EPISODE TRANSCRIPT

How the FTC's Rule on Non-Competes May Impact Financial Advisors: An Attorney's Perspective

A conversation with attorney Matt Baum, Partner at Fox Rothschild.

Louis Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is: How the FTC's Rule on Non-Competes May Impact Financial Advisors: An Attorney's Perspective. It's a conversation with attorney Matt Baum, partner at Fox Rothschild. I'm Louis Diamond, and this is The Diamond Podcast for Financial Advisors.

Mindy Diamond:

This podcast is designed for advisors like you who are interested in learning more about the evolving wealth management industry through candid dialogue with breakaway advisors, those from the C-suite, and industry thought leaders. It's available on our website, Diamond-Consultants.com, as well as Apple Podcasts and other major podcast platforms. So be sure to subscribe and share it with your colleagues.

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Louis Diamond:

On April 23rd, 2024 the Federal Trade Commission announced a comprehensive non-compete rule banning non-compete for all workers, even senior executives, as their website states. Advisors are very curious about how this ruling might impact their businesses current agreements, and ultimately their ability to transition should they choose to in the future. As advisor advocates, we cheer any action that enables advisors to freely choose if they're in the best place for their clients and to do so without limitation or threat of litigation. However, as it stands now, we aren't convinced this new rule will significantly impact an advisor's business life. And with any new ruling, it simply begs more examination, particularly as it relates to those in the wealth management industry.

So we asked attorney Matt Baum to join us on this special episode. Matt is a partner at the law firm, Fox Rothschild and specializes in the financial services industry. He represents financial advisors, broker dealers, and RIA firms in litigation and arbitrations, a go-to resource for transition and recruiting related matters. Matt weighs in on what advisors stand to gain from the non-compete rule, the ripple effects, what may come next, and how elements of an advisor's

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current employment agreement may ultimately be non-enforceable as a result, and more. It's an important conversation. So let's get right into it.

Matt, thank you for joining us today on very short notice. We have a very timely and exciting topic to get to.

Matt Baum:

Thank you so much for having me, Louis. And of course, since I'm a lawyer, I have to give you a couple of disclaimers. My remarks today are meant for general informational purposes only. Should not be construed as legal advice or relied on for any purpose. My comments don't create an attorney-client relationship and may be considered attorney advertising. But yeah, let's get into it.

Louis Diamond:

Perfect. Thank you very much for those enlightening disclaimers.

Matt Baum:

It's a workplace hazard, what could I tell you.

Louis Diamond:

There we go. So before we jump into the topic at hand, which I know everyone's very excited to peer your perspective on, can you just give us some background? What's the type of work that you do at your firm and just to hear a little bit about your experience within the space.

Matt Baum:

Happy to. Thanks. So I'm currently a partner at Fox Rothschild, which is an 1,000 attorney firm. We have 70 practice areas, 30 locations throughout the country. My personal practice is traditionally representing financial services firms. That's probably 80% of what I do. The other 20 being general commercial matters and businesses. And in the financial services space, I represent broker-dealers, RIA firms, and financial advisors typically in disputes. So that would be regulatory issues, SEC licensing issues, arbitrations both customer and industry side. I've handled over a hundred Finra arbitrations for clients over the years. I've worked on hundreds of advisor transitions from one firm to another. So I handle disputes of that nature. And of course, as a natural offshoot of working with financial advisors, I deal with all kinds of related issues such as transactions, M&A, we can help firms with operating agreements, et cetera. So a lot of the offshoot-related things that go into a transition process we also assist advisors with. Either I'll do the work solely or I'll work with a team of folks who are more specialized, let's say, or focus on transactional work.

Louis Diamond:

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Great. So let's jump into this. Can you summarize for those who weren't refreshing Google like I was the last few days and what the FTC announced on April 23rd of 2024?

Matt Baum:

Sure. The FTC announced its approval of a final regulatory rule which bans most pre-existing and future non-compete agreements. In a nutshell, the rule holds that an employer can't enter into or attempt to enter into a non-compete, can enforce or attempt to enforce a non-compete, can't represent to a worker that he or she is subject to a non-compete. For purposes of pre-existing non-competes that might be in place, the ban applies to workers not deemed to be "senior executives". And senior executives are individuals employed in a policymaking position who received at least $151,164 in annual compensation in the prior year. The policymaking piece of that senior executive definition is probably going to be one of the more subject to interpretation components of the rule. Candidly, I don't see this applying to most advisors because the policymaking provision doesn't seem to relate based on the rule with a specific department or division that you might be working in. It's fundamentally firm wide. So I'm almost thinking in terms of C-level executives, doesn't have to be C level, but it's getting to more of that company high level that might apply to an advisor. In most cases I don't think that would apply.

