SRG
SUCCESSION RESOURCE GROUP

Ebook for Financial Advisors

A How-To Guide for Protecting Your Business

Make the Uncertain Certain

Introduction

As financial planning experts, advisors help their clients preserve their wealth and lifestyle into retirement and hopefully for generations to come, preparing for unexpected life events just in case. Most advisors are using these same principles for themselves to ensure that arrangements are made to protect their family assets in the event something were to happen that causes their premature departure. The plan, however, often does not include the one asset advisors have worked for most of their life – their business.

This e-book addresses why you need a death and disability plan, and describes the four most common types of contingency plans, including valuing and funding, and how Succession Resource Group (SRG) can assist in protecting your business.

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Why You Need a Death & Disability Plan Now

Ensure Continuity of Service to Your Clients

What you have built over the course of your career, and what represents the main asset of your business, are your strong relationships with your clients. As their financial advisor, you have guided them through the various stages of their lives and have become a valuable resource as they made important decisions for themselves and their families.

As a result, your clients bestow on you their trust in handling their financial planning affairs, which is not easily transferred, especially in the event of your sudden death or permanent disability. If not handled with care and proper planning prior to something happening, the most valuable asset in your business – your client relationships – can become your least valuable asset almost overnight.

To avoid this unfavorable outcome, present your clients with a well-thought-out plan with a highly capable successor who will continue to serve them in your absence, at the same high standards they have become accustomed to.

By planning ahead, you can ensure continuity of client service by designating a suitable advisor who has a similar investment strategy and service model to yours and is willing to step in, either temporarily and/or permanently, when you are no longer able to work.

Preserve Your Business Value for Your Loved-Ones

Your business is one of your most valuable assets, and is the result of your hard work as well as the support of your family and friends. Naturally, most advisors want to capture this value when they exit the business.

While it is relatively simple to preserve the value of your business for you and your loved-ones in case of your retirement, because you can be involved when the sale occurs, an unplanned transition is more complicated and riskier for a successor with you suddenly gone.

This increased complexity and risk stems from two primary obstacles:

01 The potential for significant client attrition in an emergency situation.

In times of uncertainty, you can lose your capacity to support a transition in cases such as your premature death or permanent disability.

This necessitates having a plan in advance, but even so, buying and taking over an advisors business when they are suddenly gone is riskier than buying at retirement, and this must be factored into the plan's valuation and buy-out terms.

Once the plan is in place, don't keep it a secret – share your plan with your clients, communicating to them with confidence that they will be in good hands in the event of your untimely departure.

02 Your regulatory environment.

SEC and state registered RIAs will soon be required to have a succession plan and contingency plan in place, and registered reps under a broker-dealer must be sure they satisfy FINRA Rule 2040 and associated SIFMA no-action letters.

The key to satisfying all of these compliance requirements is to have a plan. That's it – it doesn't have to be complicated. You just need to have a plan and write it down.

With proper planning and documentation, you can resolve these issues and preserve the value of your business for those you care about.

Four Types of Contingency Plans

There are many different iterations of contingency agreements, and each plan should be adapted to your unique needs. The following four descriptions summarize the most common types of plans, as well as who the plan serves best, ease of implementation, and the value an advisor is likely to be able to extract should something happen:

01 Cross Purchase Agreement

A reciprocal agreement between you and a peer, wherein you promise to buy each other's business upon a triggering event. The agreement lists the type of triggering events (death, permanent disability, and loss of license), specifies how the value is determined, and practical terms for a buyout. The plan might be funded with life insurance, but this is not required. The parties can also provide for an optional purchase upon retirement or temporary support in case of a short-term absence (to ensure continuity of client service). These plans are relatively easy to implement, and risk of client attrition is low because you have named a successor in advance, which stabilizes the value.

Ease: ★★☆☆
Value: ★★★☆
Attrition Risk: ★★☆☆

Best for:
Solo advisors with peer who will agree to buy and also need a plan

02 Contingency Retainer Agreement

If you do not have a peer or employee to create a plan with today, you are not out of options. SRG's Contingency Retainer Agreement is a contract between you, your business, and your broker-dealer/ custodian, and provides for SRG to broker the sale of the business upon a triggering event. SRG collaborates with the various parties acting as your or your executor's advocate to facilitate the sale of your business. This plan does not require naming a buyer today, making it easy to implement. Because the sale of the business will be brokered quickly, attrition should remain low and the value extracted will be relatively high, but time is of the essence to get the best value possible.

