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More Brokers Flee Big Firms, Taking Investors With Them

By E.S. BROWNING

Independent financial advisers are gaining ground from Wall Street brokers in the competition to manage more than $5 trillion in Americans' savings.

The ranks of brokers at major Wall Street firms have been shrinking, along with those firms' share of the retail-investing market. At the same time, independent advisers are growing in number and market share.

The financial turmoil of the past 18 months is fueling the shift. Shaken by the collapse of some Wall Street firms and the tarnished reputations of others, more big-firm brokers are breaking away to manage money on their own, taking clients with them.

Eric Thurber and two associates, who oversaw $740 million at Morgan Stanley Smith Barney, set up their own business in August. Many clients followed them.

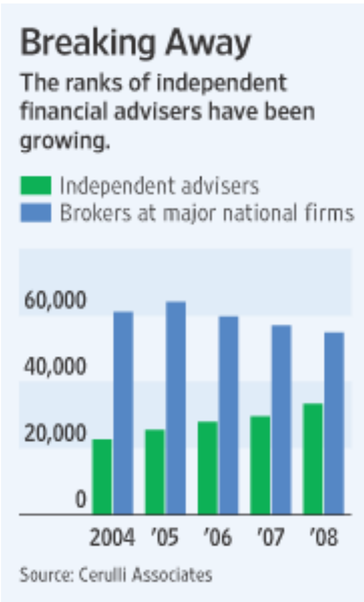
After the collapse of Lehman Brothers in the fall of 2008, Mr. Thurber says, "we realized that we could be at risk" even at a major firm.

Boston research firm Cerulli Associates last year projected that brokers leaving major firms would take $188 billion in client accounts with them in 2009, the first year Cerulli has tried to measure that movement of money. Cerulli expects the trend to continue this year.

Other data suggest that big firms saw money flow out in 2008, too. Financial statements from the biggest brokerage firms, including UBS AG and Bank of America Corp.'s Merrill Lynch Wealth Management, show a collective net outflow in 2008 of about $20 billion in client money, counting both money removed by departing brokers and money withdrawn by clients whose brokers didn't leave. Those figures reflect client actions, not market gains and losses.

The big firms say they are poised to rebound and that they wanted to push out many of the departing brokers because they weren't bringing in as much profit as others. "The majority of departures have been people with below-average revenue production," says a spokeswoman for Morgan Stanley Smith Barney.

Major Wall Street firms still handled 48% of the money from individual investors under management at the end of 2008, while independent advisers handled 19%, according to Cerulli. But Cerulli forecasts that by 2012, the big-firm share will be down to 41%, while the independent advisers' share will be more than 23%. The balance of the money is managed by smaller brokerage firms, insurance companies and banks.



The number of brokers serving individual clients at major firms fell 14% to less than 55,000 in the three years ending in December 2008, while the number of independent financial advisers rose 29% to 33,000, Cerulli Associates says.

Mr. Thurber, the Morgan Stanley Smith Barney broker who jumped ship, says he hadn't considered a change until Lehman collapsed and he saw friends at that firm suffer. His employer then was Smith Barney, which hadn't yet merged with Morgan Stanley and was part of Citigroup Inc., whose stock was plunging. He and his two colleagues, whose brokerage-firm salaries were well into the six figures, manage money for entrepreneurs and venture capitalists in Silicon Valley.

They secretly planned their move for nine months before they left. Mr. Thurber recalls a tense debate in the dining room of one of his partners about whether they could afford to abandon their salaries and bonuses.

"It certainly gave each of us pause about whether it made sense for us to walk away," he says. Initially, the cost of starting and running a business would reduce their incomes, he says. In the longer run, he says, "we did the analysis that, counting equity in our new firm, if we did all the hard work, it would be worth it."

At their new firm, Three Bridge Wealth Advisors in Menlo Park, Calif., they are free of certain constraints, Mr. Thurber says. At big brokerage firms, brokers can sell only financial products approved by their firms. Independent advisers face no such restrictions.

A Morgan Stanley spokeswoman says that turnover among brokers overseeing larger amounts of money "is at historic lows."

Not all brokers leaving major firms are going it alone. Independent firms say they're seeing an uptick in interest from big-firm brokers.

"We are receiving unsolicited resumes from senior people" at major brokerage firms, says Steven Giacona, founder of wealth-advisory firm Round Table Services in Westfield, N.J., which oversees about $700 million. "I have been talking to people who never imagined they would be talking about these things. But these events have put them and their clients in a situation where they feel they need to make a change." So far, he says, he has hired one big-firm broker.

Brokerage firms are fueling the movement by pushing out lower-volume brokers. A typical strategy is to cut compensation, a process known as putting brokers "in the penalty box." Lower producers who had been taking home 40% of their fees and commissions might be told they now will keep only 20%. Their realistic choices: boost revenues, move to a smaller firm or go independent.

