Markel Cambridge Alliance
A division of Markel Service, Incorporated

Investment advisors

safety 1st

Risk management tips

Important considerations for succession planning

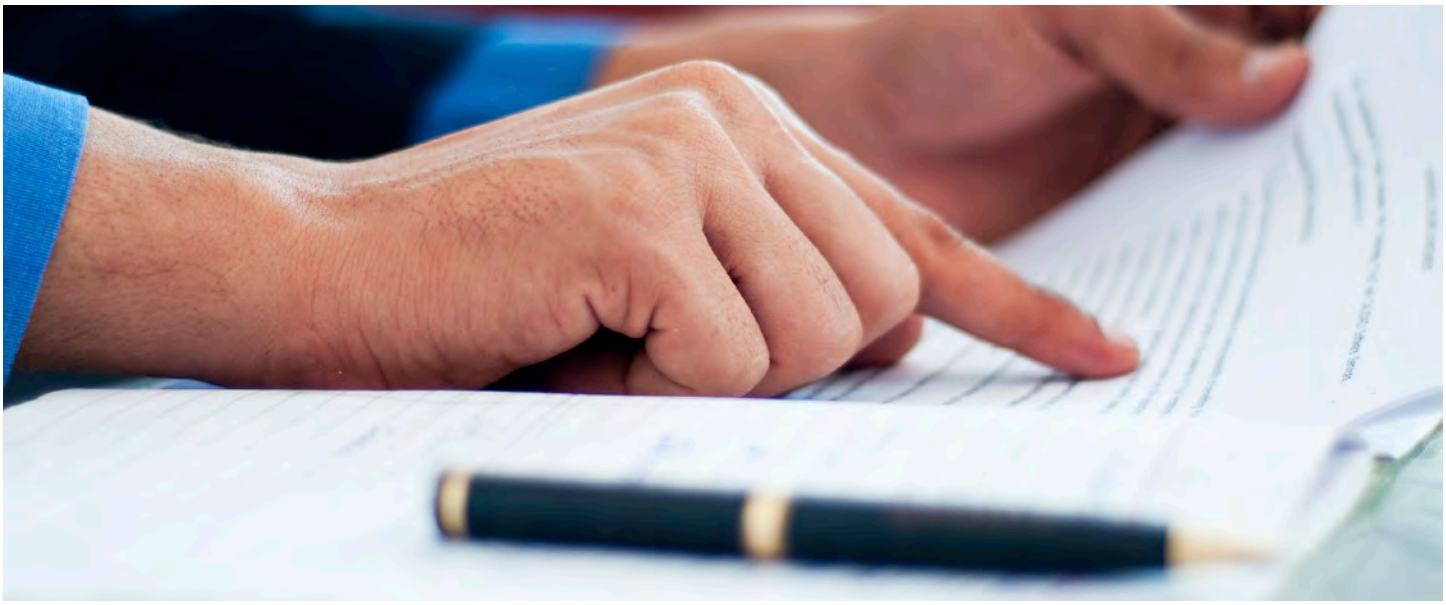
Developing a succession plan helps to mitigate risk to not only an adviser's clients but to his or her personal assets as well. An unforeseen event that puts the RIA's ongoing operations in doubt can create uncertainty unless a succession plan is in place. There are several options; among them internal succession, transfer to an heir, merger or sale with peer, and full divestiture or sale.

The documents listed below provide general considerations and guidelines for both the internal and external succession planning process. This summary should not be construed as the substitute for individualized advice from professionals (e.g., attorneys, CPAs, insurance brokers) of your choosing. Questions regarding the applicability to your specific situation should be addressed with those qualified professionals.

I. IAR due diligence document/information checklist

In order for an SEC registered investment adviser (Adviser) to learn important background information prior to the hiring (and subsequent thereto) of a prospective individual as an adviser investment adviser representative (IAR), the following due diligence procedures should be considered:

