

**Legal Risk Management Tip**  
**September 2015**

**THE IMPORTANCE OF STRATEGIC TRANSITION AND BUSINESS SUCCESSION PLANNING**

Ever since the financial crisis of 2008, we have witnessed an increase in registered investment advisory business growth. Traditional brokers are “breaking away” to form their own independent businesses and existing registered investment advisers are joining forces with other advisers in order to accelerate growth opportunities in the marketplace. Also, mergers and acquisitions are becoming more and more common place as a result of strategic transition and business succession planning. Each of these scenarios has a series of regulatory compliance considerations the business must face, whether on the breakaway path or on the merger and acquisition side. This month’s legal tip will focus on those considerations that businesses should keep in mind prior to implementing the transition plan.

**Formulate a Strategic Plan**

The key to beginning any successful business lift-out is to formulate a strategic plan. The strategic plan should outline, among other things:

- The types of products or services that will be offered;
- Business goals and objectives;
- A marketing plan to target new clients and service existing clients;
- Management and organizational structure;
- Staff and recruiting needs;
- Internal controls and resources necessary to comply with complex regulations;
- Financial goals, budget considerations and earnings projections; and
- Operational systems and outsourcing necessary for the business.

**Hire Strategic Business Advisors**

Prior to making any transition, it is paramount to obtain professional counsel. Dependent upon what side of the table you are on, that may include lawyers, accountants, consultants, valuation companies and/or tax advisors. Counsel should be engaged at the onset for the preparation, development and execution phases of the transition. Some of the most common areas that counsel may analyze and provide guidance on include:

- Current employment agreement and any restrictive covenant provisions;
- Client contract requirements for notification and assignment;
- The company’s business plan to see if any material provisions were not included and need to be addressed;
- Custodial relationships, considering the best techniques for transitioning clients; and
- Current payout and other compensation arrangements, including terms pertaining to commission and bonus schedules, promissory notes and related payback provisions.

## **Transitioning to the New Firm**

There are several areas that need to be addressed prior to making any transition. To help ensure that things are in good order and fully operational at the new firm, be sure to:

- Complete all filings and corporate resolutions for formation of the entity (LLC, S-Corp, Partnership, etc.);
- File Forms ADV to apply for registration with the state(s) or SEC;
- Complete Forms U4 (as required) and Form ADV Part 2B for those professionals who will provide advisory services;
- Engage counsel to draft client agreements, employee and independent contractor agreements and other business contracts;
- Develop operational documents, including privacy notices, written policies and procedures, business continuity plans, code of ethics and marketing collateral<sup>1</sup>;
- Identify and engage key vendors to support the business (including custodial arrangements, electronic record maintenance, E&O insurance carriers, information technology (IT), etc.); and
- Secure appropriate insurance coverage for the new business.

## **Compliance Risk Management Considerations**

Often the role of compliance is that of a business advisor. The Chief Compliance Officer (“CCO”) plays a critical role in providing guidance to the business and liaising with the firm’s professional advisors as to what regulatory compliance requirements should be considered whenever a business transition occurs. Because of the numerous considerations for transition planning that go beyond the scope of this article, it is important to work with a team of professional advisors at the onset to ensure that material factors are weighed prior to and during the transition.

The CCO may be delegated with the responsibility of communicating the myriad of complex business and compliance requirements that the company must consider. The following checklist is designed to help navigate through those areas.

### **COMPLIANCE RISK MANAGEMENT CHECKLIST FOR TRANSITION PLANNING**

- Formulate the strategic business plan
- Assemble your list of professional advisors
- Evaluate current employment and independent contractor agreements for restrictive covenants on non-competition, non-solicitation and trade secrets and other terms relating to termination
- Commence application for registering as an independent investment adviser
- Discuss with counsel options for pay back terms for existing promissory notes with the employer

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<sup>1</sup> Depending upon whether the adviser is a state or SEC registrant, requirements differ and may not be mandated. Advisers are strongly advised to confer with professional advisors to find out more information for their specific situation.

- Create client disclosure documents, including Forms ADV, privacy notices, offering memoranda and marketing disclosures, as applicable
- Prepare client servicing agreements
- Have counsel author agreements and letters, as necessary, for all employees and independent contractors
- Conduct background and compliance checks on all new hires
- Prepare or update written compliance policies and procedures
- Confer with your insurance carrier to purchase E&O, Directors and Officers (D&O) and other forms of insurance
- Assess all compliance and operational requirements and develop a project manager for implementation
- Select broker/custodian or prime broker as needed
- Prepare communications for announcing the launch of the new firm, service area or team and work with counsel to understand the boundaries involving solicitation

JLG assists firms and individuals through the labyrinth of considerations for transition planning. For more information on this topic, please contact us at (619) 298-2880 or at [info@jackolg.com](mailto:info@jackolg.com).

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