were. They ran a blue-plate special on Merrill Lynch advisors throughout the industry. Smith Barney kind of lost at that game: They had one too many management meetings [during] the wrong week—so they messed up. But UBS and Morgan Stanley kind of swept up.

OWS: Since Sallie Krawcheck left, none of you seem crazy about Citi and Smith Barney. Do you think that her successor, Mike Corbat, will do better?

Diamond: The moment that Corbat came in—that following week!-deals got slashed. He comes from the banking side—there's a real disconnect there and that's the concern.

Peterson: Sallie's [departure] is going to be felt throughout the whole firm. First of all, brokers had empathy toward her. The very first thing she did was revise that horrendous compensation plan they had.

They gave her an enormous amount of credit for reaching out to clients. She was the voice of retail. When they announced that she was leaving, one of the theoretical things that she had done wrong was she'd fought [Chief Executive Officer Vikram] Pandit on returning client money on auction-rate and structured-investment vehicles. The Smith Barney culture has disappeared. It really is just Citi. Citi runs everything.

And look at Citi stock: It's just gone into the tank. Corbat's got nowhere to go but up, but I'm afraid he's not going to have the backing of the Smith Barney brokers. They're voting with their feet.

Degenhardt-Burke: Smith Barney in itself is actually a victim of Citi—it's been a victim for a long time now. It's not really Sallie, it's not really Corbat. It's the model; not the firm.

OWS: Last year, Carri, you said that Citi might sell off Smith Barney, which didn't happen.

Degenhardt-Burke [laughing]: I meant to say Merrill.

OWS: So what's going to happen to this wealth management unit?

Rosen: That's a ship that [can't be repaired]. Pandit is not an FA-friendly CEO. He doesn't appreciate the model. He doesn't like it. He's always exhibited that.

Smith Barney has basically been victimized by Citigroup. The morale is low. It's been totally decimated and we're going to continue to see advisors flee. They're going to have to do something. Their model is not just broken—it's destroyed.

Willis: It could be spun off, but the question is: To whom? It's a very viable and profitable part of Citi's business right now. The only reason they'd sell it this year is if they had to. If they don't have to, this is a terrible time to be selling a brokerage firm.

King: If you look at how we voted four years ago and three years ago, almost everyone thought Smith Barney was a buy. Smith Barney and Merrill were two of the strongest cultures—you couldn't get brokers to move from them. That's changed.

Diamond: The brokers would be thrilled if they got sold off. They've been praying for that.

Wasserman: Last year, we voted Sallie Krawcheck one of the most influential players in the industry. And she's gone now. Several divisional directors and regional managers at Smith Barney are gone now. I believe that morale there is at an absolute, all-time low. Selling it would probably be the best thing that could happen to the Smith Barney brokers.

Combining Three Corporate Cultures

OWS: Last year we discussed Wachovia's takeover of A.G. Edwards. What do you think about Wachovia and Wells Fargo?

King: Wachovia, A.G. Edwards—culture-wise, they've been working fairly well. It's worked okay—not great, okay. But the Wells Fargo thing gives it a lot of stability.

Willis: Wachovia had a very good plan for bringing in A.G. Edwards: Don't rush them in. Let them stay in separate offices, stay on the separate path. They really ran it as parallel firms for a while.

Admittedly, A.G. Edwards was a unique place. They paid advisors quite well, and let them do their own thing. Now, of course, all bets are off—the firm is changing completely. We have to wait and see what type of payout it's going to give and how advisors are going to be treated.

Wasserman: I'm hearing the A.G. Edwards people are very upset. They don't like the idea of changing their name two times in 12 months. There may be a herd of A.G. Edwards guys getting out of the new Wells Fargo. I have a message to the Wachovia guys: They're going to be in shock. They're going to get a lot less than they're expecting as well. There are not a lot of places to go so they have to be very careful in their choices.

Peterson: When Citi took over Smith Barney, they kept the name. Bank of America is going to keep the Merrill name. We don't even know what the name's going to be on Wells Fargo. We're assuming, maybe incorrectly, it's going to be Wells Fargo Securities. Does that mean it's going to be run by the bank? Brokers have an innate distrust of banks and bank involvement. Let's see if Wells Fargo tries to mess with a culture that's developed between A.G. Edwards and Wachovia.

OWS: Is any particular regional firm going to do really well recruiting in the next 12 months?

Diamond: Regionals have always differentiated themselves by having the horsepower of a wirehouse—but a smaller, more-nimble, flexible culture. Raymond James has done a fabulous job of that. I also like RBC; the only problem is that their deals are really not competitive.

Sarch: I'm a big fan of Raymond James & Assoc. They do certain things that nobody else does. They put it in writing as an employee that you own your business. If you don't owe them money, they say they won't go after your accounts.

King: Raymond James is probably the best; all these regional firms—Oppenheimer, Stifel, Janney Montgomery, RBC—can do well if people want to go into different cultures. Oppenheimer, because it's still a good name, would attract a lot more people if it had a more competitive offer.

Willis: I see Stifel really expanding out West-appealing, singularly, to the individual who wants to work in a smaller place. It's just sort of a throwback. Stifel hasn't been in the news, which is a great thing these days. They haven't had a lot of missteps. They're fairly aggressive in terms of attracting brokers. They don't match the wirehouse deals but they have aggressive deals.

Wasserman: I agree about Stifel, specifically on the West Coast. John Lee, who runs the West Coast, was from A.G. Edwards and is particularly attracting a lot of Edwards brokers .

Peterson: I like Janney. Legg Mason, a big client of mine for years, grew that "We're a small firm" culture but with all the infrastructure of a large firm. They had a family atmosphere. Janney's trying to create another Legg Mason. They'll stay within their footprint geographically.

Stifel is another firm that has great potential but they don't really have a footprint yet.

Breaking Up Is Hard to Do

OWS: Are firms fighting to keep the client assets of departed advisors?

Sarch: They're being a little nasty, making sure that the client understands that the guy got upfront money. They're saying: "Do you realize that he only moved because he got a bonus?" They're going aggressively after the portfolios, which is kind of sad. They're also very carefully checking to see whether [the departed advisor] truly adhered to the protocol. If they see any deviation from it, they use that as a way to shut the person down.

Degenhardt-Burke: In the last three months, brokers have told me that a manager actually came into their office, took them to lunch and just started ranting and raving: "You know, if you move, you're only going to take 50% of your assets, right?" Very, very threatening language.

Schwarzkopf: I recently had a multimillion-dollar broker with 15, 20 years in the business with no complaints. All of a sudden [he] has three complaints in a matter of weeks because the firm knows he's going.

That's going to hurt. Wirehouses do not like three "yes" answers on the Central Registration Depository (CRD). I've just seen it a few times. I wonder how much more of this is coming?