Louis Diamond:

I think what you're alluding to is someone can make the case that if I'm an advisor who's running my own team, picking the investments for clients, determining who I want to hire onto my team, determining how I'm going to prospect, that in and of itself can be construed as making policy. But you're saying it goes far beyond just someone's individual contributions to their business. You're talking more about the board of directors of a firm, the CFO, the CEO, and the folks making millions of dollars at the major banks to run the business, not necessarily act as a financial advisor.

Matt Baum:

Generally speaking, it's high level. But, the best way to think about advisors who this might apply to is if you think about RIA firms where someone might be a top partner in that practice or an executive within a large RIA firm. There, we could start seeing, yeah, the person's both an advisor and a senior executive making firm-wide policy and making an income in excess of over $151,000. So that's probably more where I could see the rule touching upon folks in the industry.

Louis Diamond:

Makes sense. So what happens now? Will this go into effect right away? And if that's not the case, when can we expect to see the changes carry through?

Matt Baum:

Yeah, so assuming that the ongoing legal challenges that already have occurred, and frankly more likely to be expected, the rule doesn't go into effect until 120 days after it's published in the Federal Register. As of our conversation today, Louis, I don't think it's been published yet, so that 120 day clock has not begun to tick. But with the legal challenges, the game is certainly afoot, so to speak. It's worth noting that the US Chamber of Commerce and other groups have already challenged the rule. Any of these legal challenges could cause delay or even block the FTC rule from taking effect. It's also worth noting that the FTC rule requires employers to provide clear conspicuous notice to affected workers that there will not be and cannot be legally enforced. So some advisors may be receiving those notices which might provide them with further comfort as to the effectiveness of their particular noncompete.

Louis Diamond:

And I know you're not a Washington insider or a lobbyist or have a crystal ball, but in your expert opinion, do you think this rule will be put into effect essentially?

Matt Baum:

Well, whenever you see a rule like this, my expectation would be that the rule as it exactly exists in the, I think it's 560 pages that were released, probably will be changed in some capacity. But, I can't predict what that capacity will be and what that will look like.

Louis Diamond:

So it seems like you think this rule will go into effect, but how it gets changed and how it's going to matter, is still left up for interpretation.

Matt Baum:

No, I would not say that. I would say who knows. Right now there are legal challenges against the rule and how the DOL rule, which was anticipated, ultimately didn't come into effect, you just don't know what direction it's going to take. And I certainly wouldn't wager one way or the other on what direction it'll take.

Louis Diamond:

Fair enough. So how important or impactful do you think this ruling is for advisors? And let's take it, I mean, I think your answer is probably going to be different depending upon what type of firm an advisor's at, whether they're employed by a bank or a financial institution, they run an RIA, they're employed by an RIA, et cetera. So maybe if you can answer that question, but feel free to kind of do the different constituencies that's going to impact your answer.

Matt Baum:

Sure. So practically speaking, and I think most folks and most folks listening will probably want the practical side. I don't expect for most advisors this rule will be all that impactful. Non-

solicitation agreements are certainly prevalent in the advisor space. I find that non-competes are rarer types of restrictions. We already have states within this country that ban them fundamentally anyway. So this just becomes more on a federal level and involving more folks. The impact of the rule will more likely be on how pre-existing non-disclosure or non-solicitation provisions are construed, whether the language could be deemed to have the effect of a non-compete and worker movement goals that the FTC seems to be espousing. So for example, even though this rule is a ban on non-competes, it's not a ban on non-solicits or non-disclosure agreements or confidentiality provisions, however you want to refer to them. But if those provisions in some way would serve as an effective non-compete, they could be impacted.

So I think what we can anticipate regardless of model, as you had mentioned in the question Louis, there are different models out there, of course, more than anyone, about the different value propositions that firms have and how they treat advisor movement and competition and solicitation and all of those things. But it'll be interesting to see wherever this rule winds up and as firms gear up to deal with it in whatever form it takes, what will firms do about pre-existing non-solicits? Will firms without non-solicits implement them? Will firms revise compensation programs? Different things that might achieve the same goals they sought to achieve with a non-compete, but now that the non-compete is no longer applicable, assuming it's not, how else do we align ourselves with those goals and protect the firm in the way that we were seeking would be how a lot of firms would think about it.

