FEATURE

# Transitioning Broker Dealers

Is making the move to a new broker dealer the right choice for you? What factors are at play in the decision to make a change — and in making the move itself?

BY ELAYNE R. DEMBY

**OHN SMITH'S ADVISORY FIRM RECENTLY CHANGED BROKER DEALERS** to better serve clients and business. ERISA plans make up 60% of Smith's practice, with $580 million in retirement plan assets under management. Smith's previous broker dealer, however, did not fully understand the qualified plan business, nor could it provide the services and technology needed to effectively service plans. Furthermore, Smith says, when ERISA fiduciary issues came to the forefront, his firm needed more capacity to serve as fiduciary. The broker dealer's offerings, however, did not meet Smith's needs, nor would they be brought up to speed in a timely manner. Smith (not his real name) realized that to maintain current offerings and grow the business, he needed a broker dealer on the cutting edge of ERISA, willing to grow their ERISA business along with his.

Smith does not want to name his former broker dealer. "We had really good relationship with the old broker dealer, but we came to the conclusion that we weren't in a good spot," he says. "We started looking not because we were unhappy, but it was time to move on to a broker dealer that could better support the qualified plan business." Smith's firm eventually landed at an independent broker dealer that is committed to the qualified plan space and is strong on the retail side.

Industry watchers say that, as new rules and regulations come into play, more retirement plan advisors will switch to broker dealers that are better equipped to support the qualified plan business. In particular, the 408(b)(2) rules have created a trend of retirement plans switching from generalist investment advisors to retirement plan specialists because of its requirement that advisors must declare whether their services make them a fiduciary. "There is definitely specialization occurring in the industry, as more plans move to advisors whose primary business is servicing retirement plans," says Randy Long, managing principal at SageView Advisory Group, an investment advisory firm that services more than 500 retirement plans (98% of firm business), with over $22 million in assets under management.

As more plans move to retirement plan specialists, experts believe that the number of retirement plan specialists with at least 10 plans will double to 10,000. There is a tremendous demand for retirement plan specialists, as more plan sponsors understand that they and their participants need more help and only experts can help them. Therefore, many of the 75% of plan sponsors who now are working with advisors with fewer than five plans (see sidebar) will be move to retirement plan specialists.

Consequently, retirement plan specialists are now looking for specialized support and services from their broker dealers. They're seeking firms that understand the retirement business and support it as a separate business line. Long's firm

## GENERALISTS RULE

The vast majority of investment advisors are generalists, with far fewer focusing their business on qualified plans. Of 300,000 advisors actively selling to the public, about half have at least one retirement plan, according to research from The Retirement Advisor University (TRAU) in Jupiter, FL. Approximately 75,000 active advisors have at least three plans, and there are about 15,000 advisors with at least five plans. Only 5,000 advisors are retirement plan specialists who have at least 10 plans with a minimum of $3 million in retirement plan assets, according to TRAU, and just 1,500 have at least 20 plans and $100 million in assets.

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## DEALING WITH THE OLD BROKER

Smith says that because his firm had a good relationship with their previous broker dealer, they were open and honest and told them upfront that they were leaving. "We shared our reasons for leaving because we thought we owed it to them after 23 years," he says, "and discussed the transition plan." The old broker dealer was not surprised, he says, but they did attempt to keep them in the fold. Smith, however, realizes that a similar course of action may not be available to other advisors making a switch. "It would depend on the relationship," he says. "Some broker dealers can make it difficult."

Smith's actions were the exception to the rule. Transitioning broker dealers is usually a secret thing, done in the middle of the night, says Fred Barstein, who counsels advisors through the process of evaluating whether to transition and making the transition. Generally, no advisor would ever let you know that they are considering moving, says Barstein. Even after the transition, he says, as was the case with Smith, few want to publicize their switch.

There are a number of reasons for the secrecy, says Barstein. Perhaps the biggest reason is that the wire house may try to poach clients from the advisor prior to their leaving. "Even if they don't start calling clients, they may not give the advisor good service," he adds.

