Sunset vs. Succession:

Realizing the Value of a Career in Financial Advice

SRG
Succession Resource Group

LiveOakBank

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Introduction

Financial advisors typically enjoy long, lucrative careers. But while they help clients build lasting wealth, they may neglect to create long-term plans for themselves. Succession planning — the key to understanding and realizing the full value of the business financial advisors work so hard to build — is a lot like flossing teeth: Everybody knows they should be doing it, but that doesn't mean they actually follow through. Today, even captive advisors should be thinking about how to derive the most value from their book, because they have beyond those provided by their broker-dealer, especially if they give themselves enough time to develop and execute a multi-year strategy.

In the days when just about every financial advisor was the employee of a large firm, the only retirement option available was a "sunset"—in which the firm owned the client accounts, but gave the employee a payout as s(he) transferred those accounts over to another, younger advisor. Now, with the ascendance of the independent advisor, there are many more lucrative paths to a successful exit. A skilled advisor can leave the corporate world, affiliate with an independent broker-dealer or open a RIA, and then, after a few months or years, sell the business for substantially more than any current sunset plan offers. Competition from the independent segment of the industry has forced large brokerages to sweeten the pot of their sunset plans as well, yet even these improved sunset programs pale in comparison to the value received by an independent advisor who is able to sell his or her business.

This white paper will look at the financial benefits of independence followed by a sale of the business to a successor, as compared to a traditional corporate sunset plan. Your practice can be your most valuable asset. You've worked hard for many years and have built real value in your practice. But, will you realize the value of what you are building, or will your broker/dealer reap the rewards of your hard work? Based on current market conditions, advisors who are able to sell their business (independent advisors) receive 3-4 times more value net of taxes than those that take their firm's sunset offer.

Using data collected by Succession Resource Group (SRG), Live Oak Bank and others, we've put together some realistic sample plans that will help you think through your business plans. What we've learned over the years is that independent practices have become increasingly transferable, thanks to expanded access to capital and advances in advisor technology. For 2019, for example, SRG published deal data on 153 sales of RIA practices, and investment banker DeVoe & Company reported a similar figure of 132 sales of RIA practices with $100 million or more assets under management.[1] According to SRG, RIA values rose 13.81% over the last decade (2010-2019), and RIA sales have increased every quarter for the past seven quarters, according to DeVoe. Since 2000, the trickle of advisor deals has turned into a steady flow.

1 DeVoe & Company RIA Dealbook, Q3 2019

Models For Succession

Sunset Programs

Once you examine employee and independent models closely, the differences are stark. Employee advisors can make use of the sunset program at their firm or they can jump ship. Although programs vary from company, advisors can typically expect to reap approximately 1x their GDC, paid contingently based on the buyer's success over a period of up to five years, taxed as ordinary income and therefore subject to income tax.

The programs work as follows: The advisor enters sunset program, selects a successor, negotiates duration and % split within confines of sunset program, then senior advisor retires. Compensation is split with the successor, who receives a larger percentage over the course of the program (paid out over a maximum of five years).

Exiting Advisor – Sunset Example

Retiring Advisor with 20+ years of service and $1 Million in production.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Revenue Payout	**$315,000**	**$292,500**	**$292,500**	**$225,000**	**$202,500**	
Taxes	**($318,528)**	**($129,202)**	**($129,202)**	**($101,223)**	**($91,897)**	
State Tax	($25,200)	($23,400)	($19,800)	($18,000)	($16,200)	
Fed Tax (Blended)	($100,800)	($93,600)	($79,200)	($72,000)	($64,800)	
Medicare	($4,568)	($4,241)	($3,589)	($3,263)	($2,936)	
Social Security	($7,961)	($7,961)	($7,961)	($7,961)	($7,961)	
Total	**$176,472**	**$163,298**	**$136,950**	**$123,777**	**$110,603**	**$592,637**

After tax dollars, NPV assuming 7%

Table 1: Exiting Advisor - Sunset Example

Certainly, participating in a corporate sunset program has its advantages. The primary benefit is convenience, for both advisor and client. The employer manages the payout process and there's little to no paperwork for you or your clients to deal with. But the downsides are important to consider. First and foremost, you're likely to get less money than you would if you sold an independent practice (more on that later).