So I think when we see how the legal challenges affect the rule and what rule actually comes into effect, which is still going to be several months down the road at the earliest, I think that's going to really show us where the puck is heading, so to speak.

Louis Diamond:

So it sounds like in its current form what was announced on April 23rd has maybe marginal impact as it currently stands for advisors. But what's really interesting that we should spend some time on is how the current regulatory climate or what the knockdown effects of a rule like this might impact something that most advisors have, which is a non-solicitation. Can you elaborate a little bit on that thread where you said that, in essence, even though most advisors don't have non-competes, that perhaps the way that firms carry out non-solicitation clauses, those could be next in line to be changed? So can you elaborate on that and even just maybe giving a prediction, maybe a specific example of where you think this could impact folks in the future?

Matt Baum:

Sure. So if we talk about a non-solicitation agreement, they come in a lot of different forms and shapes and the applicable state laws traditionally we'll guide the enforceability of such provisions. So different states have different authority relative to certain types of restrictions and what would be an enforceable restriction, what wouldn't be an enforceable restriction, et cetera,

et cetera. There are firms that may have very broad definitions of solicitation. Those definitions may be inconsistent with this rule. On the flip side, if firms were relying on non-competes in the past, they may beef up or include non-solicitations in future agreements or compensation incentive plans or otherwise in order to achieve those aims. So we could be talking about legacy restrictions that could be impacted. We could also be discussing future restrictions or compensation plans that could be impacted.

Louis Diamond:

So when I saw this ruling my initial read was very similar to yours, that we didn't really see non-competes that often, but what if other restrictive covenants are changed? And one of the first things that ran through my mind is, it's no secret that firms are paying top dollar to recruit advisors across the industry. It doesn't matter what channel. And one of the, they pay so much is because they're in essence buying the business or even if it's not legally buying the business that they're bringing an advisor over, and obviously they're expecting the advisor to stay at least for a period of time. Do you foresee a situation where the regulatory climate changes in a way where all of a sudden firms no longer have a clear path to return on their investment, where folks can just move at will and there's an impact to what firms could be willing to pay advisors in the future? Do you see that possibly, or is that too much of a leap?

Matt Baum:

Well, again, going along with my impressions and experience in yours as well in the space, I don't see non-competes that frequently. So if we start from a place of this isn't a frequent event, we certainly don't want to extrapolate and pretend like this is the beginning of a whole wave of change, et cetera, per se. Having said all of that, one exception that we didn't get to yet in our conversation is the purchase or sale of a business. The rule provides that you can still have an enforceable non-compete in connection with the purchase or sale of a business, assuming it's a bona fide purchase or sale. So the folks who are engaged in M&A, whether it's individuals or at a firm level or an aggregator level or whatever, assuming that you are applying the principles set forth in the rule of a bona fide sale or purchase in connection with a practice or a business in the space, you should still be able to achieve those protections that you seek through the non-competes.

Louis Diamond:

So maybe it'll be part two of this episode is, and we'll see how this shakes out, but it is just a good thought topic, thinking about if you're an advisor, what are the risks to your business? You always have to understand that. And if advisors should always be thinking about what's the best way to maximize my career enterprise value, it's a concept we talk about pretty frequently. So if one of the levers in that is I can get paid a forgivable note or some amount of money to change employers, to go independent, fill in the blanks, is there possibility that as the regulatory climate

changes that the value of my business has diminished because firms are now much more worried about the real likelihood that advisors can leave much more freely than they can today?

Matt Baum:

Yea, and I think the proof's going to be in the pudding as the challenges are determined as the final rule takes shape, whatever shape that is and whatever effect or non-effect that it may take ultimately with all of this. But again, if you think about a firm utilizing a non-compete, we can think of a non-compete as a tool. It's a tool to achieve some aim. And other tools can be used to achieve similar related aims. So it'll be interesting to see how different firms and different advisors react as those rules come into play. And we could see how it shakes up, but you can certainly expect that firms and advisors are going to start taking this seriously, perhaps pull out their old agreements if they've left them in a drawer dusting for years, just to get a sense of what they're subject to and what may be coming into effect. Obviously, if advisors get the notices that are required by the rule to indicate that certain restrictions they had are no longer in force and effect, that certainly could play a role.