There was a time, says Barry Papa of Raymond James, when if an advisor tried to change wire houses, the previous wire house would get a restraining order preventing the advisor from soliciting former clients. In 2001, however, many wire houses signed an agreement which provides that if an advisor follows certain protocols, then they can solicit their books of business after the transition. If a wire house is a party to this agreement, the transition is much easier for the advisor, says Papa. But if the previous wire house is not in the agreement, and there is a non-compete clause, things can be much more difficult.

Of course, says Bohanan, there is some business that an advisor may want to leave behind. Retirement plan advisors may want leave the smaller plans at the bottom of their books with the old firm, he says, particularly if managing these smaller plans takes a fair amount of time. Typically, advisors only bring 80-90% of their book with them to the new firm.

has not made a switch, but he reports seeing more advisors moving because of new rules and perceived conflicts of interest for advisors affiliated with broker dealers.

The problem, says Smith, is that most broker dealers only “dabble” in ERISA, leaving advisors who specialize in retirement plans underserved. A lot of smaller, independent broker dealers provide almost no support, he says, and many of them are exiting the retirement plan business altogether.

Historically, most broker dealers have had expertise on the retail side but not so much on the retirement plan side, agrees Lisa G. Kottler, AIF®, Senior Vice President of Retirement Services, Corporate Benefits, NFP Insurance Services in Austin, TX. Yet, while lack of a complete understanding of the retirement plan business may not have been a huge drawback in the past, new rules and regulations now make working with a broker dealer who knows and understands the qualified plan business more critical for advisors.

Additionally, in the retirement plan space, there are retirement plan advisors who initially built up a wire house business but now are looking for more freedom, says Bo Bohanan, director of retirement plan consulting at Raymond James. Not all broker dealers, however, fully support the hybrid model of advisors who are also registered investment advisors. Those advisors, Bohanan says, want greater product choice options and greater ability to assume fiduciary status. Raymond James, along with Wells Fargo Advisors, is one of the few national broker dealers that support the independent 1099 model as well as the fully supported employee wire house model.

**Evaluating Whether to Leave**

Transitioning to a new broker dealer is a decision that should be made with a great deal of consideration and due diligence. Transitioning is very labor intensive, so advisors should carefully consider whether making a switch is right for them. Advisors should also evaluate the cost of the transition and consider the impact that going through a transition will have on their economics, says Peter Vincent, former director and head of advisor programs at Bank of America Merrill Lynch.

There are a number of reasons why advisors may believe that moving is the best choice. At the top of the list is whether or not the current broker dealer allows its advisors to assume fiduciary roles to the plans they service. Many broker dealers still do not allow their advisors to acknowledge fiduciary status, says Long, or to act in a 3(21) or 3(38) capacity. With more and more qualified plans seeking advisors to take on fiduciary status, advisors may have to consider moving if their current firm does not allow it, simply to remain competitive.

Lack of understanding of the retirement plan business and lack of adequate support and products is another reason to leave. If a retirement plan advisor is with a broker dealer that has no retirement plan expertise and inadequate support and services, then that advisor should consider looking at one that does, says Kottler.

The culture of the current broker dealer may also not fit with the advisor’s style, Bohanan notes. Broker dealers can often be quite specific in telling advisors how they should run their businesses, he says, including limiting what markets they can sell in. But advisors may want to do things differently. “The broker dealer’s way of doing business becomes [the advisor’s] way of doing business, and it probably should be the other way around,” says Smith.

Advisors should also evaluate their own commitment to the retirement plan space and the commitment on the part of their current firm to the retirement plan business, says Vincent. If an advisor wants to grow in the retirement plan space, he says, then they should evaluate whether the current model they’re with helps growth or hinders it.

Smith recommends taking all emotions out of the decision. Don’t make the decision lightly, and don’t let it drag on too long. Smith says his firm spent two years doing due diligence but probably could have made a decision after one year.

Advisors should also speak to other advisors to see what their experiences are like with their broker dealers, says Vincent. Reaching out to advisors who have made a transition themselves is a good idea too.