Ease: ★★★★
Value: ★★★☆
Attrition Risk: ★★★☆

Best for:
Solo advisors without peer to name today

03 Buy-Sell Agreement

A one-way agreement between you and a peer, wherein your peer or employee agrees to buy your business upon a triggering event. The agreement lists the type of triggering events such as death, permanent disability, and loss of license, and specifies how the value is determined as well as practical terms for a buyout. The plan might be funded with life insurance, but this is not required. The parties can also provide for an optional purchase upon retirement or temporary support in case of a short-term absence (to ensure continuity of client service temporarily). These plans are relatively easy to implement, and risk of client attrition is low because you have named a successor in advance, which stabilizes the value.

Ease: ★★★☆
Value: ★★★☆
Attrition Risk: ★★☆☆

Best for:
Solo advisors with peer who will buy

04 Shareholders' or LLC Buy-Sell Agreement

For more evolved equity structures like a corporation or limited liability company, a Shareholders' or LLC Buy-Sell Agreement is a detailed agreement amongst two or more owners of an entity that governs any and all equity transfers and possible triggering events (including death, disability, loss of license, unresolved dispute, termination, etc.), and how equity share will be valued and paid for. Combined with the owners' fiduciary duty to act in the best interest of the entity, this agreement provides for successful business continuity during an owner's absence. Solo practitioners using an entity should look to the Buy- Sell or Cross Purchase Agreement with a peer or employee.

Ease: ★☆☆☆
Value: ★★★★
Attrition Risk: ★☆☆☆

Best for:
Multiple owners of entity

Valuing and Funding

It is important to ensure that the plan you create is as comprehensive as possible and leaves nothing to chance after you are gone. Be sure to include in the agreement a simple way to determine the current value of the business, as well as a funding strategy.

Value

The value of your business will always be a moving target, and this must be considered when building your contingency plan. The most common valuation strategies SRG uses in the agreements we help advisors put in place include:

1. valuing the business when something happens; or
2. valuing the business today and using this valuation to build a simple valuation formula that can be applied when something happens.

Having the business appraised at the time something happens will provide the most accurate value. However, timing must be considered in advance to ensure this is a viable strategy. Is there someone capable of gathering the data within a week of something happening? If the answer is yes, this is the preferred strategy to ensure you have an accurate third-party opinion of value prior to the sale. This is important, considering the potential for stepped-up basis and the spouse/estate paying little to no taxes on the sale of the business. If you are unsure whether the necessary data could be gathered quickly, value the business today and track it annually. Use the valuation result to build a simple-to-interpret formula that can be applied at a moment's notice. While it will not be the exact value of your business, it will generally be close.

In some cases, the contingency plan valuation will include a discount for the circumstances. A sale triggered by death, disability, or loss of license is higher risk than a planned retirement buy-out. However, because of the way most contingency agreements are funded, in most cases there is no need to explicitly discount the value.

10-30% The average depreciation of a practice in an emergency sale.

Payment Terms

Most advisors assume their contingency plan will be funded by life insurance, yet less than half of all plans involve any life insurance at all. Most contingency plans are established between two peers, and the most common funding strategy is using a promissory note with payments over 7 to 8 years. These notes include a look-back clause which ensures you or your family will receive full value if all clients and assets are retained by your successor. If, on the other hand, there is a material amount of client attrition after a year, the balance owed under the note will be reduced. This ensures that you won't need to apply a hefty discount because of a 'fire sale' and the successor does not take undue risk being your contingency partner. These notes provide a simple solution that works in case of death, disability, or loss of license, where life insurance will only solve for one of those three.

Life insurance can be a viable solution for many plans if it can be obtained cost effectively, but it is important to ensure the insurance is setup correctly and fairly for both parties (specifically, who should the owner be, who is the insured, who is the beneficiary, and who is responsible for the premiums). Even the simplest Buy-Sell funded by life insurance can be structured suboptimally. For those with Cross-Purchase Agreements or Shareholders' Agreements with business-owned life insurance, there are even more nuances to ensure funding is structured correctly to avoid issues in your absence. Internal succession buy-sell arrangements and Partnerships/Shareholders' Agreements are the two most common strategies to include life insurance as a funding mechanism.

Special Note: Make Sure the Plan is Practical

There are many plans that are "legal" but not practical in their implementation. How the plan is funded and/or the timeline in many cases is simply not practical. A sale triggered by death or disability requires fast action in order to avoid high attrition rates. Long notice periods, negotiation periods, due diligence, or required lending approval prior to the sale occurring are not practical if you wish to preserve the value of the business.

The requirement to act fast, however, is predicated on you having (or finding) a successor quickly, and having the terms figured out in advance. This will make the process less burdensome for your loved-ones, the deal less risky to a buyer, and increase the likelihood of a successful transition at the time of your premature departure.

