

Sole Adviser & Responsible Manager

White Paper by Licensee Solutions Pty Ltd

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A. Planning for the Unexpected: Steps for Sole Advisers to Ensure an Orderly Transition upon unexpected death or disability

In the financial advisory world, the sudden death or disability of a sole adviser who owns all the shares in a company which holds an Australian Financial Services Licence (AFSL) creates significant challenges.

To ensure an orderly procedure for their spouse or family to follow, sole advisers should take proactive steps now. This White Paper will help sole advisers prepare for such eventualities, with the assistance of Licensee Solutions, an Australian compliance firm.

We're not suggesting creation of a complex legal document. We've seen too many succession situations where a desire for perfection means that no helpful document or procedure has ever been finalised, despite initial enthusiasm. This paper is all about practical steps. The situation which will need to be managed could be best described as analogous to a situation where someone must immediately take over captaincy of a boat in rough weather.

The paper does not focus upon the issues associated with life insurance. We assume as a financial adviser you already have that in hand.

B. Understanding the Sole Adviser Scenario

The situation we are addressing involves a sole adviser who is the key person and Responsible Manager (RM) for the AFSL, sole director, and ultimate beneficial owner of the shares in the company which owns the AFSL. The important roles in the business are concentrated in one individual.

That person's sudden death or disability can lead to significant operational and regulatory challenges. This scenario is not uncommon, with the increasing average age of advisers who are facing increased health risks.

To show how this might be, we provide a simple case study below. The case study reflects common facts. In real life, the facts would likely be more complex.

C. Case Study: Graham's Story

Let's consider a hypothetical adviser named Graham. Graham is 57 years old, happily married, and owns 100% of the shares in a company that holds an AFSL. He is the sole adviser and RM, with 120 fee-paying clients and two part-time administrative staff. His spouse is not involved in the business and has limited knowledge of the financial services industry.

Graham has \$1 million in life insurance, which is sufficient to pay off the mortgage on his family home. There is no debt in the business. Unfortunately, Graham suffers a catastrophic heart attack and dies. The immediate business consequences are significant. The company loses its key person and RM, triggering regulatory requirements and operational challenges. The Australian Securities and Investments Commission (ASIC) must be notified within 5 business days of losing the key person, and a way forward must be proposed.

Graham's widow is distressed and confused.

D. Immediate issues

There will be immediate critical issues.

These include

- a. Graham will almost certainly be a key person on the licence. Within 5 business days the AFSL must notify ASIC of Graham's death, and a proposed way forward and replacement.
- b. He was also the sole director, so the key decision-maker for the company with knowledge of the company's affairs can no longer make decisions, authorise anyone else to make decisions, or authorise anyone else to take actions.
- c. Who will provide services to the clients? Immediately the value of the business will start to drop.

E. Steps to take now to address the situation

There are simple steps to take now.

Step 1: Develop a Roadmap

A well-documented road map is essential. This will help spouse or family navigate the complexities of managing the business during a difficult time.

This road map should outline the steps to be taken immediately following the adviser's death or disability. It should include details such as who will take over the role of RM and key person, how clients will be notified, how clients will be serviced, how the business will continue to operate, and key contacts (more on that below). The road map should be reviewed and updated regularly to ensure it remains relevant.

During the process of applying for an AFSL, a succession plan was likely written. However that plan may have been generic, or the situation may have changed. Individuals referred to in that plan may no longer be involved with the business. The existing succession plan may look good on paper, but be of little help to a distressed spouse or other family member. (Some companies which hold an AFSL drafted those procedures at the time of licence application, and have rarely if ever looked at them since.)

The road map must be easy to read and comprehensible by someone outside of the financial services industry. This can be tricky – be careful to avoid the use of words such as “platform” which generally have little relevant meaning for people outside the financial services industry.

The road map must include key contacts and information. These are the people at all the relevant organisations who will provide assistance and need to be informed.

A key part of the road map is to specify an immediate meeting between the spouse/ family members, whoever will be running the company and the company's compliance provider and lawyers as a first step. This meeting should be held before unrelated third parties are informed because in some cases, as soon as you inform an organisation, there will be consequences.

For example, the AFSL has 5 business days to inform ASIC of the death of the key person. That is likely to trigger reasonably prompt action from ASIC.

