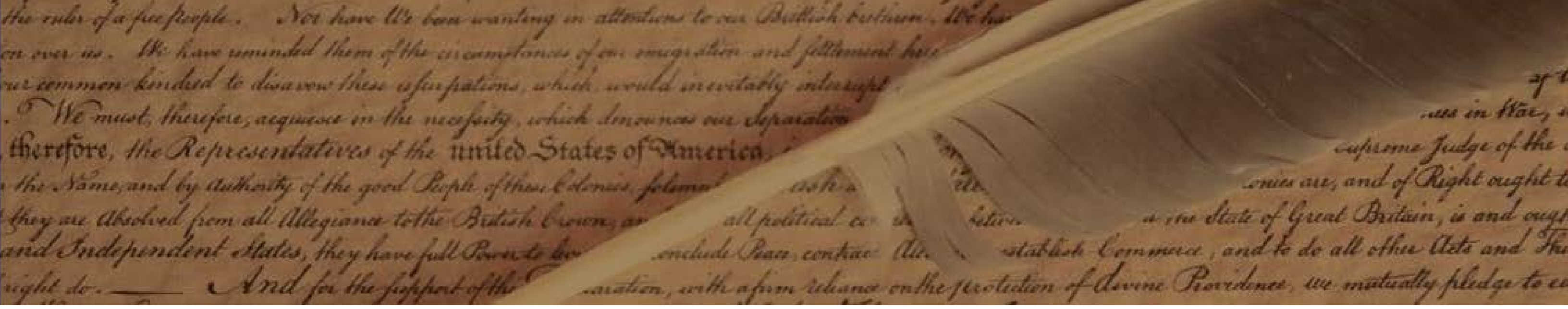
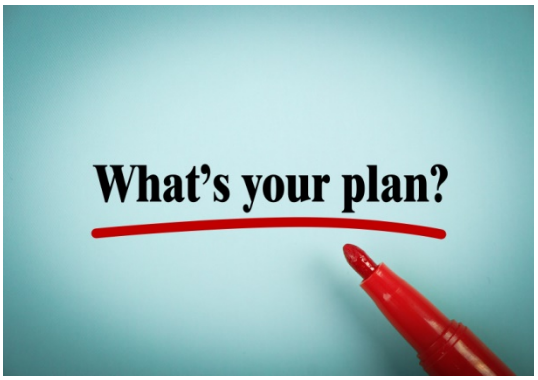


# Emergency Succession and the Practice Continuity Agreement

In previous articles we've established the importance of having an emergency continuity plan in place should the unthinkable occur. In this installment, we're going to take a deeper dive and examine the mechanics of a popular option that exists for sole proprietors, the Practice Continuity Agreement (or PCA).

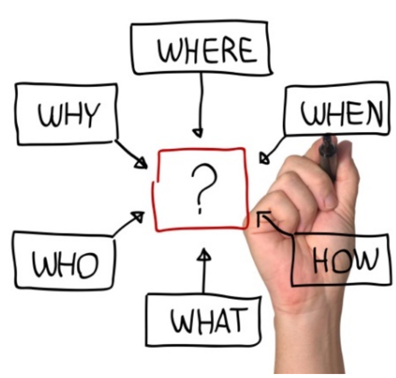



For advisory firms with only one significant owner, a Practice Continuity Agreement is the equivalent of a buy-sell agreement. For some years now, PCAs have been recommended as a way for financial advisors to insure against sudden, unforeseen calamities. A PCA would, in the event of a Principal's incapacity or death, provide for another advisor or advisory firm to step in and run the company during the period of incapacity, or, in the event of death, conduct an orderly sale, or possibly acquire the practice. A continuity agreement would provide for a means of determining the fair market value of your business and in certain instances, provide the funds necessary to carry the purchase.

The important difference between a buy-sell agreement and a continuity agreement is that in the first instance, the sale is to an insider, who is involved in the business on a daily basis. In the latter instance, the sale or continuation services are provided by an outside advisor who may, at the time of the event, have limited day-to-day working knowledge of the client base he or she is going to take over, and for which to take responsibility and liability.

A PCA is an agreement between two firms stating that, in the event that you are disabled or die, the other firm will take over the practice either permanently or temporarily. Particularly in the event of short-term disability, where you may be unable to return to the practice immediately, a PCA can act as an effective back-up plan or temporary bridge. Some PCAs are bilateral in that both firms commit to the other to be the successor. Some are unilateral, usually where only one of the firms is realistically capable of becoming the successor. The terms of the PCA usually contain at least:

- A definition of the circumstances that will trigger the succession
- The successor's obligations (usually this covers managing client relationships and providing ongoing client services)
- The terms of the acquisition if the successor is expected to buy the practice
- Provide a formula for determining the fair market value of your business
- Establish the compensation to the continuity provider during your period of disability
- Provisions for appropriate non-competition and non-solicitation protections for both you and the buyer/continuity provider
- Indemnification and hold harmless protections for an incoming, unprepared buyer



Also, the agreement sometimes allows for support without succession, meaning that the firms agree to client cross-referrals or support during staff shortages.

