Understanding Business Transition and Retirement Options for Wirehouse and Independent FAs, and RIAs

This is the first in a seven-part series of special reports providing Wirehouse FAs and independent FAs and RIAs perspectives on business transition and retirement options available when they choose to exit their careers in the financial services industry.

A recent report by Cerulli Associates financial services research firm estimates 110,337 advisors, or 35.5% of all practicing advisors, expect to retire within the next 10 years. This group manages $52.6 million in assets on average and controls $5.8 trillion of total advisor-managed assets in aggregate.1

The projected trend of this vast number of Financial Advisors planning to retire and sell their books of business over the next several years prompted a qualitative and quantitative research initiative by Wells Fargo Financial Network and Alan Newman Research (ANR) in August 2017. The objective of the study was to seek to understand the “ideal” practice structure that a retiring Financial Advisor would like to have and how it impacts the likelihood of success of the transition/sale of their book of business to another Financial Advisor.

Financial Advisors who participated in the research study – which included wirehouse FAs and independent FAs and RIAs – were also interviewed about their familiarity and awareness with various sunsetting and business transition exit options. In addition, participants indicated preferences and expectations for levels of client engagement during a transition.

Familiarity with business transition and retirement models varied across interviews. For example, the term “sunsetting” was not commonly used by all participants, and terms such as “retirement,” “succession planning” and “transition” were used interchangeably. The majority of participants only seemed informed about options specific to their firm.

This whitepaper compares and contrasts the various business transition and retirement options Financial Advisors have when they decide to leave the industry.

Internal and External Transitions: Opportunities and Challenges

Wirehouse Financial Advisors typically have two types of sunsetting options: immediate transition or gradual transition ranging from two to five years, each with gradually declining percentage payouts. These payouts include similar weighted formulas consisting of: AUM, T12 production, experience with firm, book revenues at the end of the agreement, composition of client base, and concentration of product types.

While wirehouse FAs were generally positive about the standardization, predictability and relative profitability of their structured sunset deals, research survey participants typically only had familiarity with their own sunsetting options. Independent FAs and RIAs reported satisfaction with having control over multiple transition options as well as having confidence in their ability to sell or transition the practice.
A well-designed internal succession plan can help a practice owner take the steps necessary to realize the full value for the firm. It offers Financial Advisors the opportunity to monitor the value of the practice, identify and address any weaknesses, and execute a successful transfer of the business.

Internal succession is a transition to a Financial Advisor within the seller’s organization, such as another partner, a younger advisor or a family member. This option offers a high degree of continuity for clients, since the successor is usually known to the client base. The current owner manages identifying and training the successor, and can help ensure job stability for other firm employees.\(^2\)

In the 2017 survey by ANR, internal succession was often cited as a preference because it is typically easier, takes less time, minimizes client disruption and/or increases retention, minimizes compliance/regulatory issues, and can be more profitable. Wirehouse Financial Advisors reported perceiving a slight lack of control and flexibility regarding succession (e.g., the new FA must be someone on their team or part of the firm). Independent FAs and RIAs indicated they had the flexibility to transition their business however they preferred.

According to FP Transitions – which values advisor practices for sale – client retention rates for fee-only businesses are in the 95 to 98 percent range, and clients who have been with a firm for at least 10 years are the least likely to leave. The retention rates are lower for transactional practices that rely on the old advisor model of selling products and receiving a commission.

To enhance a business’ value upon transition, practice owners must ensure an ideal client mix across age ranges and demonstrate that they are able to connect with the next generation. Since next-generation clients are often looking for a younger advisor who is likely to outlast them, it is critical to attract young, skilled talent into practices.\(^2\)

The 2017 ANR survey revealed that internal transitions – either within a wirehouse, a network or a smaller firm/group – were almost always preferred. Participants noted these internal transitions were typically easier, enhanced business continuity, and minimized client disruption, which resulted in increased client retention.