1. If the individual is an existing registered investment adviser (or a principal thereof), obtain current Form ADV (Part 1, Parts 2A and B) and proof/confirmation of current registration status with the SEC and/or states, as applicable;
2. So as to provide preliminary and current important due diligence information, an investment adviser may consider requiring each prospective IAR to execute a Representative Questionnaire and an Investment Adviser Representative Agreement;
3. For the purpose of determining the appropriate qualifying examinations and/or state registration filings that may be required by the IAR (and/or notice filings required by the Adviser as result of becoming engaged by existing clients of the IAR), the Adviser should obtain from the IAR: (a) a list of all current clients of the IAR by state of residence; and (b) a list of all locations (i.e., city/town and state) where the IAR maintains (or plans to maintain) an office (i.e., principal branch, or otherwise) while acting on behalf of the Adviser;
4. To the extent that any IAR is/was a registered representative of a FINRA broker-dealer, obtain a current CRD report for each such person to ascertain additional information, and to confirm the information previously reported on Parts 1 A and 1 B of Form ADV pursuant to Item 1 above;
5. To the extent that any IAR is/was currently an IAR for another adviser and is in a state that requires IAR registration on the IARD system, obtain a current CRD report for each such person to ascertain additional information, and to confirm information previously reported on Parts 1 A and 1B of Form ADV pursuant to Item 1 above;



6. By obtaining the above information, an Adviser will be able to determine that the IAR or RIA is: (a) not subject to an order issued by the United States Securities and Exchange Commission (the "Commission") under Section 203(f) of the Investment Advisers Act of 1940, as amended (the "Advisers Act"); (b) has not been convicted within the previous ten years of any felony or misdemeanor involving conduct described in Section 203(e)(2)(A)-(D) of the Advisers Act; (c) has not been found by the Commission to have engaged, and has not been convicted of engaging, in any of the conduct specified in paragraphs (1) (4) or (5) of Section 203(e) of the Advisers Act; (d) is not subject to an order, judgment or decree described in Section 203(e)(3) of the Advisers Act; and (e) is otherwise involved in any activity, proceeding, etc. that an investment adviser would determine as disqualifying the IAR from becoming associated with the Adviser;

7. Obtain a list of all outside investment-related and financial services industry activities so that an Adviser is informed of any such services, affiliations, etc., so that it can determine if those affiliations and/or services warrant enhanced ongoing due diligence or disqualification from serving as an IAR of the Adviser;

8. Obtain written verification of current examinations (i.e. Series 6, 7, 65, 66, etc.) and designations (CFP, CFA, ChFC, etc.) for each prospective IAR; and

9. E&O insurance issues (to the extent applicable). Will the Firm maintain coverage for the IAR's former activities or is a tail policy necessary? Has the IAR provided proof of coverage for any Outside Business Activity per Item 7 above (i.e., CPA, Attorney, Insurance Agent, etc.)?

All of the above should be maintained in the IAR due diligence file. In addition, the information/responses should be codified in the representations section of the Investment Adviser Representative Agreement, which agreement should be executed by the IAR prior to becoming associated with the Adviser, and should, among other requirements, require the IAR to immediately notify the Adviser of any change in his/her response to any previously provided information. As part of the Investment Adviser Representative Agreement, the IAR should acknowledge his/her duty of confidentiality and prohibition from soliciting and/or serving clients of the Adviser in the event of termination of the IAR's association with the Adviser. These obligations should be set forth in a separate Confidentiality and Restrictive Covenant Agreement to be executed by the IAR in favor of the Adviser, which agreement may exclude from the solicitation/service prohibition specific current clients of the IAR that transferred their accounts to the Adviser.

II. Documents to be considered during an internal RIA transition process

1. **Investment adviser representative questionnaire**. Initial document to be completed by the IAR candidate prior to his/her becoming an employee of/associated with the Company, pursuant to which the IAR candidate shall answer various background questions regarding his/her relevant experience, designations, disciplinary history, potential conflicts of interests, etc., so as to allow the Company to perform initial due diligence on the IAR candidate;

2. **Restrictive covenant agreement**. Critical initial document (preferably to be executed upon commencement of the investment adviser representative's [IAR] employment/association with the Company), pursuant to which the IAR shall agree (among other covenants and restrictions), that upon termination of his employment/association with the Company, to maintain all Company information confidential, not to render services to Company's clients, or induce any Company employees to leave the Company's employ, etc.;

3. **Investment adviser representative agreement**. Also to be executed by the IAR (preferably to be executed upon commencement of the IAR's employment/association with the Company), pursuant to which the IAR acknowledges the terms and conditions of his employment/association with the Company;

4. **Purchase agreement**. To be executed between the Company and the IAR, setting forth the terms and conditions of the IAR's prospective purchase of a Company ownership interest (i.e., as a shareholder, member, or partner); and

5. **Shareholder/operating agreement**. To be executed by the Company and each of its owners, setting forth, among other substantive provisions, the terms and conditions for the disposition of each owner's ownership interest upon the occurrence of various events, including death, disability, statutory disqualification, employment termination, etc.;

6. **Insurance-related documents**. Pursuant to which insurance would be purchased (the amount of which would be routinely evaluated) by the Company (or its owners) on the lives of the Company's owners, the proceeds of which insurance policies would be used by the Company (or its owners) to fund the purchase of the ownership interest from the deceased owner's estate;

7. **E&O insurance issues**. Will the Firm's current coverage be sufficient to cover the pending new representative's business activities?

