THE ART AND SCIENCE OF RELATIONSHIPS IN TRANSITION

The Psychology of Financial-Advisor Succession

By Greg Heffington, RCC, David Garfield, MD, and Daven Morrison, MD

Challenges abound for advisors who are retiring or otherwise leaving the business and for those who are inheriting clients. The challenges are especially heightened now due to imminent changes in regulatory compliance from the U.S. Department of Labor (DOL). These changes will impact client conversations and relationships between clients and advisors. They will impact practice transitions as well.

This article discusses the challenges of selling a practice amid potential complications due to the new DOL regulations. Additionally, it describes five relationship skills that are key to successful transitions.

Financial-advisor succession is an interesting, important transition for client, buyer, and seller. Most every firm has a process to systematically make this easy and efficient —for dotting I's and crossing T's, if you will. But what appears to be missing most is any significant consideration of how the client is affected.

In many instances, the client is left wondering, "What just happened?" At any given step, the ball may get dropped. Three individual perspectives—buyer, seller, and client—need to be understood. The following three relationships also need to be understood:

- The known, established relationship between the retiring advisor and the client
- The new, fragile relationship between the buyer of the practice and the client
- The relationship between the selling and buying advisors

Buyer, Seller, Client

Imagine Jim, who is selling his practice to a larger practice owned by Carolyn. If Jim's book of business has significant value, then his clients likely have strong relationships with him. They feel good about Jim's service and performance and believe he has their best interests in mind. As Jim decides to retire, and because the relationships matter to him, too, he wants to make sure his clients will be well taken care of by Carolyn's team of advisors. Jim also wants to be compensated for the business he has built and the assets he has gathered. This is a reasonable position and is understandable to his clients. Jim's clients are motivated to keep things going well and would like to have a successful experience with the new advisors. In fact, there may have been aspects of the relationship with Jim that were satisfactory but not stellar. Still, Jim's clients may fear that things may be worse with Carolyn.

Carolyn has a lot on her mind. She sees the pending legislative requirements for compliance and the transition to her practice as a threat to the relationships Jim created. Her practice is growing and she has plans to acquire additional books of business. Her investors are eager for her to bring these new clients online and for her practice to show the profits outlined in her business plan. For clients, Carolyn represents a risk as well as a potential opportunity, depending on whether she can tune in to a more comprehensive view of the client.

The pending DOL changes weigh heavily on both Carolyn and Jim, For Jim, it is driving him to sell. Carolyn sees the chance to build processes and take advantage of fire sales. Updates about compliance requirements arrive in their e-mail inboxes as well as by snail-mail. Offers for education programs also flood in, adding to their anxiety about the compliance.

Clients are generally unaware of the complex forms they will be required to complete in early 2017.

The success of the transition from Jim to Carolyn depends greatly on the relationship Jim has with his clients and on the relationship Carolyn and the new team establish with Jim's clients.

The strength of the relationships between advisors and clients has been directly correlated to:

- More referrals
- Higher wallet share
- Comfort with higher fees
- Less inclination for clients to switch advisors

Research shows the importance of solid relationships in the financial advisory business (Pingitore et al. 2014).

Interpersonal Alliance and the Succession Hand-Off

Advisors like Jim who have successful practices have good relationships with their clients. How well those relationships transfer to the new advisor(s) depends greatly on how well the transition is orchestrated. We have seen many poorly executed transitions. We also have seen transitions that were well done, primarily because significant consideration was given to how the client was treated in the process. A big differentiator between the two outcomes is the strength of the relationships between advisors and clients. Another is the consideration given to the client's reaction to any given part of the transition.

Jim and Carolyn's Compliance Lead Meets a Client

When Crossing the T's Leads to Crossing the Client

Carolyn has a compliance expert, Frank, on her team. To get out ahead of the compliance requirements, Carolyn's advisory board and her attorney advise her to have Frank meet with Jim and each of his clients early in the transition process. In one of these meetings, Jim and Frank met with Steven at his house. The two of them are soon surprised to receive a bland note from Steven announcing his departure to another practice. Indeed, it was one of several such rejections. Carolyn and Jim get anxious. The deal is in jeopardy. What happened?

