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SUCCESSION & CONTINUITY PLANNING

For Financial Advisors
and Independent Reps

What is YOUR Succession Plan?

As a financial advisor, you spend much of your time working on the nuts and bolts of retirement planning with your pre-retiree and retiree clients.

What if you were to ask yourself the same questions you ask your clients in regards to your advisory practice, business partners and your own desires for the succession of your business?

If you haven't recently considered succession and continuity planning you're not alone.

Succession and Continuity – What Do the Statistics Reveal?

Studies indicate that a succession or continuity plan is missing at a majority of advisory firms. Research from Cerulli Associates cited in Barron's in June 2017 based on an article in *InvestmentNews* finds that, of the estimated 118,000 advisors within 10 years of retirement, **44,000, or 37%, have no formal succession plan in place.**

Based on assets under management (AUM), though, it appears that smaller, independent advisors standout as lacking a formal plan. "Specifically, these standalone advisors manage just 22% of AUM that could change ownership in the next decade," the Barron's article notes.

61%

of advisors planning to retire in the next 10 years have developed plans for succession, sale or client reassignment.

These advisors handle

$4.5 TRILLION

or three-quarters of aging advisors' assets.[1]

Numbers like these may seem like positive news for an advisory industry often cited as not being ready for succession. Yet, broader statistics suggest that succession or continuity planning still has room for improvement. Research going back to 2012 found that, of financial advisors targeting a transition within three to 10 years, 50% did not have a succession plan in place. *Forty-two percent* of those targeting a transition of their practice *within two years* lacked a succession plan.[2]

Valuation – What is Your Practice Worth?

Succession planning is the long-term, controlled transition of your firm to another owner-advisor. Continuity planning for advisors, in contrast, provides for the continued running of your practice if you pass away or become disabled. In other words, an unexpected transition that does not involve you.[3]

In a perfect world, both would be part and parcel of an overall long-term strategy for the succession of your business. Whether or not you have a succession plan in place, it makes sense to know what your practice is worth on several different fronts.

Knowing the numbers is a good first step to deciding how to go about succession planning. Business valuations are needed, for example, for buy-sell agreements, estate planning purposes and as a means of deciding whether or not to sell your practice outright.

Also, in any succession agreement in which you may decide to stay on as a consultant, a detailed valuation of your production and business development can bring clarity on your worth to the new owner and your compensation.

In terms of valuation, do you know, for example, the sources of your firm's growth in AUM? If you don't already, consider breaking down AUM by "evolutionary stage." This is what's tracked in the industry standard *InvestmentNews* Advisor Compensation & Staffing Study.

These items include:

- New assets from new clients
- New assets from existing clients
- Lost assets from lost clients
- Lost assets from existing clients
- Changes due to performance

Within the new assets from new clients item, you may also want to track:

- New assets from client referrals
- New assets from professional referrals
- New assets from firm business development

This information is vital. FP Transitions, a prominent firm in the succession planning space, says, for example, that 90% of exit strategies within financial advisory businesses that have been created are not tied to an actual business value.[4]

What About Your Value?

In terms of your own production within your firm, know your personal value. Make sure you have assigned "commission renewables" to your beneficiary on all of the life, disability and long-term care business you write, as well as any income streams you receive from separate accounts you may currently be managing.

You can also identify those renewables, have a valuation performed, and include those figures as part of a selling agreement you enter into with your firm. Any arrangement or agreement you have with your firm will likely depend on whether you are a partner, junior partner, employee or independent contractor.

Keep in mind that another firm partner, associate, or third party could be assigned to service these revenues, so your commission renewables may be discounted from its present value and you may want to explore options to offset any income gaps you might foresee for your family.

Buy-Sell Agreements

Since, in many cases, the value of an advisor's practice is tied up in the overall business, a common way to avoid a liquidity squeeze if the need arises to buyout another business partner because of death, disability or retirement is through a buy-sell agreement.

Life insurance is often used to fund the purchase of the business in the event of the owner's death. Depending on the type of buy-sell agreements, the policies could be purchased in a few ways. With business-owned life insurance, the company buys life insurance on the lives of the owners, with the company designated as the beneficiary. These agreements are also commonly referred to as an entity or stock redemption plan.