Tim Noonan, who faced a compensation cut as a broker in Merrill's Atlanta office, left in February 2009 with most of his clients. He formed Noonan Capital Management with about $40 million in client money, he says.

Mr. Noonan says he didn't like being pressed to boost revenues. He also didn't like working in a system where he was paid more to put his clients into stocks than into certificates of deposit. At his own firm, he charges clients a flat percentage of money under management, no matter how it's invested.

"I wanted to own my own business, create my own value," he says. "I can will it to my children. I can sell it."

Independent advisers have a powerful ally in the competition with big firms: discount brokerage firms.

Independent advisers need someone to conduct trades, store securities, keep track of client accounts and perform other back-office jobs. The discount-brokerage operations of Charles Schwab Corp., Fidelity Investments and TD Ameritrade Holding Corp., among others, have built big businesses doing those things for independent advisers. As the trend toward independence grows, the discounters are redoubling efforts to persuade brokers to go independent.

Tom Cantillon leads a group in Schwab's New York office that urges brokers to go independent and bring their business to Schwab. He and his people phone brokers at their offices, sometimes early in the morning or at night in hopes the brokers will pick up directly. Mr. Cantillon says he asks: "Have you ever considered a different model for your business?"

Discount firms are using emails, seminars and junk mail to lure brokers into independence. They offer free help with paperwork, free software, and reduced-cost or free trades during the transition period. If breakaway brokers aren't comfortable creating their own businesses, the discount firms will help them, for no charge, find existing independent financial firms that want new associates.

Schwab held workshops around the country last year to show brokers how to go independent. Fidelity hired a senior executive from Morgan Stanley to handle its business with independent advisers, including attracting them from brokerage firms. In the first three quarters of 2009, Fidelity says, breakaway brokers brought it more than $6 billion in new money to be managed, equaling the amount it received in all of 2008.

Brian Doe left Merrill in 2009, urged on by Schwab recruiters. Before the financial crisis hit, he and his clients liked being at a big, established firm, Mr. Doe says. After Merrill teetered and was sold to Bank of America, Mr. Doe, a nine-year Merrill veteran who managed more than $50 million for 90 clients, rethought his position.

"The day that a company of that tenure and stature can get sold off to a bank over a weekend is a little disconcerting to someone at my career level," says Mr. Doe, who is 42 years old. "I was spending a lot of time explaining what the firm was doing, at a time when the market was down and people's portfolio values were careening."

Unhappy to see Merrill cutting support staff, he began speaking with others in the business and discovered that the man who had helped him start at Merrill had founded his own firm, Atlanta's Gratus Capital Management. Mr. Doe joined Gratus in February 2009.

Steven Schwalb, a client, says he was happy with Mr. Doe but wary of the hassle of moving his money from Merrill. His mortgage-banking business was chaotic and he was helping care for newborn twins, so he didn't follow Mr. Doe to Gratus.

"We had a lot going on in our lives, so the last thing we wanted to do was upset anything else," he says. "We weren't really sure it was the right move for us to go to a smaller company."

But he says he didn't develop as good a relationship with his new Merrill broker, so he got back in touch with Mr. Doe and moved his money to Gratus. At Gratus, Mr. Schwalb says, he has access to a wide range of mutual funds and other investments, with lower commission costs than at big brokerage firms. The Schwalbs pay Mr. Doe an annual fee to monitor their finances, including advising them on all investment and financial-planning decisions.

A Bank of America spokeswoman says clients are benefiting from the Merrill acquisition, internal surveys indicate that they are satisfied, and "we continue to attract and retain highly successful advisers."

Some banks are trying to take advantage of the changes. The brokerage arm of Wells Fargo & Co., which acquired Wachovia Securities in late 2008, is offering brokers who want to go independent the chance to work with it on a contract basis, even if they are former Wells Fargo brokers. They sell financial products through Wells Fargo's trading desk but operate as independent businesses. Wells Fargo now works with about 1,000 independent advisers.

Officials at other brokerage firms say the shift toward independent advisers is something they can reverse. Many brokers are more comfortable staying at big firms, which take care of product support and back-office issues. Big firms say they are retaining brokers they want to keep, notably those who handle wealthier investors.

"I think that we have capabilities in this business to be able to do things for clients that the boutiques will just not be able to do," Robert McCann, chief executive of UBS's U.S. brokerage arm, said at a recent conference.

Some in the brokerage business argue that the Madoff Ponzi-scheme scandal will frighten clients of smaller firms, pushing them toward brand-name brokerages. They also say that if money managers face new regulation, as has been discussed, smaller firms might be less well-equipped to deal with the burden.

That doesn't appear to be diminishing interest among brokers contemplating change.

Ralph Courage, a broker in Norfolk, Va., left UBS to set up an independent firm in 2008. "I have received many calls from top investment folks at brokerage firms around the country," he says, "who have heard that we have made this move, saying, 'We would really like to do this and tell me all about it.'[nbsp]"

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