Focus on Your Future:
Succession Planning for Financial Advisors

It happens all too often – financial advisors spend their entire careers helping clients achieve their financial goals. But when it comes to preparing for their retirement, they can often overlook a critical element until it's too late – their succession plan.

Vantage Impact CEO Boston Cardinal says it's one of the biggest challenges he sees advisors facing. "They are quickly realizing that succession planning is kind of like insurance. It's not important until you need it. And up until that point, it's a really easy thing to neglect."

Paul Lally, who is the lead partner of the Wealth and Asset Management Industry Practice at Wifpli, LLP. a national accounting and consulting firm has noticed a similar trend. "I've seen too many advisors over the years wait too long. I've seen the advisors or their heirs not receive what they should probably receive for the equity within that business." He has also worked with many advisors who have unclear or unrealistic expectations about the pace and level of work they want to do as they edge toward retirement.

It's really about making sure they are creating a transferable entity during the businesses lifecycle and not waiting to the last minute to plan or hope their business can be transitioned," Lally said.

It's no wonder advisors procrastinate succession planning. It can be an overwhelming process!

Let us help you by breaking it down into some key considerations.

First, if you haven't started planning for retirement, when is the ideal time?

"I'm smiling because usually my joking comment back is 'the day you start the firm,'" Lally said.

"Or at least five years, typically, in advance. It's like taking a trip. If I'm taking a trip with my family and I have a year to plan, then I'm getting everything I want! I'm getting the hotel, the car, the airfare, the restaurants - all of it. With that said, I can wake up on Friday, and still take that trip on Monday. But now I've narrowed my options immensely," he continued.

Generally, there are three major scenarios for a financial advisor in transition:

1 - You're W-2 advisor that is part of a large firm

There are very different sets of considerations and tax implications based on your current status. If you are 5-10 years away from retirement at a large firm and are planning to sell your practice back to the firm when you retire, we recommend you start researching your firm's succession process and options as soon as possible.

- **Check in** with your firm to learn more about how their succession program (if they have one) is set up.
  - Is it a financially competitive and formalized succession program?
  - Do you qualify to participate in the program?
  - How long has the program been in place and how often does it change?
  - How is the value of your practice determined? How is the money you receive taxed?
    - Will it be considered ordinary income or a capital gain?
  - Is the amount you'll receive guaranteed, or can it fluctuate based on performance?
  - What is the timeframe during which the money is paid out to advisors?
  - Do you get to choose the advisor who takes over your practice upon your retirement?
- **Compare** your company's succession program to a few others in the market.
  - Consider succession programs and offers that other broker-dealers may provide.
  - Consider whether joining a new firm could be beneficial to your retirement.
- **Think** about benefits beyond the price - like flexibility.
  - What would your ideal flexible work arrangement look like?
  - Would you like to scale down to part-time work?
  - With a reduced workload, will the firm remove penalties for not hitting sales goals?
  - How will your transition deal be formulated? How much will be paid up front vs. on the back end with stipulations attached?

2 - You are an advisor leaving a large firm to launch your own independent practice

"Advisors step out because they want freedom," Lally says. "They want freedom of income; they want freedom to build wealth; they want freedom of time."

If you are planning to make a shift to independence, you have the opportunity to sell in the open market and possibly structure your deal as a capital gain as opposed to ordinary income, and the cost differential can be significant.

It's not all about the gains

While financial drivers like ordinary income vs. capital gains are important, "It's also the non-financial characteristics that are either going to enhance your value or decrease your value," Lally said.

- Do you own and manage the majority of relationships for your firm?
- Are you the key business developer?
- Is there attrition risk on these accounts once you leave?

"What I tell a lot of advisors is that it's not just the price that you sell your practice at, but it's also the terms and the optionality around it," Cardinal said. "How is the deal structured? Is this going to be a sudden retirement or gradual? Are you going to phase back the number of hours you work?"

If you are planning to go independent in your last 5-10 years of your career, you need to think about more than just the tax benefits and income. What will the structure of your practice look like?

"More often than not, we see people who want to gradually scale things back rather than hit an off switch. It should be a dimmer switch," Cardinal said.

Moving to Sell

There is another scenario that advisors should think about when researching and discussing transition deals. If you're planning to leave your firm, then you may be able to capitalize on both ends of the transition. Advisors who are in a situation of feeling dissatisfied with the firm they are at and hope to find a better platform for their business are finding the market is offering appealing overall compensation packages when factoring in recruiting deals and pairing them with eventual succession packages.