Let's look at Steven's point of view. Here is what Steven reported to his colleague Mike, who also is a client of Jim's, after asking Mike if he'd met Frank:

> *Jim and Frank came in after I got home from work and sat down with my wife and me at the dining room table. After an hour and a half, my wife excused herself saying she had laundry to finish. Jim said he was handing over the income/expenses, review of current investments, and presentation of the investment vehicles to Frank, who he was training. Frank's asking a lot of questions but he's got a stiff style and he seems pretty uncomfortable. By this time, two hours have gone by, and I was absolutely fried. I told them we needed to finish. Jim said it would only take 10 minutes more. A half hour later I said I was exhausted and had a busy day the next day, and Jim said they were wrapping up. After another 20 minutes, I was getting really annoyed. I told them they needed to go, now. I told them I felt like I was being held hostage by used car salesmen. Jim seemed insulted, but too bad. Jim had not told me he would be bringing an associate. It took me another 15 minutes to get them out the door. That's when I decided there was no way that I was going to have Frank working on my account.*

Knowing Steven's perspective, you can appreciate why he and Mike left Jim's practice before the sale. Their departures doomed the deal. How did this obvious misstep not get managed in real time?

Pace of the Transition

Indeed, it is hard to imagine that anyone could be so clueless about the effect of Jim and Frank's behavior on the client. Yet it happens all the time because advisors get fixated on obtaining the information they need to do their jobs. They forget that clients are human beings and they keep pushing through, and the bond between advisor and client ruptures. Sometimes advisors can even see it happening, but we have worked with many who are ill-equipped to do much to change the course of such a meeting.

Five key ingredients require attention when assessing one's skill set in relationship-building. These five points apply to all advisors who are transitioning into or out of a practice:

1. Alignment—being on the same page with the same agenda
2. Teamwork—sacrifice and understanding on the part of the advisor
3. Mutual navigation—seeking out opinions and new ideas, checking in frequently
4. Durability—understanding disruption and repair
5. Respect—realistic praise and admiration for the client

It's easy to consider how Steven would rate these factors with regard to Jim.

Before the meeting with Frank, Jim likely received high marks on all five factors. But afterward, the picture is very different:

- There is an absence of alignment resulting from a lack of response when Steven shares he's tired.
- Frank's presence and his stiff style have harmed the sense of teamwork.
- Jim missed his client's rapidly dropping sense of mutual navigation as the meeting went on for more than three hours.
- Imagine the threat to the durability when Steven feels as if he is being held hostage by used car salesmen; imagine his courage to say so, and the lost opportunity for repair when Jim is insulted.
- Respect has suffered because Steven wasn't told Frank would be at the meeting.

By heading into the compliance weeds, Jim and Frank shredded the working relationship with Steven. It torpedoed Carolyn and Jim's transaction. The tactics at Carolyn's firm likely put other transactions at risk as well. Frank and the new process were running roughshod over years of goodwill.

Implications for the Industry

If your practice can manage the new DOL requirements and/or a financial-advisor transition, you are likely to be successful. However, the financial-advisory industry does not appreciate the importance of this process, and it has never provided proper training in a rigorous science-based manner to help advisors manage it.

Whether you are selling or buying the book of business, keeping client relationships intact is critical. Respect, mutual navigation, clarity, buy-in, and attention to disruption indicate that you are concerned that the client is well cared for and is an important factor in whether or not the transition is successful.

Greg Heffington, RCC, is founder of Heffington Consulting, LLC, and has more than 30 years of financial services industry experience. He has spent the past 17 years coaching and consulting with individuals, teams, and corporate entities interested in making better connections and seeking better results when interacting with clients. He is the principle advisor to Applied

Continued on page 58

FINANCIAL-ADVISOR SUCCESSION
Continued from page 39

Psychoanalytics, LLC. Contact him at greg@heffingtonconsulting.com.

David Garfield, MD, is the founder of Applied Psychoanalytics, creator of the original Financial Advisor Strength Index, a professor of psychiatry, and a psychoanalyst. He is a co-author of The Psychology of Smart Investing *and several other practices on psychotherapy and psychoanalysis. He has been director of the professional development program for psychiatry at the Chicago Medical School for 25 years.*

Daven Morrison, MD, is a partner in Applied Psychoanalytics, and an advisor to financial advisory service firms, banks, insurance companies, and other professional service firms. He is on the faculty of the Midwest Leadership Institute and is a committee member of the Group for the Advancement of Psychiatry. He is past president of the Academy of Organizational and Occupational Psychiatry. He is a co-author of The A.B.C.'s of Behavioral Forensics: Applying Psychology to Financial Fraud Prevention and Detection.

Reference

Pingitore, Gina, David Garfield, Rockwell Clancy, Daven Morrison, and Suxi Li (February 6, 2014). *Assessing the Strength of the Advisor-Investor Relationship; A Groundbreaking New Method*. McGraw-Hill Financial Global Institute.