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Morgan Stanley, Citigroup to Give Brokers Big Retention Fees

By AARON LUCCHETTI

Building the biggest brokerage firm on Wall Street is proving costly to Morgan Stanley and Citigroup Inc., which are planning to pay brokers about $3 billion to keep them from being poached away from the joint venture, people familiar with the matter said.

While the terms aren't expected to be announced until later this month, the issue could grow politically sensitive, because the U.S. government holds stakes in Citigroup and Morgan Stanley as part of its bailout of the financial system. Morgan Stanley is paying Citigroup $2.7 billion to take control of the joint venture, which was announced last month and will combine its brokerage operation with Citigroup's Smith Barney unit.

Broker payments have been a regular part of Wall Street mergers for years, because rival firms see them as an opportunity to poach top producers. The payments got little attention, compared with big bonuses raked in by colleagues trading exotic securities and negotiating big-ticket mergers at the corporate headquarters. But once-booming businesses on Wall Street have fallen dormant, leaving brokers as the financial world's new breadwinner.

Indeed, some brokers are getting flooded with five or more calls a day to jump ship, says Darin Manis, who runs broker-recruiting firm RJ & Makay in Colorado Springs, Colo. "The deals are aggressive," he says, but necessary to keep the commissions and fees that brokers generate for their firms.

The pay packages, ranging from 50% to about 260% of a broker's annual production, are rubbing some the wrong way, especially at a time when financial-services firms have taken government money and many of the brokers' clients are suffering losses. Depending on the size of the individual broker's business, the payments can exceed $10 million.

"I'm incredulous that the regulators" and administrators of the government's bank investments "aren't focusing on this," says Michael Campbell, head of boutique brokerage firm Dominick & Dominick. "It's been a mindless recruiting war."

The House Committee on Oversight and Government Reform is also looking into the issue, according to Ronald Stroman, the committee's staff director. Another congressional staffer said this past week that the presence of broker-retention payments "doesn't help" convince Congress that Wall Street understands the need for change.

Morgan Chief Executive John Mack acknowledged at a House hearing Wednesday that "the American people are outraged about some compensation practices on Wall Street, and I can understand why." Mr. Mack has declined to take a bonus during the last two years, and other top executives at his firm also declined them in 2008. Citigroup CEO Vikram Pandit has said

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he'll work for $1 a year until he can return the bank to profitability, and Morgan has instituted a new pay plan that can claw back past compensation.

Morgan Stanley, whose management will run the joint venture, is planning to offer retention payments to top-producing brokers who are joining the company's new wealth-management joint venture with Citigroup's Smith Barney unit. Not all of the combined joint venture's 20,000 brokers are expected to get payments. One who brought in $1 million in revenues for the firm last year would expect to get $500,000 to $1 million, though much of it is contingent on the broker producing revenue for the combined Morgan Stanley Smith Barney in coming years.

"Our financial advisers at Morgan Stanley and Smith Barney are getting heavily poached by competitors," says James Wiggins, a Morgan Stanley spokesman. "We need to be able to retain" them "to ensure the success of the joint venture."

Morgan Stanley has cut back on riskier businesses such as trading, making its brokerage business more important. Morgan Stanley officials plan to brief any government officials who ask about the plan, but it is unclear how much concern there will be, according to people familiar with the matter.

In a conference call earlier this month, Morgan co-President James Gorman told brokers that the joint venture would pay retention awards based on revenue generated in 2008, a generous position if 2009 revenues for brokers drop sharply, as expected.

Among the biggest recruiters recently is UBS AG. During the fourth quarter, UBS took about 100 brokers from Smith Barney and 200 from Morgan Stanley, according to people familiar with the matter.

Unlike a traditional Wall Street bonus, there are some strings attached to broker payments. Brokers, who make most of their annual pay directly from the fees they generate, often have to stay seven to nine years to keep the whole payment. Firms regularly make part of the payment contingent on asset or revenue targets, and spread the cost of the plans on their financial statements over the life of the contract.

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