In a merger, a practice owner merges their business into another firm with a similar advisory approach and cultural fit. An alternate option is for the owner to sell a portion of the firm to a larger collection of practices. Both options provide the owner with an immediate liquidity event for part of the business. Payment is usually in the form of cash – or a combination of cash and equity – in the merged firm. Clients are provided with a relatively high degree of continuity, while firm owners benefit from the economies of scale that come with being part of a larger organization.

Finding a merger partner with a compatible service approach and investment philosophy can be difficult and integrating firms can be complex and time consuming. Cultural fit is also crucial, but can be hard to attain, and there is risk of both employee and client attrition after the merger.\(^2\)
CONTINGENCY PLAN

A contingency plan takes effect when the leader of a financial advisory practice dies or becomes incapacitated. If the owner is unable to work, a contingency plan allows for a designated advisor to lead client relationships immediately. The contingency plan is also crucial for an advisor’s family, as the absence of one could severely depress the value of the practice.²

In addition, the Securities and Exchange Commission is currently considering rules requiring advisors to adopt contingency plans. This may include identifying a licensed person who is willing to service their clients in the case of an emergency.

With a book sale, the practice owner seeks to sell his or her entire share in the business and transition client relationships to the buyer after the deal has closed. This strategy provides an immediate liquidity event to owners and common deal terms often involve an upfront cash payment, combined with an interest-bearing note typically paid over a period of approximately four years.

Seventy key factors determine what a practice is worth, including free cash flow or future expected earnings, probability of client retention, fees versus commissions, location, and comparable sales.

All of this applies to an independent practice that can be sold via an arm’s-length transaction. Wirehouse reps and others who work for a firm don’t own their books, so they’re obligated to transition plans offered by their firms. However, they do have the opportunity to change firms for an upfront bonus or go independent, then work out a succession plan going forward.

RETIEMENT

Virtually all survey participants indicated that assuring a smooth transition for clients was their top priority when considering retirement.

Most survey participants identified a target age of 65-70 for retirement. Reasons for this included availability of Medicare and Social Security, Social Security payments maxing out at 70, RMDs from 401(k)s/IRAs began at 70, and lack of motivation to keep pace with the industry.

Retiring advisors should begin the transition process a year or two before the actual date to get clients comfortable with the new advisor. This includes communicating with clients about plans to retire so they will be confident that their investment strategy is being maintained, and there will be a smooth transition to retirement. These communications can fuel growth in an advisor’s practice because they give clients confidence to share additional assets – and refer business from other family members – with a firm that will continue to provide the responsible stewardship of wealth over generations.

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Client Engagement: Laying the groundwork for a successful transition

The majority of the participants in the 2017 ANR Survey indicated they would need to be fully engaged initially – and likely throughout – the practice transition to facilitate a positive experience for clients. The consensus was that it is critically important for retiring and new FAs to work in concert, be aligned throughout the process, and to educate and set expectations for clients about the transition.

Some FAs stated that the engagement level would be tiered and vary by client. They observed that some clients would only need an introduction and endorsement, especially if they had been well prepared for the transition. Participants emphasized the importance of being engaged throughout for client retention purposes, which impacts revenue and, ultimately, their payout over the course of the transition agreement.

Exploring the Flexibility and Control of Independence

Wirehouse FAs in the survey were generally satisfied that they had structured, well-supported, and financially acceptable sunset agreements in place at their firms. Independent FAs and RIAs valued having a wide range of practice transition options (i.e., buyers and deals that they identified, selected, negotiated, and controlled).

The majority of participants indicated they would be interested in hearing about additional opportunities to provide clients with an ideal transition to their eventual retirement. While most wirehouse FAs understand that RIAs had more flexibility and control when it came to negotiating their sunset agreements, their awareness of the specific options available for sunsetting as an RIA was fairly limited.

Seizing Opportunity

As a Financial Advisor, being prepared to effectively review and select business transition options and ensure a positive experience for your clients is more than smart business. It’s another responsibility to your clients.

Wells Fargo Advisors Financial Network’s experience has enabled us to develop a process that makes the transition seamless for Financial Advisors and their clients. Our team works with Financial Advisors step-by-step plan based on their business mix, assets under management and staffing plans. This includes guidance on obtaining an annual business valuation as well as connecting advisors to our strategic partners in marketing, legal and healthcare.

