

Sparks fly over plan to disclose bonuses

By Dan Jamieson InvestmentNews

December 2, 2012

A Finra proposal to require brokers to tell customers about bonuses and other compensation incentives they receive to join another firm drew sharp reactions after it was announced last week.

The Financial Industry Regulatory Authority Inc. said that it will introduce such a proposal at its board meeting this month.

“For them to poke their noses into this is nothing short of ludicrous,” said Ron Edde, director of recruiting at Millennium Career Advisors.

“It gets down to whether a financial package received by an adviser is relative to clients,” he said. “I don't think it is.”

Mark Scheffler, a former broker who now runs his own advisory firm, Appleton Group Wealth Management LLC, disagrees.

“Clients should absolutely know how much the broker is being paid,” as they do for registered investment advisers who are compensated from fees, he said.

“Often, brokers will say they're jumping because the research is much better or the management is better, but they never disclose that they're getting this huge check,” Mr. Scheffler said.

Recruiting incentives have been in regulators' sights for a while.

This year, Finra began reviewing conflicts of interest at 14 of the largest brokerage firms, reportedly focusing on compensation and recruiting arrangements.

In August 2009, after the brokerage industry ramped up recruiting bonuses to target disaffected wirehouse representatives, Securities and Exchange Commission Chairman Mary Schapiro sent a letter to chief executives of securities firms, warning them to carefully supervise brokers for churning or unsuitable sales, given the financial incentives for brokers to meet production and asset targets found in recruitment packages.

Finra declined to comment.

Regarding disclosure, “the real question is, where do you draw the line?” said industry lawyer Marc Dobin, founder of Dobin Law Group PA.

“Do you [disclose] only if a broker gets a forgivable loan when moving between firms? Or if they move and they're on a nonstandard payout?” Mr. Dobin said.

How about when a broker doesn't move but receives higher compensation? For example, “Should you put on a confirm that your broker is now getting a 32% payout instead of 25%?” Mr. Dobin asked.

That higher payout would occur if a representative reached a higher production tier, thereby increasing the commission percentage received.

Recruitment deals “could be disclosed in broad strokes and refined over time,” said Pat Burns, an industry lawyer in Beverly Hills, Calif., who works with independent advisers.

RIAs already disclose that they get specific benefits for moving to a custodial firm, such as financial help in acquiring technology or research, he said.

Brokers could do something similar without getting bogged down in details.

Some think that disclosure of recruiting deals might make brokers think twice about jumping ship.

“The vast majority of wirehouse brokers [have] great client relationships, but [disclosure] will hurt their ability to retain assets as they move from firm to firm, because it just looks icky,” said Jonathan Foster, CEO of Angeles Wealth Management LLC, a high-end advisory firm. “If you tell [clients] you got a \$20 million bonus, they might say, “Great, but we didn't do that well last year.””

Brokers should disclose deals to clients because they will hear about them anyway from brokers at the former firm, said Danny Sarch, founder of Leitner Sarch Consultants Ltd. (see his blog below).

Concern over recruitment packages has existed for more than a decade.

In 1998, former SEC Chairman Arthur Levitt called for the disclosure of recruitment packages, and in 1999, Finra followed up with a rule proposal that would have required disclosure of accelerated-payout arrangements for brokers changing firms. Finra, then known as NASD, never acted on the proposal.

“I think that's great,” Mr. Levitt said of Finra's most recent plan to introduce a disclosure proposal.

Clients should know what their brokers are getting and that disclosure would “diminish” the incentives being offered, he said.

But “I think the industry will probably kill it,” Mr. Levitt added.

The original NASD proposal died because it was too difficult to draw the line between what needs to be disclosed and what does not, Mr. Dobin said.

djamieson@investmentnews.com Twitter: @dvjamieson