In a cross-purchase agreement, each business owner takes out life insurance policies on the other owners and lists themselves as the beneficiary.

In the case of several partners involved in a cross-purchase agreement, a business structured as a partnership might establish a trust, with the assigned trustee purchasing and owning life insurance on each owner. This type of agreement can also be structured so that any potential cash value accumulated from the life insurance policy may be used by either owner to fund a buyout if either decides to retire.

Entity and cross-purchase agreements each have tax advantages and consequences for surviving owners as well as the deceased's estate. So careful consideration and planning may be required before a decision is made as to whether an agreement is pursued and what type is chosen.

Indexed Universal Life Insurance and Deferred Compensation Plans

In addition to buy-sell agreements, other nonqualified plans can be used to provide for succession and continuity. These include supplemental executive retirement plans (SERPs), split-dollar plans and nonqualified deferred compensation strategies, among others. While establishing these agreements at the time may be primarily to provide highly paid employees with the ability to save more for retirement, they can also address income needs in the event of a disability and include death benefits.

SERPs provide key employees with supplemental retirement income above that of qualified plans such as 401(k)s which by law must be offered to all employees. The supplemental income is often provided through the cash value of the life insurance policy.

The terms of split-dollar arrangements may vary, but its basic form involves the business owner and employee splitting the premiums on the policy with the business typically owning the policy and designated as the beneficiary. In the event of death, the company recovers the premiums paid, while the employee's beneficiary receives the face amount.

Key employees may also agree with their employer to defer a portion of their compensation to supplement their retirement plan on a tax-deferred basis. That's because of limits on contributions to qualified savings plans and caps on Social Security benefits. These plans may be unfunded or funded. If funded, corporate-owned life insurance (COLI) is a popular vehicle.

Indexed universal life (IUL) insurance is also being used to fund these agreements. That is because these strategies generally provide supplemental income for retirement or a disability, and include a death benefit. The policy's cash value can accumulate without taxes to the business, be used to pay the benefits to the executive, and the death benefit proceeds are free from income tax upon death of the covered executive. For the company to receive the death benefit tax free, it must comply with rules for employer-owned life insurance within Internal Revenue Service Code Section 101(j).

Communicate with Clients

As you already know, serving your clients and their continued business is the key value within your practice. Keep your clients in the loop about your succession and continuity plan so they know there are provisions in place for the servicing of their accounts.

Successors within your firm should already know the value your clients provide to your business, but potential buyers and other outsiders don't. That means client retention must be a major focus of any succession plan. Buyers and mergers and acquisitions firms expect to retain upwards of 90% of the practice's assets and revenues, NFP Advisor Services notes. Client communications may also reveal additional service needs.

"A well-implemented succession process might even lead to increased production; the systematic discussion and hand-over of client cases and the associated client discussions could uncover client needs that have not been previously addressed."[5]

Contact your attorney, legal and tax provider for additional information about your specific situation.

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[1] "Good News on Advisor Succession Planning," Barron's, June 29, 2017. https://www.barrons.com/articles/good-news-on-advisor-succession-planning-1498754196 (accessed December 13, 2017).

[2] "The Efficient Frontier of Succession: Maximizing Practice Value," NFP Advisor Services, May 2012. This report leverages an online survey of 228 practice owners conducted by Aite Group in March 2012. http://www.fa-mag.com/userfiles/stories/whitepapers/2014/NFP_June_white_paper/NFP_Advisors_Services_SuccessionPlanning.pdf (accessed December 13, 2017).

[3] "Continuity Planning for Advisors: Resolutions for the New Year," by Maria Considine King, Commonwealth Financial Network, December 15, 2015. https://blog.commonwealth.com/continuity-planning-for-advisors-resolutions-for-the-new-year (accessed December 13, 2017).

[4] "More Financial Advisors Need Exit Strategies," by Mike Byrnes, Financial Advisor, October 31, 2011. https://www.fa-mag.com/news/more-fina5ncial-advisors-need-exit-strategies-8798.html (accessed December 13, 2017).

[5] NFP Advisor Services, May 2012.