"In addition to earning their annual take home pay, financial advisors are receiving 500 -700% + of their T12 over a 10-year period," said Cardinal. "The big thing here is, when looking at new firms it makes a lot of sense to do some due diligence on how succession plans get structured."

3 - You are an independent advisor selling your business

If you have owned your firm for many years and have been a one-person or tiny operation, Lally says it's really important to distinguish between selling yourself as an advisor and selling your business.

"They have to get to a point mentally, where they're thinking, 'Am I passing on my business? And have I really created a business?' That's the key," he said.

Your firm has been your baby for years. You own the relationships. You drive the strategy. You know the ins and outs of everything. But at the end of the day, it is a business. And is your business one that can be operated and grown by someone else? Once your business is sold will something sustainable still exist, or does it cease to exist when you leave?

The average age of financial advisors today is mid-50s, with many still working into their 60s and 70s. Lally says that "most advisors resemble their clients," and that this can be a challenge when transitioning your practice.

"If I'm a 65-year-old advisor, I likely have 65-year-old clients who are now no longer in the accumulation phase and are actually in the distribution phase," Lally said. "Where advisors really get hurt in transactions, is they're now trying to transition to a mature practice. And the buyer thinks 'I can babysit this for years. But I can't grow it anymore.'"

"If an advisor's business is built on referrals, and the advisor manages all the relationships, then, as a buyer, what am I actually buying? I'm buying a revenue stream. But how valuable is that revenue stream, and for how long?" Lally continued.

Positioning for growth

If you resemble the majority of your clients - aka nearing retirement - then your firm needs growth opportunities internally and on the client side.

Here are some ways to diversify your clientele and position your firm for growth in the long-term:

- **Develop relationships with the next generation within your client pool.** Are you the go-to financial resource for your clients' children? Consider adding a new advisor to the team to help support this growth strategy.
- **Strengthen relationships with client spouses.** Historically, men have been the household financial decision-makers, but "Women are often the key income driver in a family these days," Lally says, and it's important to have a great relationship with both partners in a male and female couple.
- **Attract women investors.** In addition to being the income driver in many families today, women baby boomers are also predicted to control massive wealth transfers in the coming years.
- **Attract LGBTQ investors.** According to a Community Marketing & Insights' 2019 survey, only 22% of the LGBTQ community is engaged with financial planning professionals.
- **Groom your team for the transition.** You're used to overseeing all your clients, but it's important to have junior advisors engage more with them and develop a comfort level on both sides.
- **Get a valuation done early.** Don't wait until you are ready to sell - get a valuation on your firm 5-10 years out. "That valuation becomes your blood pressure," Lally says. And the key decisions you're going to make on this practice from now until you do sell are either going to make your blood pressure better or worse."
- **Implement the right technology.** Do you use Salesforce, Microsoft 365, Hubspot or another top CRM? Is the software easy for you and your team to use? Lally says there is often a huge disparity between technology adoption and actual utilization in firms. Identifying the right software for your firm will save money, keep clients happy, and ensure a seamless transition. Wipfli can help with that.
- **Incorporate customized services and resources.** You may need help with strategic planning, contracts or accounting. Focus on your clients and growth and let an organization like Wipfli handle the back-office business as an extension of your team.

- **Create a frictionless transition for clients.** Happy clients are critical to the successful sale of your business, so give them the white glove treatment. Introduce long term clients to junior advisors and help foster trusting relationships. Conduct training to make sure staff and clients are comfortable with technology and dashboards. Minimize disruption to your clients at all costs.

You've secured a buyer - now what?

So what if you're ready to sell and you've already found an interested party that you feel is a good match to purchase your business? You're going to need the right tax resource to help you structure the sale in a way that's fair, but also safe.

Experts like those in Wipfli's Wealth and Asset Management Industry Practice can help.

Lally says advisors often come to Wipfli when they don't want to go out to the market. They already have a buyer in mind but are not experienced in evaluating, negotiating, structuring and facilitating the transaction.

"Under our Wealth and Asset Management Industry Group, we provide hourly consulting to advisors on an as-needed basis to help them through the process, whether that's interacting with the buyer, helping them think through the documents and contracts needed, or whether it's helping them with tax structure," Lally said.

So whether you are a W-2 advisor at a major firm, leaving a large firm to start an independent practice, or an independent advisor selling your business, it's important to focus on your own future and succession plan.

This is one of the most crucial steps you can take as a financial advisor and has ramifications for your future and your clients'. Let us simplify the process for you. Reach out to us today to discuss succession planning for your business.