What's more, taxes on what you do receive under the sunset program will be more onerous, because you'll be paying income taxes rather than long-term capital gains. In addition, you will have less flexibility in choosing a successor, and your successor will be poorly compensated during the sunset period—and therefore may lack motivation to serve your clients well.

Table 1 and the detailed summary in the attached Appendix shows how much money a sample advisor can reap from a sunset program. This advisor has been with his firm for 20 years and produces approximately $1 million a year. Later, we'll show how the same advisor would fare by going independent and selling his or her business.

An independent advisor, on the other hand, has a variety of paths to succession to choose from. Each one culminates in a sale that has the potential to net three to four times the amount an advisor would receive from a corporate sunset program.

Go Independent Through a Broker-Dealer

Affiliating with an independent broker-dealer will put you in a workplace environment that's similar (though definitely not the same) as that of a captive broker.

The similarities: you can use a tech platform provided by the broker-dealer; the broker-dealer will provide compliance review; you will have a brand behind you, though it won't be as well known as that of a wire-house or bank.

The differences: You will receive a larger payout, but you will be responsible for your business operations, from hiring staff to marketing. And most importantly, you will own your business, which means you can sell it when it's time to retire. In fact, your broker-dealer may help you sell it to other advisors who affiliate with it.

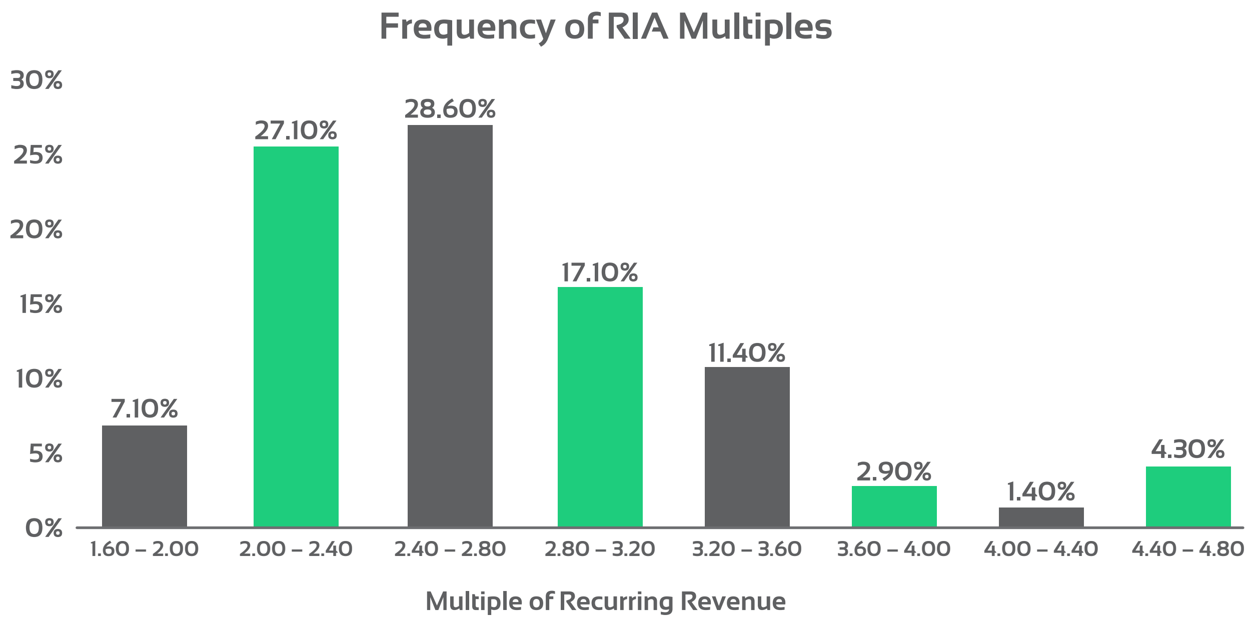

Figure 1: Frequency of RIA Multiples

Today, average prices for an independent practice consistently range from 2.0 to 3.5 times fee-based revenue (see Figure 1), which is taxed at the long-term capital gains rate, not as income — so you keep more of what you earn. You can get full payment for your practice at the close of the deal plus ongoing compensation if you plan to stay on part-time with the buyer. Consulting a succession expert such as SRG can help you prepare your practice for sale and maximize its value.

