ONBOARDING AN ADVISOR WITH AN EXISTING BOOK OF BUSINESS INTO A NON-EQUITY POSITION

Onboarding an Advisor/Recruit in this configuration means the Advisor/Recruit will NOT be relinquishing their independence or control over their clients, cash flow or value, but will share the cash flow from their production in exchange for office space, office support and various other Company benefits. This approach applies to Advisor/Recruits who do not want to relinquish their independence or share in the appreciated value of the Company.

KEY POINTS

1. *Many business Owner/Advisors confuse, or fail to understand and appreciate, the differences between equity (business value) and cash flow.*
2. *A revenue-splitting or commission-splitting approach results in increased cash flow to the hiring Company, but with the detrimental effect that such cash flow often does not result in an increase to the Company's business value.*
3. *Onboarding (or acquiring) a book of business built within a hiring Company's infrastructure can be expensive and can carry with it significant tax repercussions; consider these issues carefully prior to the hiring or recruiting event.*

a) Determine if the relationship warrants an equity position in the recruiting firm, or if an ongoing revenue-splitting relationship makes more sense. Note that in the former case, the cash flow associated with the Advisor/ Recruit's book of business will tend to increase the business value of the firm he or she is joining, i.e., an equity-centric business model. In the latter case, the cash flow to the recruiting business may increase without a corresponding change in the business value. This section applies to the latter case.

b) Formalize proper worker documentation, most likely an Independent Contractor Agreement, but maybe an Employment Agreement as discussed below. The documentation requires non-disclosure language to prevent an Advisor/Recruit from taking intellectual property, confidential property, or any proprietary information developed by the Company and using it for the benefit of anyone other than the Company.

c) Compensation or revenue splits can vary widely depending on what is actually being provided to the Advisor/Recruit (e.g. compliance oversight, office space, staff, etc.), but most revenue or commission splitting arrangements are in the neighborhood of a 50/50 split of gross revenues between the Company and the Advisor/Recruit.

d) Whether the Advisor/Recruit is an independent contractor or a W-2 employee mainly depends on the amount of control maintained by the Company and how independent the Advisor/ Recruit actually is. There is no dispositive test for this distinction but the IRS follows a list of approximately 20 items it uses to distinguish independent contractors from employees. Be aware of what those items are. FP Transitions has a separate article available on this topic.

e) Consider entering into a formal, written Continuity Agreement that protects the value of the Advisor/ Recruit's "book of business" by setting up an acquisition and guardianship by the Company in the event of the Advisor/Recruit's death, disability, or retirement. Ensure that the payment terms of any such triggered purchase not funded by life insurance are feasible given the Company's cash flow situation, taking into account the tax impact of the payments by the Company.

f) Even though this is a non-equity position, leave the lines of communication open for the relationship to become an equity-position, as described below. Many great relationships start by "testing the waters" first.

ONBOARDING AN ADVISOR WITH AN EXISTING BOOK OF BUSINESS INTO AN EQUITY POSITION

Onboarding an Advisor/Recruit in this configuration means the Advisor/Recruit will be relinquishing their independence and control over their clients, cash flow and value, often in exchange for an ownership opportunity in the Company. This approach applies to Advisor/ Recruits who are fully ready to commit to a career path with a larger firm and possibly acquire a majority, or at least a significant ownership, position in the future.

a) Allow a one year evaluation period so that the Advisor/Recruit can be evaluated and the value of the fully transitioned book can be determined. However, the longer the onboarding Advisor/ Recruit has to grow the value of their own practice, or book of business, the more likely it is that the Company will instead be developing a competitor.

b) Determine if the relationship warrants an equity position in the firm, or if an ongoing revenue-splitting relationship makes more sense. Note that in the former case, the cash flow associated with the Advisor/Recruit's book of business will tend to increase the business value of the firm he or she is joining, i.e., an equity-centric business model. In the latter case, the cash flow to the recruiting business may increase, without a corresponding change in the business value. This section applies to the former case.

c) Formally value both the Company's business and the onboarding Advisor/Recruit's "book of business" to determine respective equity values. Taking into account the benefits and detriments for each of the participants in such a transaction, it is recommended that the value of the onboarding Advisor/ Recruit's book be divided by the combined value of the Company's business and the Advisor/ Recruit's book for the purposes of determining the percentages of ownership in the combined business. Typically, no discounts are applied to what is commonly a minority, non-controlling position by the onboarding Advisor/Recruit.

d) Onboarding Advisor/Recruits should sign a formal, written Admission or Contribution Agreement to memorialize the assets contributed in exchange for stock or units of ownership received. Additional documentation will be used to formalize the equity positions of the respective parties. Any such documentation would include non-solicitation/non-competition/no-service, a buy-sell agreement, etc. If/when the onboarding Advisor/Recruit leaves, the clients and their assets remain with the Company. The Advisor/Recruit receives the value of his/her shares or units in lieu of their ability to work with the clients they contributed.

e) In an LLC taxed as a partnership (or as a disregarded entity prior to the onboarding process), it may be possible to "reset" ownership through the Company's Amended Operating Agreement (verify reset mechanism and tax issues with Company's CPA), with little or no tax consequences. In an S-Corporation, or in an LLC taxed as a corporation, the exchange of an Advisor/Recruit's book of business for ownership (stock or a membership interest) results in a taxable transaction for the Advisor/Recruit being on-boarded.

FP Transitions is the nation's leading provider of equity management, valuation and succession planning services for the financial services industry. Based in Portland, Oregon, FP Transitions operates the largest open market for buying and selling financial service practices in the U.S.

Since opening its doors in 1999, FP Transitions has completed more financial service transactions than any investment banker or business-broker in the country. FP Transitions' expertise also includes continuity planning, practice benchmarking, compensation studies, entity formation, mergers and acquisitions, and equity compensation strategies.

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