

THE NOMINEES ARE...

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With the announcement of Supreme Court Justice John Paul Stevens' retirement earlier this year, President Barack Obama was faced with the weighty task of selecting someone to fill the impending vacancy in the highest judicial body in the country. In recent years, it has become common for these presidential appointments to endure speculation and scrutiny from members of Congress, lobbyists and media talking heads. Elena Kagan was no exception. Yet, ultimately, President Obama, as with his predecessors, needed only to weigh the factors most pertinent to serving on the Supreme Court—constitutional philosophy and judicial temperament.

Similarly, it is common for executives of wealth management firms who are in the process of developing succession plans to become bogged down by all of the considerations that go into selecting a potential successor. With so much of the success of the plan hinging on this decision, it is important to make a clear and informed choice, focusing on the attributes most vital to perpetuating the success of the firm.

Sometimes wealth managers do not have to look far to find this ideal successor. For example, a wealth manager might have a child or a close associate whom he or she has been grooming to take over the firm. Other times, wealth managers may find that no clear candidates for succession have emerged within their firm, and they must look to recruit an outside partner who will be capable of eventually succeeding them.

THE FAMILY MEMBER

Many wealth managers, especially those interested in carrying on the legacy of their firms, elect to pursue family succession as a way to transition their firm to the next generation. This approach has its advantages, such as increasing the comfort level of clients when they see their financial advisors go through the same things they do. Wealth management firms with multiple family members working together in harmony will not deny that this arrangement can also be an effective marketing tool.

If you elect to proceed with selecting a family member as your successor, the transition itself will proceed like an internal succession involving an employee or partner. Common steps include preparing for the succession in advance and laying out future roles within the firm. In fact, if you proceed with a traditional sale of your firm to a family member, perhaps providing him or her with rights of first opportunity, the implementation of the entire plan would be identical to the transfer of ownership to an employee or partner.

Although a traditional sale is always a legitimate option, in most cases wealth managers want to transfer ownership to their family member gradually through a gifting program, while using valuation discounts to contain the value of the practice for capital gains and estate-tax purposes. They may also want to sell discounted shares

of the practice gradually to the family member. The most common and tax-effective ways of transferring ownership to a family member include establishing an intentionally defective grantor trust (IDGT), forming a family limited partnership (FLP) and providing lifetime gifts.

Ideally, you would want to enact your plan for family succession as soon as possible, because that would allow you to pick the perfect time to gift the bulk of the practice-when its value is likely to be at its lowest point. Yet wealth managers are usually unable to get the timing right; as a result, taxes end up being a central issue to family succession. Consequently, you should consult a tax professional to determine the best arrangement for you, your family members and your firm.

THE INTERNAL PARTNER

The first instinct of many wealth managers is to select a key employee or partner as their eventual successor. Not only have owners likely developed a rapport with key members of the firm, but these key employees and associates also likely have institutional knowledge of client accounts and firm culture, and they can provide consistency from one generation to the next. Moreover, the firm's clients and other employees will be less likely to leave if they know that someone with whom they are familiar will be taking your place after you leave.

However, there can be disadvantages to insisting on an internal candidate as your eventual successor. First, many sole practitioners lack staff with the requisite qualifications to serve as successor. In order to service client accounts effectively and legally after your departure, the candidate must have the right education, licenses and designations.

Similarly, many internal candidates may lack the entrepreneurial drive, leadership and management skills and investment management capabilities that come from years of leading a firm as a wealth manager. Finally, many employees may lack the financial wherewithal to buy the firm, forcing you to increase your risk, decrease your sale price or unattractively narrow your exit options by heavily financing the deal with promissory notes and earn-outs.

THE OUTSIDER

The alternative to selecting an internal employee or partner as your successor is recruiting one from outside your firm, with the intention of training, mentoring and grooming him or her to take over your ownership interest. Here you can require that your recruit have the necessary education, skill, experience, licenses and designations. You can also work to ensure that he or she has had the years of experience necessary to hone the required wealth management and client relationship capabilities. In addition, external candidates can bring complementary new services and expertise to the table.

Nonetheless, you should consider some of the potential disadvantages of an external candidate. First, it costs money and resources to search for and train an external candidate. In addition, your employees and clients may be put off by the idea of an outsider running the firm following your exit. To avoid this, you may want to recruit a potential successor well before your planned retirement, to give the person time to familiarize himself or herself with the firm's clients and other employees. Finally, you will likely need to ensure that your firm is a good cultural fit for your potential successor.

WHAT TO LOOK FOR

In general, you should evaluate an internal or external candidate for successor based on the following criteria:

- * Interest in being successor;

- * Personality match for firm, employees and clients;
- * Entrepreneurial and management skills;
- * Loyalty, values and character;
- * Financial means; and
- * Functional capabilities (i.e., management, client relationship, investment management, finance, etc.).

All wealth managers hope that their chosen successor will have all of these characteristics that they are looking for in an eventual owner. Some of these characteristics are hit or miss; candidates either have the quality or they don't. These include their interest in taking over; their financial means to buy your ownership interest; their loyalty, values and character; and their personality match with the firm's clients.

Other characteristics, such as proper designations (e.g., CFP) and education (e.g., MBA) can be obtained through the appropriate external channels, provided the firm has the time and resources to allow the candidate to obtain them. Everything else, such as management capabilities, client relationship expertise and investment management abilities, can be developed in anticipation of your eventual exit, turning an adequate candidate for succession into the ideal candidate for succession.

The best way to accomplish this is through coaching and mentoring, which you should undertake yourself but can also delegate to other senior professionals who have particular expertise in areas in which the proposed successor may have shortcomings. Alternatively, there are a variety of consultants and professional coaches that serve the wealth management industry.

No matter who you choose to develop as your successor, this mentoring should go beyond the classroom setting; rather, you should endeavor to increase a candidate's responsibility and involvement in the firm so that he or she can develop these skills firsthand. For example, if you think a proposed successor's management capabilities have not yet been tested, you should provide him or her with more power and responsibility so that the candidate can develop leadership abilities. Or, if a proposed successor has had limited client contact, introduce him or her to existing clients and teach the candidate how to bring in new ones.

TEAMING UP

If you do not have the time or resources for coaching or mentoring, there are other ways that you can make up for the perceived shortcomings of your successor. One way to do this is to assemble a team with skill sets that complement the successor.

For example, perhaps your proposed successor has all the makings of a great owner; however, his or her expertise lies solely within investments, and he or she does not have the marketing acumen to grow the firm or the technological knowledge to keep the firm ahead of the curve. To remedy this issue, you can develop or recruit team members who complement the proposed successor's skill set while he or she continues to gain experience and knowledge in these areas.

So, by this point, after weighing whether to choose a family member as a successor, assessing the advantages and disadvantages of choosing an internal or external successor and determining which of your employees has set himself or herself apart with a strong set of successor characteristics, you are likely prepared to determine which candidate to choose. Don't be discouraged if your best candidate is not perfect; indeed, with coaching and mentoring, or by building a strong team around the proposed successor, you can secure your future as well as the firm's future, without subjecting your protégé to a Senate confirmation hearing in the process.

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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