Start or Join an RIA

This is the most entrepreneurial option and therefore offers the most potential reward. Registered investment advisers will be completely responsible for running their firm and will work directly with a custodian, who will provide a trading platform, custody client assets, and not much more. You can run the practice as you see fit and take responsibility for all your operations, including technology, market research, marketing and compliance. RIAs are hot right now and M&A is on a roll, so starting up your own independent firm is a strong strategy. But it will be up to you to sell your practice when the time comes. Luckily, transition advisors like SRG will help you do it right and lenders such as Live Oak Bank will help the buyer underwrite the deal.

Becoming an RIA has several points in its favor: there is no payout—instead, you collect 100% of your fees; you can run the firm as you see fit, within the bounds of the law; you can sell the firm easily to any qualified buyer; your business sale will be taxed at the long-term capital gains rate rather than as income. But it also has one disadvantage. With freedom comes responsibility, and you will be burdened with running a business on your own which can take time away from business development or client service.

Prices for successful RIA firms are at an all-time high, assisted in part by ballooning asset values that have sent revenues skyward. The current average price for firms with less than $1 billion in AUM is 2.72 times gross revenue (if you are selling a book of business), or 3 to 8 times earnings (if you are selling a turnkey business). RIAs that are growing by taking on new clients are more valuable than those that merely serve existing clients, especially if those clients have retired already — they can be considered a diminishing asset as they are drawing down on their accounts. So, if you are thinking about going the RIA route, do it early enough that you can build a robust, expanding client list before you sell.

Table 2 as well as the more detailed summary in the attached Appendix, shows what an independent advisor would expect from selling his or her firm, assuming that (s)he had served the clients for at least 20 years and created approximately $1 million in fees per year. This advisor would net more than 3 times the money that she would have earned had (s)he stayed in a captive environment, and would receive the entire sum at the deal close rather than waiting for several years and waiting to see how the markets perform and if the buyer works the book.

Exiting Advisor – RIA Sale

Retiring Advisor with 20+ years of service and $1 Million in production.

Sale Price	Year 1	Year 2	Year 3	Year 4	Year 5	Total
$2,720,000	**$2,720,000**					
Taxes	**($810,873)**					
LTCG	($693,056)					
State Tax	($19,584)					
Fed Tax (Blended)	($78,336)					
Medicare	($3,976)					
Social Security	($15,922)					
Total	**$1,909,127**					**$1,909,127**

After tax dollars

Table 2: Existing Advisor - RIA Sale

Join an Existing Firm As a "Tuck-In"

Many advisors, especially those approaching retirement age, affiliate with independent advisors by joining an existing office. Called a tuck-in, this type of transition has become more popular in recent years due to financing from companies like Live Oak Bank. Tuck-ins typically receive payment in three stages: when they join a firm, when they bring over a certain percentage of their book and when they transition accounts to other advisors at the firm.

Conclusion

Regional firms, banks, and wirehouses have continued to improve their sunset program offerings, but when the total value and net tax effect are factored in, the difference is stark. It's vital to examine all your options before you make a final decision.

So be sure to talk to experts before you make a move. SRG works with independent advisors who want to buy, sell or grow their businesses to guide them through acquisition and succession planning. Based near Portland, Oregon, SRG has worked with thousands of firms nationwide. Live Oak Bank has loaned nearly $1 billion to financial advisors and has a dedicated team of loan officers who work exclusively with advisors. Based in Wilmington, North Carolina, Live Oak is the largest SBA lender in the country and provides both conventional and SBA financing to small businesses across the U.S.