Whether a Financial Advisor is actively looking to transition their business through a merger or just starting to explore the possibility of retirement, there is value in starting to do groundwork now to take control of their financial future.

To learn more about the business transition and retirement options you have available for your practice, contact Wells Fargo Advisors Financial Network today at info@wfafinet.com or visit www.wfafinet.com.

## Business Transition and Retirement Options: Decision Matrix

Although wirehouse and independent advisors have many of the same retirement options available to them, a wirehouse advisor often is subject to terms and conditions prescribed by their employer (even regarding who they transition their book to) and has far less freedom to make their own decisions. Independent advisors control the terms – everything from timing to human-resource decisions and all of the terms in between.

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<thead>
<tr>
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<th>Structure/Description</th>
<th>Time Horizon</th>
<th>Client Experience</th>
<th>Pros/Cons</th>
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<tr>
<td><strong>Retirement</strong></td>
<td>Retiring Advisors should begin the transition process and communicate with clients a year or two before the actual retirement date to get client comfortable with the new Advisor. This will also help assure clients that their investment strategy will be maintained and can lead to client retention and practice growth.</td>
<td>1-2 years</td>
<td>- Adamant client experience ensures that the new advisor is well-received.</td>
<td>- Full client experience with new advisor; transition process is smooth.</td>
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<td><strong>Transition</strong></td>
<td>The act of an FA moving from one business model to another with the goal of establishing a strategic plan to move broker dealers, merge practices or retire from the industry. To get the most from a transition, FAs must ensure an ideal client experience. Transitions internally to a practice or broker dealer are typically preferred because they are often easier for the client and advisor as business continuity is maintained and client disruption is minimized.</td>
<td>1-3 years</td>
<td>- New advisor is often seen as an improvement.</td>
<td>- Can be challenging in terms of client disruption and business continuity.</td>
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<td><strong>Business Continuity Plan</strong></td>
<td>Plans that goes into effect when the leader of the practice has a life event such as a long-term illness or becomes incapacitated.</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
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<td><strong>Sunsetting</strong></td>
<td>Sunsetting agreements are formulaic and the terms and conditions are often prescribed by the Broker Dealer.</td>
<td>5 years</td>
<td>- The broker dealer provides the solution for the customer.</td>
<td>- Turnkey solution that offers a straightforward path for departure for the retiring FA.</td>
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<td></td>
<td>The sunsetting time horizon is usually five years or less, and change of ownership is facilitated through a revenue-sharing agreement.</td>
<td>N/A</td>
<td>- Positive client experience occurs when the plan is communicated clearly by the FA with their clients.</td>
<td>- Less control for participating FAs; Broker Dealer dictates terms of sales agreement. FA may lack choice of successor; potential tax implications.</td>
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<td><strong>Exit Strategy</strong></td>
<td>A customized retirement plan that takes place over 1-5 years.</td>
<td>1-5 years</td>
<td>A positive client experience occurs when the plan is communicated clearly by the FA with their clients.</td>
<td>The plan is customized by advisor who is exiting the industry. Poorly crafted client communications can lead to client attrition.</td>
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<tr>
<td><strong>Succession Planning</strong></td>
<td>Transition a book of business to an FA typically within the seller’s practice</td>
<td>5-10 years</td>
<td>This option offers a high degree of continuity for clients as the successor is usually known to them. The positive client experience occurs due in part to a gradual and planned transition.</td>
<td>Positive client experience due in part to the gradual transition. FA is able to customize terms of succession and successor. Longer time horizon for FA’s</td>
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<tr>
<td><strong>Merger</strong></td>
<td>The joining of 2 or more practices into a single practice with a similar business, culture and client experience approach.</td>
<td>5-10 years</td>
<td>Clients are provided with a relatively high degree of continuity. The Client experience tends to be positive due to the client usually having access to new and a wider range resources.</td>
<td>Client may have access to more resources; offers practices merging with greater economies of scale in their business. Finding a merger partner can be difficult; risk of employee and client attrition after merger especially if there is a difference in practice culture and fit.</td>
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