When a financial advisor suddenly passes away or becomes disabled, the value of the practice diminishes dramatically. Many clients, especially those that are served frequently, will quickly find a new advisor. Furthermore, when a PCA is in place, you are not *obligated* to manage a difficult company transition, or sell the practice.

One of the main challenges to establishing a PCA is finding a firm that is willing to make the commitment to take over a practice with little or no notice; and for good reason. First, a firm that has made that commitment must expect to have excess capacity in place to handle 200-300 new clients all at once. Second, a properly structured PCA needs to address the same issues in the same detail as a purchase agreement. This might mean a lot of time spent dealing with a matter that is contingent upon a set of specific circumstances. What's more, many of us find it difficult to address mortality issues and risks that don't seem at all pressing. It is extremely important that while your current team may not be the ultimate successors of the firm, they are motivated to remain with the Company during and after a transition period.

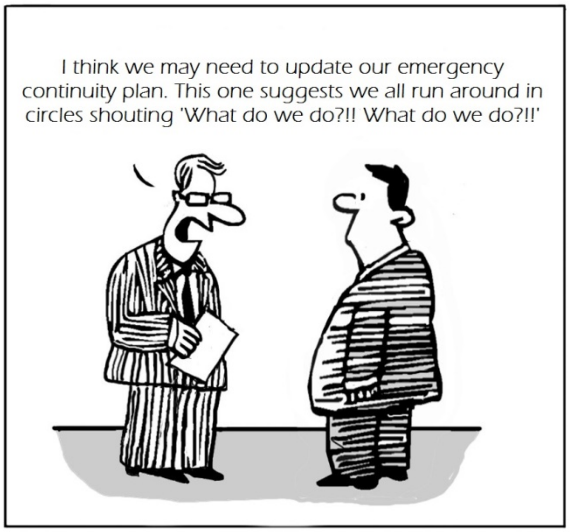
If you decide a PCA is for you, you'll need to explore strategies to ensure the agreement's success. Here are some pointers.

***Choose the right successor firm.*** Critical factors include, but are not limited to:

- Chemistry – If you're not comfortable having lunch with this person, don't expect your clients to be comfortable doing business with them.
- Excess capacity – Does the successor firm have the resources necessary to replace you in either the short term or the long term?
- Continuity – Does the firm's fee structure, practice philosophies, location, and appearance mesh with yours? Does the practice offer the same niches, industry expertise, and certifications?
- Longevity – If some or all of the successor firm's Principals are nearing retirement, they may not be available when you need them.

***Structure the deal.*** Like any agreement, the right documentation has to be in place. Make sure your PCA addresses these areas:

- A definition of temporary disability versus permanent disability.
- If you are temporarily disabled, when is the other firm required to jump in?
- How will the firm be compensated for supplying this back up?
- When and how do you determine that the disability is permanent?
- Upon permanent disability or death, what are the terms of the buy-out payments from the successor firm?
- What is the value?
- How long is the payout period? Will there be a down payment?
- How is the deal to be treated for tax purposes?
- How is the collection of accounts receivable and work in progress to be handled?
- To what extent are these assets included in the purchase terms?
- What are the liability issues and indemnification?
- What are the restrictions on competition?
- How will staff, leases, and other operational matters be handled?




It is a good idea to provide the successor firm with your client list, a biannual update of the list, pertinent client files, and a software manual with a complete set of operating documents. These should include a list of the types of services offered, as well as the duties and responsibilities for each employee and his salary, payroll processing information, location of accounting records, bank account information, contracts and lease agreements, a client list to include: key contacts, services provided, important deadlines, and procedures used to monitor work in progress (so the standby firm can easily determine the status of uncompleted work), location of work papers, description of the filing system, and a complete guide to the office procedures *(Extra: Find out how a **Day After Plan** can allow an organization to return to its daily operations as quickly as possible after a triggering event)*. From the clients' perspective, the assistance of your staff during and after the transition phase can make or break the entire process.

While these agreements should not be used in lieu of life and disability insurance, they can be a successful means to keep a practice going until you recuperate or a successor is found. What's more, these agreements can help to ensure that you receive the appropriate compensation for the years of sweat equity you put into building the practice.

As with any type of succession planning, it is a good idea for you to inform your clients that you are implementing such a strategy. The circumstances under which such an agreement will actually be implemented are always difficult, so having well-informed and supportive clients is essential. This is a chance to show your clients what planning for the future of the business actually looks like.

You also need to keep your continuity provider up to date. Calendar an annual meeting to discuss the plan and the steps needed to successfully implement it. Practices evolve and change, and the provider of continuity services in the early years of a practice may not be a good fit in the middle to later years. Additionally, a PCA should not be used as a succession plan in the traditional sense. There are much more effective methods to use when you ultimately create an exit strategy for retirement. PCAs, when structured correctly, are an effective solution for the need of sudden practice succession.

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