There are many reasons an advisor may remain with current firm and sunset, but value is not one of them. You can do better by taking the extra step of going independent, so it is worthwhile to consider. Leaving the captive environment isn't without its challenges, but the payoff tends to be substantial. Selling an independent firm rather than working through a sunset program can leave you with more than three times as much money in your hands — and when you are looking at retirement, that extra wealth can certainly provide a lot of satisfaction.

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Appendix

Data Analysis

Key Assumptions

Revenue	$1,000,000	
Avg. Multiple of Rec. Revenue	2.72	(2019 figures, Succession Resource Group)

Tax Assumptions		
Long Term Cap. Gains	20.00%	
State Tax	8.00%	(Assuming state cap gains tax applies)
Blended Effective Fed Rate	32.00%	
Fica - Medicare	1.45%	(For independent sale, this is doubled)
Fica - Social Security	6.2%	(For independent sale, this is doubled)

Sample Payout Structure

Wirehouse	
Revenue Production	**Payout**
$2 Million	49%
$1 Million	45%
$600K	43%
$400K	36%

*Based on reports to On Wall Street

Sample Payout Structure

Independent	
Revenue Production	**Payout**
$2 Million	100%
$1 Million	100%
$600K	100%
$400K	100%

Sample Sunset Arrangement

Sunset Arrangement						
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
"Selling" Advisor	**70%**	**65%**	**55%**	**50%**	**45%**	**285%**
Successor	30%	35%	45%	50%	55%	

Split based on a million dollar producer with 20+ years of service and having been on a team for more than 3 years is eligible to receive splits of 285% on Qualifying Gross Revenue During 5 Year retirement period.

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Tax allocation for sale assumes:

91% of Sale Price Paid for Clients
5% for seller transition consulting (12 months)
4% for restrictive covenants

*All numbers above are industry average based on SRG deal data for 2018 and 2019.

By selling to an independent advisor, the wirehouse advisor can obtain

322% more value

for the same practice.

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About The Authors

David Grau Jr. | President, Succession Resource Group

David Grau Jr. is the founder and CEO of Succession Resource Group, the nation's leading consultant on advisor valuation, acquisition, and succession planning. Over the last decade, David and his firm have been nominated for and won numerous awards – including the Inc. 5000 American's Fastest Growing Companies, WealthManagement.com Industry Award, and was nominated for InvestmentNews' 40 Under 40 award. David is a published author and accomplished speaker on advisor succession planning and has been interviewed and cited in dozens of publications over the last two decades. David holds a Bachelor's degree from Portland State University and his MBA from Willa¬mette University where he is currently a professor of management.

John Turner | Managing Director, Live Oak Bank

John Turner joined Live Oak Bank with nearly 30 years' experience in the financial services industry. Prior to joining Live Oak Bank, John ran a successful practice as a financial advisor in the Midwest. He went on to hold several executive positions within the two largest broker dealers in the industry and the largest fraternal benefit society. John's latest position before joining Live Oak Bank included leading a practice management department where he developed deep expertise in practice staffing, practice financial management, practice acquisitions and succession planning.

Samantha Martin | Loan Officer, Live Oak Bank

Samantha joined the bank in 2016 as an Underwriter. She became the dedicated underwriter for Investment Advisory Lending in January of 2019 and was later promoted to her current position of Loan Officer. Prior to joining Live Oak Bank, Samantha worked as a Loan Officer for a regional bank. She has nearly 20 years of banking experience working with small businesses. Samantha is a graduate of Indiana University where she majored in Management and Finance.

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About Succession Resource Group

Succession Resource Group, Inc. (SRG) is an award-winning succession consulting firm with decades of combined industry experience. SRG possesses a unique combination of skills, resources, and expertise to provide turnkey solutions helping advisors understand the value of their business, develop strategies to improve that value, protect the value with proper agreements and plans, grow through M&A, and create/execute their exit strategy. To learn more, visit www.successionresource.com.

About Live Oak Bank

Live Oak Bank, a subsidiary of Live Oak Bancshares, Inc. Nasdaq:LOB), is a digitally focused, FDIC-insured bank serving customers across the country. Live Oak brings efficiency and excellence to the banking process, without branches, by using a focused approach to technology and innovation. To learn more, visit www.liveoakbank.com.