Legal Risk Management Tip
April 2018

SUCCESSION PLANNING 101: SAFEGUARDING YOUR BUSINESS

You're running a broker-dealer firm, or an investment advisory firm, and business is great. You have a terrific management team and they make sure that everything is running well and being profitable. But what happens if one of the owners or managers leaves or dies? No one likes to think about the worst happening, but if it does, what happens to your well-established company?

That depends on your Succession Plan.

Succession planning is an integrated, systematic approach for identifying, developing, and retaining capable and skilled employees in line with current and projected business objectives. That is, of course, if you want to promote from within. The 2015 State of Succession Planning Report[1] describes succession planning as, "Any effort designed to ensure the continued effective performance of an organization, division, department, or work group by making provisions for the development, replacement and strategic application of key people over time."

But before you get to that stage of your plan, you must first do an exhaustive study of what the position requires. What are the risks with a person who does not meet the requirements? What tone do you want to set in the company? Is the replacement person a good fit for management and your employee population in general?

In the past, succession planning was something companies did to plan for the worst-case scenario: replacing senior leadership due to retirement or career change. This process ensured the executive team was taken care of, but, ignored key contributors in lower ranks across the firm that are also critical to the business.

[1] https://oig.federalreserve.gov/reports/board-diversity-inclusion-mar2015-full-report-promotions-and-succession-planning.htm

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The firm must identify operational areas and positions that are critical to the firm's business activities. This can happen in a dedicated risk assessment, or as a part of assessing your internal controls. Consider which positions would be negatively impacted if the leader of that area is no longer there. Determine whether there are any areas where changes could negatively impact your client base. Once you have identified these areas and/or positions, you must create a search focus. What are the capabilities that are required for this position?

By way of example, if an owner dies, has it been determined who will step in? In many small firms the company would be inherited by the owner's family. In those small firms, it's often unknown if anyone in that family knows anything about the business, is licensed, or is even willing to take over. When that's the case, what needs to be done when there is a change of ownership like this? The FINRA enforcement case below describes the steps necessary for the transition of ownership.

> **First Dallas Securities Incorporated (CRD #24549, Dallas, Texas)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it implemented a succession plan that resulted in the transfer of ownership from the firm's chairman and majority shareholder to his relatives who were at that time minority shareholders, and the transfer represented 27.91 percent of the voting shares in the firm's holding company. The findings stated that the firm failed to file for FINRA approval of a material change in ownership or control at least 30 days prior to a 25 percent or greater indirect change in ownership or control. The findings also stated that the firm failed to file for FINRA approval of a material change in ownership or control related to the transfer until several years after the transfer had taken place. **(FINRA Case #2009016267801)**

This should be discussed in a board of directors meeting, a management committee or whatever governing group your firm uses. If none of those exist in your firm, then Human Resources and Compliance should be brought in to discuss the issue. It's important to know what specific knowledge and skills the replacement person needs. If your firm does international business, for instance, then the replacement person may need to know a different language. If the firm is a high-tech firm, then maybe the new person needs an in-depth knowledge of IT. A list of these sorts of qualifications should be set out and updated as the firm changes.

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Once the requirements are set, there should be discussions with current employees to see what their career goals are, if they have the leadership qualities necessary, if they are interested in replacing that person, and if they have the skills necessary to do that job. If all else is good, then it may be time to start priming that person to be the replacement.

The priming of that potential candidate should start with defining the learning, training and development that would be required for that person. The learning process should be made part of their normal work week. The person currently in that position should work with the potential replacement to bring them up to speed on all aspects of the job. Any potential replacement should be monitored closely during the learning stage.

Make sure that you have a succession plan for all key areas and positions. Fill all key positions quickly to avoid leaving the position open for too long. Monitor the replacement for efficiency and overall performance. It would be advantageous to use a firm organizational chart listing the replacement person for each vital job. Everyone should have a backup.

All businesses lose good people. Whether it's for personal or professional reasons, planned on unplanned, losing talented employees can leave a large gap in any organization. Filling critical vacancies can prove to be challenging, expensive and time consuming. That's why succession planning is vital. It ensures businesses are well-positioned to continue growing and performing, minimizing the impact of losing key talent and leaders.

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