The other interesting component here, and this applies to a subset of advisors, is certain banking institutions and federal credit unions aren't subject to this rule. So where you have advisors who might have a dual relationship with a banking institution or a credit union, there could be interesting impact on those folks as a subset.

Louis Diamond:

So to take that one level deeper, let's say it's an advisor who works for JPMorgan Chase.

Matt Baum:

I'm not going to speak to any specific firms.

Louis Diamond:

So hypothetically, if you're an advisor who works for a big bank or a banking institution that also has a wealth management division, doesn't matter what firm it is, those are the types you're talking about where because the banking institution is carved out from this or is not overseen by the FTC, that there's a chance that a case could be made that everything we're talking about is disregarded anyway, because the opinion is that those folks are not under FTC jurisdiction.

Matt Baum:

My expectation is more where you have... Think of an example where you might have a small local bank somewhere that because they also want investment advisors or financial advisors in their ecosystem, maybe they affiliate with a broker dealer as well, that provides them with some of that service. And someone's both employed by the local bank, and they're also part of this other related broker dealer probably is an independent contractor. So with the independent

contractor agreement, which might be a three-party agreement, meaning the broker dealer, the local bank and the advisor, and then the agreement between the bank and the advisor, perhaps there's force and effect on one of those restrictions and not the other.

So you could have a scenario where you have folks who are subject to certain restrictions in one relationship, but not in a related relationship. And I certainly haven't dug deep in the last few days in the 560 pages of the rules to specifically dig out on those scenarios. But I think if an advisor has those types of relationships where they're working for a bank, but also working as a financial advisor, that may be something worth exploring, assuming you think you might be impacted by this rule.

Louis Diamond:

Makes sense. What about garden leave? I mean, many advisors don't have garden leave, they're not even familiar with the term. But there are certain very notable firms, I'll mention them because you can't name them specifically. Goldman Sachs, J.P. Morgan Private Bank, Neuberger Berman, Bernstein, and a multitude of other private banks, and probably some RIA firms too where they have garden leave. Meaning, the firm will compensate the advisor for typically 30, 60 or 90 days to continue to be employed by that firm. But by doing so, the advisor has to sit on the sideline. So as a non-advisor, seems great. You get paid to go on vacation. But as we know for advisors, the more time they're on the bench without being able to contact clients, it's a big deal and it impacts things like portability and continuity with clients.

So I'm curious to hear your take on garden leave because it feels like garden leave is a form of a non-compete. Do you think that in its current form, from what you've read and understand, that garden leave could be in the chopping block here?

Matt Baum:

If a garden leave provides that a worker will still be employed and is receiving the same total annual compensation benefits on a pro rata basis, then they are not non-competes as contemplated under this rule. Because, if you think about the rule, this relates to post-employment restrictions. If you're in a garden leave where you're still employed by the firm and you're still getting paid the same compensation, fundamentally, it's not a post-employment restriction, you're still in your employment process.

Louis Diamond:

Interesting. So to give a more tangible example, let's say you're an advisor at Goldman Sachs, just to pick a random example, and I was making $200,000 a month between maybe the nominal salary unpaid, but most of the compensation comes from your grid, your compensation from running your business. If I was making about $200,000 a month, I go to leave Goldman, I have a 60 day garden leave, then as long as Goldman fundamentally continues to pay me about

$200,000 a month over that period, then you're saying then seemingly they're in the clear and that's not a post-employment restriction.

Matt Baum:

Yeah, taking out commenting on Goldman or not, just to look at a hypothetical example. If we hypothetically have an employee who has a garden leave where they remain employed and they're getting paid the same comp, that garden leave should not be affected by this rule and should not be invalidated.

Louis Diamond:

Okay. Very good. Last question to bring this home and we'll have to follow up once we have more indication of what this rule is actually going to look like. What do you suggest advisors do? So you see this rule and you're an advisor. Is there anything to do? Is there anything that advisors should be readying, should be thinking about and should be getting ready in the background as this rule takes its shape?

