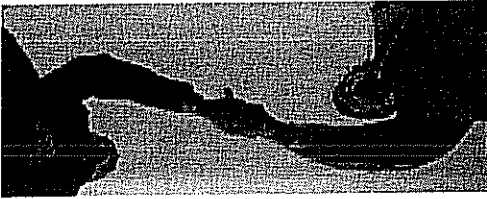


## Questions you must ask in buy/sell arrangements

Mark Noble / June 18, 2009



The value of a practice is only partly based on forward earnings. Advisors looking to either buy or sell a practice must be aware of myriad other factors that could turn a book of business into a book of problems.

Presenting at LOMA Canada's recent conference in Canada, Arnold Scheerder, compliance officer for R.G. Packman & Associates, a managing general agency (MGA), and Kim L. Lea, a regional compliance officer with Manulife Financial, emphasized that advisors in the buy/sell market need to be aware of risk beyond the price negotiated.

### Revenue sharing

The first question advisors will likely want to ask is what compliance hurdles they will face with their buy/sell arrangements. For instance, many selling advisors don't just sell their businesses and retire; referral or commission-sharing arrangements are often part of the deal.

Lea points out that advisors have to ensure that these types of arrangements are acceptable to regulators, carriers or the dealer.

"At Manulife, we recommend that a selling advisor stick around for a year, not necessarily to stay in the business but to wind it down," Lea says.

In order for a commission-sharing agreement to work, the following have to be considered:

- Both advisors must be licensed to sell the products where a commission is being shared.
  - If licensed, commission splitting is allowed on the life side" regardless of an affiliated dealer relationship.
  - Commission splitting is allowed only on fund business if both advisors are registered with the same dealer.
  - Clients must be made aware of commission-splitting arrangements.
- Referral arrangements in which a flat rate is paid to the selling advisor are allowed. Again, the clients must be made aware that such arrangements exist.

### Other compliance risks

Compliance issues can also rear their head with private information. It's imperative that the selling advisor ensure that clients have consented to have their private information

transferred to the new advisor. Otherwise, both advisors are setting themselves up for legal liabilities under Canada's privacy laws.

"It is important that consent be obtained from the client before handing over the file from one advisor to another," Scheerder says. "A really good advisor probably has more comprehensive information about his or her client than a doctor or a lawyer. They deal very frequently with family affairs, which are not only financial. Very private underwriting and medical information may be disclosed."

Scheerder says it's absolutely vital that there are no overhanging client complaints on the new book of business. He emphasizes that advisors should check with the applicable regulatory bodies to ensure that no enforcement action or complaints have been taken against an advisor and, if they have, ensure that the complaints have been resolved.

"The buyer needs to ask, 'Have any clients launched a complaint against you, and were these complaints resolved?' If you buy a book of business, are you buying a solid book of business or are you buying a block of nightmares?" Scheerder says. "Buying a book is much more than just the value in dollars that you get. Value may very quickly disappear if all of sudden a lawsuit comes up that you have to deal with, whether you like it or not, because you are now the servicing advisor. That may eat up anything that you gained on the purchase of the book of business."

Scheerder says a buyer should insist on tail errors and omissions insurance coverage.

"I would insist they have tail coverage because, as a buyer, if you're taking on a book of business of insurance and something goes wrong, you'll want that coverage," he says.

The same due diligence should also be carried across to the dealer and carrier relationships that exist with a new book of business. For example, does the purchasing advisor have an existing relationship with the product providers? Dealers and MGAs will be very attentive to this.

"That advisor could be selling a block of business that is spread over 10 different companies. From our perspective, we want to know what that block of business consists of and who are the carriers involved," Scheerder says. "Is the individual already contracted with an individual carrier? If not, can he or she be contracted by another carrier? All of sudden, you have a block of business that the advisor can no longer serve. We need to find out who is going to take it over."

### Valuing the advisor

A purchaser is buying not necessarily a book of clients but the service that a previous advisor has provided to clients. It's hard to put a dollar figure on the work of a good advisor or underestimate the liability of shoddy service. If the purchasing advisor cannot meet client expectations or overhanging service needs, that book of business can fall apart quickly.

The purchaser may be buying decades of client relationships, and happy clients expect service to remain the same. Of course, there may be some disgruntled clients who will relish a change in service quality.

But the buyer should not count on these clients sticking around, and Scheerder recommends that the purchasing advisor look at the persistency of client business. If the selling advisor had a high turnover rate, there is no expectation that those clients will have any loyalty to the practice or necessarily follow the selling advisor's recommendation to go with a new advisor.

Of course, the opposite is a big bonus. A transition can be made very easily if the departing advisor had a stellar reputation and serviced clients well and, Scheerder says, comprehensive recordkeeping is a good sign of quality service.

"The better a client's file is built up, the bigger the equity in the business, because that goodwill adds value," Scheerder says. "If I walk in as a new advisor, I'm going to feel very comfortable going to see a family when I know who their children are and I know their ages. I know what plan is in place for the family, I've seen their needs analysis, and I understand all of it. I have a statement with regards to their various holdings. I know a lot without even meeting them and that adds value to me as a buyer, and I'm pretty sure it adds value to the book for the seller."

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