In the end, the decision to change broker dealers has to really benefit the advisory firm, clients and the new broker dealer, says Barry Papa, director, AdvisorChoice Consulting, Raymond James. Transitions are not

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## TRANSITION RISKS

For retirement plan advisors, says Raymond James’ Bo Bohanan, the risk exists that clients may think that the transition is a good time to go out to the market and shop for a new advisor. Clients may view the transition as an opportunity to put out requests for proposal to look for a new advisor.

Another risk is potential lost opportunities. Doing a transition can be time consuming, says Lisa Kottler of NFP, perhaps causing the advisor to take an eye off the ball when it comes to new client prospecting.

## FINRA REVIVES BROKER BONUS DISCLOSURE PLAN

Last month, FINRA's board took up the issue of whether advisors will be required to report bonuses received when switching broker dealers. The issue had been on the agenda for their July board meeting, but scheduling delayed its consideration.

The disclosure is considered to be important to a client that's trying to decide whether to move with their advisor to a new broker dealer. It's uncertain whether such a disclosure would dampen broker movement, or whether it would affect the number of clients who choose not to move to their advisor's new firm.

easy, he says, but advisors often find they can improve their lifestyles by going to a new firm.

**What to Look for in a New Broker Dealer**

Once the decision is made to move, the next step is finding the right broker dealer to move to. As part of the process of finding a new broker dealer, advisors have to take a hard look at their practice and have a good sense of the services delivered to the clients, says Smith. "You can't know enough about your business before making this decision," he says.

If an advisory firm is unhappy with their current wire house, an assessment should be done to determine what caused the unhappiness and whether another wire house would be a better fit, echoes Papa. For example, an advisor may want more independence, more control over business operations, the ability to assume fiduciary status or access to open architecture platforms. Issues such as technology, says Papa, can be a big irritant, as can other issues, such as how payouts and branding are handled if advisors want to build their own brands.

Once an advisor really figures out why he is unhappy and what he wants to do, he should discuss options with the recruiting departments of firms and visit firms to find one that meets his needs. Discuss the products and support that are available. Advisors should also talk to other advisors to see what other firms offer.

When reviewing alternative broker dealers, retirement plan advisors should review the staffing devoted exclusively to the retirement plan business, note the experts. According to the NAPA Net Broker Dealer list (see page 25), only 40 broker dealers out of thousands in the United States have at least one person to service advisors in the DC plan market. Even then, many of those 40 broker dealers are still restrictive in terms of the education and certification needed for their advisor to assume fiduciary status.

The retirement plan business can be labor intensive, says Kottler, so finding a broker dealer that has a scalable due diligence process, a streamlined RFP process and staff that keeps clients up to date on the latest legal/regulatory issues is key. The retirement plan rules differ from the SEC rules, notes Kottler, which require compliance with ERISA and DOL regulations. NFP, she says, has a compliance department that can support plan advisors and their clients by answering tough legal and regulatory issues, as well as tools to help with RFPs.

Long agrees that advisors have to look at the specialized support the broker dealer is providing and if it can support a hybrid RIA relationship on their platforms. Finding out how the broker dealer helps the advisor with compliance issues such as 408(b)(2) disclosures is critical, he says, as is support for participant education and whether or not the broker dealer allows advisors to assume fiduciary status.

How the broker dealer helps advisors to grow their qualified plan practice is also an important consideration, says Long. For example, Merrill Lynch helps plan advisors find new retirement plan business by helping move retirement plans from advisors who do not focus on ERISA plans to those who do. Advisors should also review the degree of commitment that a new firm makes to development and specialist support.

**Making the Transition**

Actually going through the transition from one broker to another was a "nightmare," according to Smith, and very disruptive to his firm's business. Smith says his firm lost about six months of staff time in the move and approximately 20-25% of revenue over the six months it took to get back to business as usual.

Transitions are a major disruption to current business operations because legal requirements require advisors to move each client one piece of paper at a time. The only solace for retirement plan advisors is that transitions are easier on the qualified plan side than on the retail side. Generally, says Papa, retirement plan advisors have fewer clients than retail advisors do, so the process can be shorter.