Matt Baum:

Yeah. Thank you for the softball, Louis. Consult with an attorney. And I say that semi-tongue in cheek, but I say it with all do candor as well. If you are contemplating a new employment, you were recently terminated, you're thinking about a move, you're thinking about a purchase or sale of a practice, you're thinking about succession, you're thinking about retirement. These are all natural inflection points to think about what your goals are, where you want to be, and how you're encumbered or unencumbered by whatever restrictions you currently have in place. Better to be prepared than surprised. So I think the best thing that advisors could do is pay attention, continue to keep up with the news. And obviously if you have one of these life cycle events in your career, like I had just mentioned, those different alternatives among others, that's the time to really speak with council and understand whether this rule impacts and if so, how it impacts upon your practice and your future wishes.

Louis Diamond:

I didn't mean that to be a softball for you, but I completely agree. What about... I mean, another thing, and you mentioned it earlier, I forgot to call it out, but I work with a lot of advisors who we say "As part of this process, you should get all of your agreements reviewed by an attorney." And a lot of times advisors are like, "Well, I joined the firm in 1998, I have no idea where my employment agreement is." Or, "I signed 50 different things since I've been here, and how do I do that?" And advisors, rightfully so, are typically worried about going to their manager or going to HR to ask for those types of documents.

Is this kind of a once in a lifetime opportunity where an advisor has pretty tight air cover to say, "Hey, I just saw this ruling came out, I'm just really curious about how it applies to me. Can I get

a copy of my employment agreements or my rep agreement?" Or whatever the employment document is.

Matt Baum:

It's an interesting question, but also keep in mind, Louis, that there's that notice provision. Firms are going to have to provide notice to folks whose non-competes are being invalidated. So that could actually be a breath of fresh air for an advisor who is nervous about whether they had a non-compete in place or something like that. But I don't necessarily know that you're not going to still raise the same red flags that you'd always raise if you're going to ask for copies of those agreements. On the other hand, who knows? It really depends on the context and why you're asking.

Louis Diamond:

Yeah, fair enough. Well, maybe it's an opportunity if you feel brave. I lied, I actually had one more question and it came to me as you were just saying something. It's common practice these days that most major financial institutions have succession agreements, sunset programs, Merrill Lynch's CTP, UBS's Alpha, Wells Fargo's Summit, et cetera, et cetera. And those agreements, an advisor who's retiring typically signs an extra layer of restrictive covenants, and it changes from firm to firm and obviously you have to review the documents to really know what's signing. But broadly speaking, what you know about those types of agreements, do you see any sort of impact that this ruling has in its current form or could impact in the future?

Matt Baum:

There is possible impact. But having said that, I will go back to the sale of practice exception where if it's a bonafide sale of a business or a practice, the rule probably does not override or do anything to a non-compete that might be in place. Having said that, there are some deeper issues, and depending on how the rule shapes out, there could be impact on how sale of practice is being defined, because in some cases, some folks are employees of firm and how those firms are characterizing those practices, et cetera, may trigger different outcomes. So it's actually an interesting question, but one that I think we all have to sit tight on a little bit just to see how the rule shapes up as legal challenges mount, and it hasn't been rolled out yet.

Louis Diamond:

Yeah, because on one hand, let's say you're an advisor at UBS, UBS goes out of their way to say, "We own your business, we own the clients. If you leave, you're soliciting our clients or competing for our clients." But on the other hand, perhaps they can make the case that you entered into our sunset agreement and you sold the business to us. I guess the question is, "Well, you said I didn't own the business, so what did it actually sell you?"

Matt Baum:

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Well, again, Louis, we'll have to see how everything shakes out. I don't want to take a position on that quite yet, and we really do need to see how the rule comes into effect to see if those impacts occur.

Louis Diamond:

Fair enough. Well, I'm not a lawyer, so I can try to bait you into a thought topic, but-

Matt Baum:

Not going to happen.

Louis Diamond:

I don't expect anything different. But I guess like everything else, I mean, there's so much nuance, every situation's different. We always advocate that advisors seek expert counsel if they're considering a move or even thinking about whether it's possible to move. So I think a rule like this is just more ammo to that concept that you should always make sure you're safe, you have expert guidance, and if you do decide to make a change that you're doing it safely and you're doing it in a way that maximizes your possibility for success. So it seems like overall this is probably neutral or perhaps a net positive with potential knock-on effects for advisors. But like you said, we'll see what the final rule says and every situation's going to be different.

Matt Baum:

Absolutely.

Louis Diamond:

Very good, Matt. Well thank you very much for spending time with us today, and if anyone has questions, I'm sure they can reach out to you directly.

Matt Baum:

Yes. Well, thank you so much, Louis. It was an absolute pleasure and I appreciate the time.

Mindy Diamond:

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