We understand that as soon as most fund managers or insurers (i.e. insurers for the clients of the business) are informed that the sole adviser has died, they will cease payments of ongoing fees. Once there is no qualified adviser operating under the licence, ASIC would likely expect that fees are no longer charged, and may require a refund of fees which have been charged.

(Note - This paper does not set out all the administrative details which must be attended to over time, for example, informing the ATO of the death of the public officer. This paper focuses on practical and immediate steps to protect the value of the business.)

Step 2: Appoint a Second Director, or have paperwork already prepared to appoint a second director

One of the most critical steps is to appoint a second director for the company holding the AFSL, so long as the company is generally compliant, in both the sense of ASIC type compliance and taxation. This could be a spouse, trusted family member, or friend. Having a second director ensures that there is someone legally authorized to make decisions and manage the business in the event of the adviser's death or incapacity. Without another director, the company may face operational paralysis.

Often families choose to only have one member of a couple be a director, hoping liability will be restricted to one director, and family assets be owned in the name of the spouse.

Business structuring is all about balancing risk. There are relatively few cases where directors of well run companies have been found to be liable for financial loss due to negligent advice. It is true that in well known case of Storm Financial the directors of a financial services company were found to be liable. (**ASIC v Cassimatis (No 8) [2016] FCA 1023** - this case was brought by the Australian Securities and Investments Commission (ASIC) against Emmanuel and Julie Cassimatis, the directors of Storm Financial, for breaching their duties as directors.) Most reputable financial advisers would likely have viewed the behaviour of Mr and Mrs Cassimatis as extreme and outrageous. There is a world of difference between the risk for a director of a well run small advisory company and the Storm situation.

Usually, the risk of not having a second director will be greater than the risk of liability for advice. (This position will be different if a third party requires directors' guarantees, and if a new director is added, the third party requires them to give a guarantee. In that case, we say the risk associated with the guarantee could outweigh the benefit of having 2 directors. The situation is also different if the company is not up to date with tax payments.)

A question is often asked about appointing directors by will or enduring power of attorney. Section 201F of the Corporations Act provides that if a person who is the sole director and sole shareholder of a company dies or becomes mentally incapable, the deceased's legal personal representative (such as an executor or administrator of the estate) has the authority to appoint a new director. There are two problems with this approach. First, if the director dies without a valid will, it will be some time before an administrator of the estate is appointed. Second, in many cases the shares in the company will not be owned directly by the deceased. These problems may lead to a situation where there is confusion and complexity at a time when a spouse is distressed and vulnerable. An enduring power of attorney ceases to be effective at the time of the donor's death, and a director cannot be appointed by enduring power of attorney in any event.

An alternative approach which could be adopted but is slightly more complex now is to have a clear process with paperwork already prepared through which the spouse may become the director. The process for appointing the director under this option must be set out clearly in the roadmap. This alternative could be especially suitable for a company where third party guarantors require all directors to provide security, or where the company is generally higher risk.

Step 3: Establish a Relationship with someone in a similar situation

We think you could do worse than developing a relationship with another experienced adviser in a similar situation, and having an arrangement with that person that you will each step in and assist in death or disability occurs. After many years of working with financial advisers, we have found virtually all advisers to be kind and helpful. Advisers are relationship oriented. Frequently advisers will step in to help colleagues, even in different firms. Many advisers provide free services for needy clients. It is

this side of the industry which is so frequently overlooked. The other adviser should be someone with experience running a financial advice firm. They should understand the financial advice industry.

The identity and contact details of this person should be included in the roadmap referred to in step 1.

Step 4: Establish a Relationship with an experienced compliance provider such as Licensee Solutions

You may already have this relationship. If you do, identity and contact details of the compliance provider should be included in the road map referred to in step 1.

Engaging Licensee Solutions would provide a structured and professional approach, and Licensee Solutions can assist in many ways, including:

- a. **Regulatory Compliance:** They can handle all regulatory notifications and ensure that the business remains compliant with ASIC requirements. They can liaise with ASIC regarding the key person condition, giving ASIC comfort that the situation is in hand.
- b. **Professional Indemnity (PI) Insurance:** Licensee Solutions can address potential PI insurance issues and ensure that any backup adviser is properly authorised under the AFSL, and understand the complex authorisation requirements.
- c. **Search for a suitable stand-in adviser** to ensure that services can keep being given, and fees charged. A recently retired adviser can be perfect for this situation.
- d. **Search for a suitable RM.** Extensive industry knowledge will be key to finding a suitable RM.
- e. **Assist in managing and liaising with third party fund managers and insurers.**
- f. **Draft communications with clients**

Step 5: Maintain the business in a saleable condition

Your business is a valuable asset. Ensure it is compliant, orderly and efficient. This will mean the business is immediately saleable. The longer the business remains unsold after the death or disability of the individual, the more damaged it will be, and less money will be realised for the benefit of the spouse and family. Failure to ensure compliance, order and efficiency will likely mean the loss of hundreds of thousands of dollars, or more.