How Do You Start Your Plan?

Determine whether you have a successor to name today, and then have your business appraised and work on getting an agreement in place that is customized to your particular situation and result of comprehensive, industry-specific consulting.

Succession Resource Group will work with you after completing your valuation to develop the appropriate agreement, and then tailor it to your particular situation. Unlike local counsel, SRG has form agreements designed for your industry that have actually been used by our clients in fire sale situations, and the experience working with hundreds of broker-dealers and custodians to develop a plan that will meet their standards. Working with an industry expert like SRG and leveraging field-tested resources, combined with a final review with your local counsel (tax and legal) will result in a more comprehensive solution you can rely on in your absence and save you time and money.

We will also provide a sample letter you can customize and use with your clients to inform of the proactive steps you have taken to ensure they are taken care of should something ever happen to you, as well as a detailed checklist of items to prepare in advance to ensure someone could step-in and operate your business without you. This final step will help ensure a seamless transition even under the worst scenarios and that the business will be retained by your successor – ensuring maximum value for you and your family.

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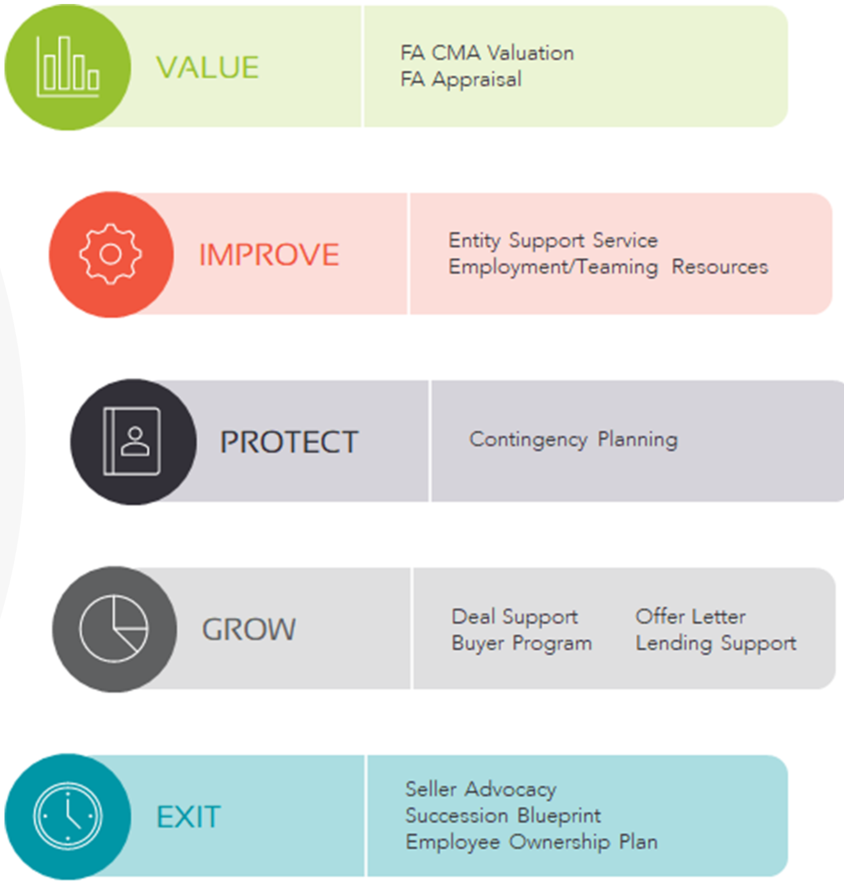

Contingency Plan

Creating your contingency plan to protect the value of your business and ensure your clients are taken care of is an important step for every business owner in case of death, disability (temporary or permanent), loss of license, etc. It is even more critical for advisors given the strict regulatory environment requiring such a plan to be in place in advance for a spouse/estate to be paid. Whether you are creating a contingency plan with a peer, partner, employee, or need us to help find one in your absence, we can help. SRG has the experience, industry knowledge, and form contracts to make the process of creating your plan easy, efficient, and effective.

Next Steps

Schedule a Consult

About Succession Resource Group

Ranked as one of the top 100 fastest growing private companies in Oregon by Portland Business Journal, Succession Resource Group, Inc. (SRG) is a boutique succession consulting firm specialized in helping financial professionals value, protect, merge/acquire, and develop exit strategies for their business.

With decades of combined industry experience, SRG possesses a unique combination of skills, resources, and expertise to help advisors understand the value of their business, develop strategies to improve that value, protect it with comprehensive contingency and succession plans, and grow through acquisition.