8. **Regulatory filings**. (a) the filing of individual IAR registration documents with each state requiring the Company to do so (generally required by each state — with certain exceptions — in which the IAR maintains a place of business); and (b) amending of the Company's lard filing to disclose new owners.

III. Documents to be considered during an external RIA transition process

1. **Confidentiality agreements**. Should be executed prior to the Letter of Intent stage, if the parties intend to exchange information and/or documentation about the other prior to entering into a Letter of Intent. The Purpose of this document is to protect each party's proprietary interest in and to its confidential information and documents, and to provide for the immediate return thereof (including any copies) in the event that a transaction does not proceed forward within a specified period of time. (e.g. 90 days);

2. **Letter of intent**. Prelude to commencement of the Agreement of Sale preparation stage. The Letter of Intent should set forth the basic terms and understandings of the parties, which should include the initial understanding as to the basic terms of the prospective transaction, including payment terms, due diligence review, continued employment, restrictive covenants, etc. Although the Letter of Intent will usually be drafted by legal counsel, the parties should attempt to arrive at the basic terms thereof independent of legal counsel's direct involvement, including a preliminary Due Diligence Schedule. Must also contain a confidentiality provision as discussed above;

3. **Purchase agreement**. A comprehensive document to be executed between the seller and buyer, setting forth the terms and conditions of the purchase of the investment advisory entity, including, but not limited to, representations and warranties, purchase price and payment terms, remedies in the event of violation, continued employment of key personnel, restrictive covenants, indemnification, etc.

   One of the most critical sections of this documents is to indicate what happens in the event that the purchase and/or transition does not go as planned due to various events, including, but not limited to, failure to have certain clients transfer/maintain accounts (i.e. purchase price set-oft), breach of material representations or warranties (i.e. recapture of business, further set-off of purchase price or repayment of monies previously paid, etc.);

4. **Shareholder/operating agreement**. Document to be executed by the surviving advisory firm and each of its owners, setting forth, among other substantive provisions, the terms and conditions for the disposition of each owner's ownership interest upon the occurrence of various events, including death, disability, statutory disqualification, employment termination, etc;

5. **Restrictive covenant agreements**. Critical document, pursuant to which the principals and associated persons of the selling firm agree (among other covenants and restrictions), that upon commencement of their employment/association with the acquiring firm, to maintain all buyer's information confidential, not to render services to buyer's clients (including those clients that he/she previously serviced when employed by or associated with the seller), or induce any of buyer's employees to leave the buyer's employ, etc. It is critical for the selling firm to already have these agreements in place prior the Letter of Intent stage (preferably always upon commencement of employment or association with the firm) so that the seller does not run the risk of clients leaving the firm during the transition process with employees or associates who are not subject to any such restrictions;

6. **Regulatory issues and filings**. Including, but not limited to: (a) amending of the Company's ADV filings as required; (b) the filing/maintaining/withdrawal of Notice filings with each state requiring the Company to do so; (c) the filing/maintaining/withdrawal of individual IAR registration documents with each state requiring the Company to do so; (d) announcement to clients; (e) obtaining client approvals (Negative Consent letters); (f) assignment under the Advisers Act (change of management or control); (g) Advisory Agreements (assignment vs. execution of new agreement); (h) withdrawal of Seller's registration (pros and cons); (i) books and records retention; and U) maintaining/ supplementing E & O insurance;

7. **E&O insurance issues**. Will the Buyer maintain coverage for the Seller and its representatives' prior acts or is a tail policy necessary?

Contributed by Thomas D. Giachetti, Esq., Chairman, Securities Practice Group, Stark & Stark Attorneys at Law.

For more information on succession planning, read: http://www.investmentnews.com/gallery/20140729/FREE/729009999/PH?issuedate=20140730&sid=GAMECHANGE&utm_source=SpecialReport-20140730&utm_medium=in-newsletter&utm_campaign=investmentnews&utm_term=text

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If you have a safety or risk management question or a suggestion for a topic, please contact Travis Pearson at tpearson@markelcorp.com.