F. Other Considerations for the value of the business

Financial services businesses are made up of fragile assets – client relationships. Most financial services businesses have few valuable assets other than ongoing income. As soon as there is no qualified adviser to provide advice, the value of the business starts to fall. Clients will need advice, and if there is no-one to provide that advice, the client will obtain advice elsewhere. A common multiple for good advice businesses can be between 2.5 times to 3 times ongoing revenue. But if a client requires even a small piece of advice and cannot obtain that, the client may be lost to another financial advice firm.

Further, as mentioned above, once a fund manager or insurer learns there is no qualified adviser, they may switch off the fees. This will potentially have a catastrophic effect on the business value. This needs to be managed.

It is critical that a suitable qualified person can be found to provide immediate service to clients. There must be a restraint of trade drafted around that person – they are there only to provide interim service.

G. Engaging External Consultants

In many cases, the spouse or family members may not have the necessary expertise to manage the business. Engaging external consultants, such as legal and compliance professionals from Licensee Solutions, can provide valuable support and guidance. These consultants can help navigate regulatory requirements, manage client relationships, and ensure the business continues to operate smoothly.

H. Licensee Solutions: Comprehensive Services for Sole Advisers

Licensee Solutions is an Australian compliance firm skilled in assisting sole advisers in managing their businesses effectively, especially in the event of unforeseen circumstances such as death or disability. Our services are designed to ensure that your business remains compliant, operational, and valuable, even in your absence. Here's a detailed overview of how Licensee Solutions can support you and your business.

Creating the Roadmap – How we can help

A critical service we offer is helping sole advisers document a clear and comprehensive procedure for what should happen after their death or disablement. This procedure is essential for ensuring that your business can continue to operate smoothly and that your clients are well-served. Here's how we can assist:

- a. **Road mapping:** We work with you to develop a detailed road map that outlines the steps to be taken immediately following your death or disability. This plan includes identifying a replacement Responsible Manager (RM) and key person, notifying clients, and ensuring the business continues to operate.
- b. **Operational Procedures:** We assist in creating detailed operational procedures that your spouse or family can follow. These procedures include contact information for key service providers, instructions for managing client relationships, and guidelines for maintaining compliance with regulatory requirements.
- c. **Annual Review to Ensure the Roadmap and Procedures are Up to Date:** To ensure that your road map and operational procedures remain relevant and effective, Licensee Solutions can provide a service of conducting an annual review of your documentation. Many people find the discipline of this process helpful.

Leveraging Halsey Legal for Business Sales

In addition to our compliance services, Licensee Solutions is associated with Halsey Legal a financial services law firm who can provide legal assistance. Halsey Legal is associated with Licensee Solutions, and can help with the associated legal questions, ranging from staff terminations to preparing contracts for the sale of the business, or documents to appoint directors, and liaising with ASIC if things get serious. Halsey Legal has extensive experience in the financial services industry. Halsey Legal has acted on hundreds of sales of financial planning businesses and can provide significant help if it becomes necessary to quickly sell the business. Their deep knowledge of the industry and legal expertise ensures that the sale process is handled efficiently and effectively, maximizing the value of the business for the family.

The principals of Halsey Legal and Licensee Solutions have been in the financial services industry for many years, and have owned and run a successful financial planning business. Their combination of experience, technical knowledge of compliance requirements and commercial understanding is unique.

I. Conclusion

Licensee Solutions will help sole advisers ensure that their businesses remain compliant, operational, and valuable, even in the event of unforeseen circumstances. By documenting a clear procedure for after death, conducting annual reviews to keep the procedure up-to-date, and providing temporary management and regulatory compliance services, we offer comprehensive support to sole advisers and their families. Planning for the unexpected protects your business and provides peace of mind for you and your loved ones.

J. Disclaimer

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