SUCCESSION PLANNING IS SOMETHING YOU DO EVERY DAY ISN'T IT?

Make sure you have a Plan A and Plan B in place for when you want to get out of your business, Tony Vidler writes.

{TONY VIDLER}

In the USA there is a rule requiring investment advisers to "establish, implement and maintain written procedures relating to business continuity and succession".

It is a compliance requirement.

Yet, according to research by Cerulli in the USA just 25% to 38% of planning firms have a succession plan in place. Those who don't are mainly (and unsurprisingly) the solo practitioners who make up the bulk of the market – just like here.

In NZ I would suggest that the proportion with an actual plan is substantially lower.

Why is this an issue when the no-brainer option is to never sell the practice, but to just keep a slowly diminishing passive income called renewals rolling in during your retirement? After all, it isn't like there is any legal requirement for you to do anything to or for the clients in order to retain the rights to a contractual income stream, is there?

Let us put the ethics and morality of that question to one side, and refrain from the temptation to indulge in crystal ball gazing on whether advisers will be able to retain renewals without being ongoing licensed advisers with full compliance requirements. Instead we should consider why today's adviser might actually need to do something about succession.

This is why you should worry about it:

➤ For advisers planning to be in business in 10 years' time it will probably become a requirement to practice. As regulators globally increasingly align regulatory principles and standards it is not unreasonable to assume that in time there will be a legal requirement for firms in NZ to have a written succession plan too.

➤ For advisers planning to be out of business within 10 years it is about creating certainty for yourself, your estate and your clients. Of course, for those wanting a longer career there is a need to create certainty too, it is perhaps just not as urgent.

Given that "creating certainty" is something which financial advisers practice regularly on behalf of their clients it is remarkable that so little attention is given to creating it by them and for themselves.

So what should advisers do to create certainty in succession for themselves?

Three things should be done:

➤ Manage the risk of you not getting to choose your timing

➤ Create an optimal strategy

➤ Have a "Plan B"

Advisers are humans and face all the same risks and probabilities that other humans do: they are not exempt from normal mortality risks. Prudent business management of our own practices would begin by putting in place a catastrophe plan. The potential risks for a practitioner that are pertinent to being able to exit a practice at premium value and an ideal time are:

a: Death
b: Long-term disability
c: Serious medical event
d: Business partnership dissolution
e: Marital Breakdown
f: Loss of other key person
g: Loss of regulatory license

Some are clearly insurable events, which can potentially entirely mitigate the financial impact to a business owner of the catastrophe. Some are not insurable, but they are transferrable. That is, sound estate planning structures and contracts can help mitigate or even potentially completely avoid the financial impact of some catastrophes. Just as importantly as arranging capital injection from insurers where possible, and protecting and shielding through contract and structure, is having a conditional sale and purchase for the business to a pre-approved buyer. Most advisers have (or can find relatively easily) someone in the business who they would be happy to have take over their business and look after their clients. Some may have even had conversations about that happening in the event of a disaster, but few go so far as to arrange a conditional sale and purchase agreement that can be triggered by one of the defined events. Of course, it is a touch more difficult to organise from the grave, so one really should consider it beforehand.

One of the catastrophe risks is "manageable". The "cost" in creating the solution to the potential loss of regulatory licensing is the investment in internal compliance systems, external or outsourced verification of those internal systems, and an ongoing "safety" culture, which emphasises maintenance of the agreed standards.

These actions, which are so often overlooked by financial advisers, are in fact an essential aspect of ensuring that a successful exit from a practice can occur even in the event of personal catastrophe.

These actions buy time to create and put in place the optimal strategy, which is Plan A really. That is the one where you plan to dictate the timing, the terms of transfer of responsibility, and have an orderly handover of responsibilities and relationships. The optimal strategy may not necessarily aim at a specific buyer (though I believe it ideally will), but it will definitely aim at a specific outcome. Leading up to execution of the plan there will be careful consideration given to organising the practice and systems, enhancing the residual value and profitability, structuring the funding or buyout terms and laying the foundations for the necessary transfer of trust by clients which will make it a success.

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Not all plans go according to plan though, so a Plan B is required. This is the sub-optimal version of Plan A of course. Plan B is about acceptable compromise. Is a BOLR valuation acceptable? Do I have a person I could transfer to at a reasonable value, but where I would have to modify transfer or payment terms, and if so, what is acceptable? Should I semi-retire – staying compliant and licensed of course – and let the business wind down over the years?

Regardless of the decisions one eventually makes, getting what you want from succession is about being thoughtful, deliberate and then taking the actions necessary to achieve the outcome you planned for. It is about creating certainty. But for yourself.

It is just like the process you use with clients everyday isn't it? A

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