

Broker-Dealer Due Diligence

Things to Consider When Making a Change

The decision to change broker-dealers is a big one – there will be many details that you will need to manage. Some financial professionals describe the process as concurrently getting divorced, remarried and purchasing and moving into a new home. Here are a few points to consider to ensure a successful start toward a smooth transition.

How do they look to me?

Perhaps there was an attraction at first sight, or it was a case where your interest grew over time until it eventually reached a point where you are now considering a commitment towards establishing a permanent relationship. Either way, it's time to conduct a more critical analysis of your potential new partner. Beyond the initial attraction, you must seriously consider whether such a union is likely to not only survive, but also develop and strengthen over time. You should feel chemistry, and sense that the new broker-dealer's culture will be compatible with your practice.

One of the most important considerations is your current business mix. This applies to both the demographics within your book of clients, and the mix of products those clients are holding in their investment portfolios. If you work with a lot of older clients who are nearing the distribution phase of the retirement cycle, you will want to make sure your new broker-dealer has experience with these types of transactions. Likewise, if you have a lot of younger clients who are in the asset accumulation phase, ensure that your new broker-dealer offers a number of strong choices among those types of product lines. You should also carefully consider the type and amount of payout you will receive for the transactions that are most prevalent in your office.

List the advantages that you receive from being affiliated with a broker-dealer and then use that list as a checklist for evaluating your new broker-dealer. Technology can be a major source of competitive advantage for your business, so you will want to know if your new broker-dealer will have the technology in place that will allow you to spend more time with your clients and less time on paperwork. Along the same lines, you should ask yourself whether they will have the training, tools and resources that will allow you to keep up to date. Lastly, you should try to envision the type of relationship you will likely have with your new broker-dealer. Having an interactive relationship with your broker-dealer should be high on your list. Talk to other Representatives that have experience working with this broker-dealer and ask how they rate on customer service. There is nothing more frustrating than consistently having to leave voicemails with your business partner.

How do I look to them?

This question could help you understand some of the motivation behind this potential partnership. Again, your product mix will be a major consideration. In this highly regulated environment, compliance is another important area that you should examine. How will the new broker-dealer perceive your registered Representatives, on an individual basis as well as alongside their other clients?

Representatives with any of the following may trigger commonly known “red flags” in the industry:

- Discretionary accounts
- Joint accounts with customers/clients

- Power of Attorney (POA), trustee (TTEE), executor, custodian, treasurer or any other fiduciary for anyone other than an immediate family member
- Substantial business in 1031 and 1035 exchanges or switches
- Disclosures/regulatory events, arbitrations, and criminal events
- Double dipping in managed accounts
- Large B-share purchases that meet or exceed \$50,000
- Large volume of C-share activity
- Outside business activities, in particular those involving custody or control of assets (e.g. treasurer, president, secretary) or those potentially constituting private security transactions
- Penny stock sales

Kicking the Tires

Assuming that you have conducted due diligence on your new broker-dealer through phone conversations with a recruiter, email, marketing materials and Internet research, you might now feel that you have a good understanding of what this broker-dealer is all about. But making a decision at this point would be the equivalent of proposing marriage to someone with whom you developed a relationship with through email, without ever meeting face-to-face. As the old saying goes – seeing is believing. A home office visit is an excellent opportunity for you to put your gut to the test. Meet with senior management in person and ask a lot of questions. At most broker-dealers, the personality of the firm flows from the senior management team throughout the entire organization. Walk the floors at the broker-dealer's offices to experience the culture first-hand. Try to get a sense of the pace at which employees are working and take note of both the expression on employees' faces and the environment in which they work. Ask to see some of their processes and technology in action and, if permissible, jump on a desktop computer for a test drive. Your goal should be to walk away from your visit with a three dimensional view of the firm.

Moving Day

Now that you've made your choice – hopefully, a well-informed decision – it's time to move your accounts from your old broker-dealer to their new home. For the first 90-days, you'll want to ask for a dedicated point-person that you can work with while you are making your transition. In the beginning, the paperwork will remind you of closing on the purchase of a new house, but this is only a temporary inconvenience.

Aside from your new broker-dealer planning your transition, it will be helpful for you to be aware of the following issues prior to moving day:

- Will your current broker-dealer continue to pay commissions after your termination date? If so, for how long? Will they include trail commissions?
- Start the review and approval process of your business cards, letterhead and other marketing materials early.
- Have a good understanding of the required paperwork to transfer your book of business, in particular those documents that require client signatures.
- Remember that you will need to be re-appointed with the insurance companies and register again with those states with which you are currently registered.

Settling In

Next, you'll need to start conducting business with your new broker-dealer. But there's a good chance that your new broker-dealer may have different policies, practices and procedures than your old one. How can you level the learning curve? The most successful transitions are informed transitions. One way to get new Reps up and running is by conducting orientation conference calls with key departments to provide them with an overview of the firm's policies and procedures. Additionally, broker-dealers will provide new Representatives with a training manual including detailed instructions on writing new business, placing trades, etc. Some broker-dealers may also offer comprehensive Representative and support staff training, providing new offices with the tools and resources they need to run their office more efficiently.

Keeping all this in mind when carefully considering your new broker-dealer will help you forge a mutually satisfying, long lasting relationship.