While Smith's transition took six months, both Papa and Vincent say advisors can typically expect business to be back to normal in approximately three. After that, advisors may still be getting used to new technology and new systems, says Papa, but in terms of growing business it will pretty much be back to normal. How long the process actually takes depends on the size of the advisor's book of business and the size of the clients, says Papa. Smaller plans are usually easier to transition because the decision maker is usually the business owner, while larger plans have committees that can take longer to get the necessary paperwork done.

Once the decision is made to move, the advisor needs to get organized and create a game plan, says Papa. Clients will need to be contacted and meetings arranged to explain the transition and sign paperwork. "During the transition, there's a lot of paperwork to fill out and a lot of time spent communicating with clients," says Papa. Learning new systems is also part of the transition, he says, and advisors working as RIAs will also need new contracts with clients.

Smith says the reality is that many clients do not have a relationship with the broker dealer, so the transition is not a major factor for them. His firm's client

communications spelled out the reasons for leaving, he says; for the most part, clients were supportive. The biggest impact on clients, he says, was all the paperwork that had to be filled out to make the transfer.

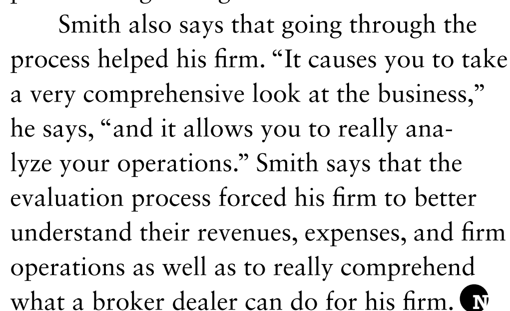
Advisors should turn to their new firms to get help. Firms like Raymond James and Merrill Lynch have transition departments that assist advisors in making the transition by answering any questions and getting paperwork done. The process works best, says Vincent, when advisors get involved early on to understand who they are, where they want to go, and which products and services they provide.

Having gone through a transition, Smith has several recommendations for advisors who are considering doing so too. Smith says his top recommendation would be to assign someone on the team to be the transition coordinator. Other recommendations include:

1. Have current client information that is as organized as possible before starting the transition. "Make sure you have lists of all your books of business, all your clients and all your accounts," says Smith.
2. Map out the transition, and have a transition calendar. Establish a calendar for paperwork, and make sure the transition plan calendar aligns properly with business operations. "If you are in the qualified plan business, you do not want to try to transition in the 4th quarter of the year, because the transition would be a huge distraction. Do it when the team can handle it," says Smith.
3. Read the contract with the current broker dealer, and know what information your firm owns and what the broker dealer owns.
4. Work with the new broker dealer's compliance office, and question everything. "You can't ask the new broker dealer enough questions," says Smith.
5. Set expectations for the team and explain why the transition is necessary. "Understand the emotional stress on team members who will be putting in a lot of extra hours," says Smith.

At the end of the day, many advisors who look into transitions may decide to stay with their current broker dealers. "Probably more advisors come to this conclusion then leave," says Smith. Despite all the work, Smith says the transition was a good one for his firm. "We focus on the long term," he says. "In the short term it didn't feel like the right thing during the transition, but now we're more comfortable. It was short-term pain for long-term gain."

Smith also says that going through the process helped his firm. "It causes you to take a very comprehensive look at the business," he says, "and it allows you to really analyze your operations." Smith says that the evaluation process forced his firm to better understand their revenues, expenses, and firm operations as well as to really comprehend what a broker dealer can do for his firm.



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## NAPA NET LIST OF DC BROKER DEALERS

NAPA Net's annual list of Defined Contribution Plan Broker Dealers identifies firms that have at least one person in the organization dedicated to working with advisors in the defined contribution plan market. Go to www.napa-net.org and click on the "Industry Intel" tab in the top menu bar. You'll also find comprehensive lists of DCIOs and record keepers.