Succession planning is more than just a legal requirement

Succession planning does more than just satisfy your compliance obligations. The planning process facilitates a smooth transition of ownership and avoids a disruption of service to clients. It also fulfils an advisor’s fiduciary duty to protect the clients' interests from being placed at risk as a result of the advisor's inability to provide advisory services.

Commission Rule 21VAC5-80-160 F requires all investment advisors registered with the Commonwealth of Virginia adopt and implement a business continuity plan that contains the following elements:

1. The identity of individuals that will conduct or wind down business on behalf of the investment advisor in the event of death or incapacity of key persons;

2. The means to provide notification to clients of the investment advisor and to those states in which the advisor is registered of the death or incapacity of key persons;

   a. Notification shall be provided to the Division of Securities and Retail Franchising via the IARD/CRD system within 24 hours of the death or incapacity of key persons.

   b. Notification shall be given to clients within five business days from the death or incapacity of key persons.

3. The means for clients' accounts to continue to be monitored until an orderly liquidation, distribution or transfer of the clients' portfolio to another advisor can be achieved or until an actual notice to the client of investment advisor death or incapacity and client control of their assets occurs;

4. The means for the credit demands of the investment advisor to be met; and

5. Data backups sufficient to allow rapid resumption of the investment advisor's activities.

Additional key areas of a good business continuity plan are:

1. The plan must be in writing and must specify how an investment advisory business would respond to emergencies of varying scope.

2. The business plan should be tailored to the size and scope of the investment advisory business.

3. Develop either an internal or external succession plan. ***Don’t leave it to your heirs, family or staff to develop a succession plan after an emergency.***

Internal succession plan

4. An internal succession plan is less disruptive to your practice, and much easier to implement if your firm employs more than one person.

   An internal advisor already has access to the client's files, has knowledge of the client's accounts, and has been indoctrinated in the advisor's culture.

External succession plan

5. For an external succession, you need to identify potential advisors who can act as a short term substitute or long term successor.

6. Once you identify an advisor, verify registrations in relevant states, professional certifications, educational background, disciplinary history and work experience.

7. It is extremely important to develop an employment agreement for the substitute advisor that contains restrictive covenants to protect the firm's proprietary interests in client relationships.

8. You may want to include the following in the employment agreement:
   - Compensation arrangements;
   - Period of time to clients to be served;
   - Types of advisory services to be provided.

9. Train the substitute advisor how to service your clients.

Internal and External succession plan

10. Check with your custodian of client accounts to determine the specific documents or processes you must complete to allow the substitute advisor to transact business.

11. Amend disclosures in client documents and Form ADV to reflect the continuity plan.

12. Obtain clients' written consent to the assignment of the advisory contract upon the occurrence of specific contingencies.

13. Establish the frequency that client accounts will be monitored until an orderly liquidation, distribution or transfer of the client's portfolio to another advisor can be achieved.

Other essential elements

14. Procedures for evacuating employees in the event of a disaster, including identification of a central meeting place;

15. Procedures for contacting clients and key service providers (including, maintenance of client contact information outside of the office);

16. Procedures for accessing "mission critical systems" (e.g. access to client accounts and trading systems). Assign an individual to be the backup CRD/IARD Administrator in case the owner dies or becomes incapacitated;

17. Procedures for backup and recovery of electronic and paper records (e.g. maintenance of a backup of all critical electronic and paper records in a fireproof safe outside of the office).

18. Alternative location to conduct business;

19. The plan should be updated at regular intervals, and each revision should be shared with employees.

Small advisors

20. Many small advisors can minimize potential tax, compliance, and legal obstacles to the successful implementation of a succession plan by choosing to organize as a corporation, limited liability company or partnership.

    The death or inability of the sole proprietor to operate the practice may legally terminate the proprietorship as well as the clients' advisory contracts. However, if the advisor is organized as a legal entity, the client's contract is with the investment advisory entity, and not with individual advisor.