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ADVISING THE EXCEPTIONALLY AFFLUENT

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THE EQUITY SOLUTION

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BY ERIC L. REINER

A FEW YEARS AGO IN BOSTON, JOHN LAPANN FACED THE classic entrepreneurial conundrum. How would the advisory firm he had founded in 1991, Federal Street Advisors, in which he held majority ownership, continue beyond his involvement?

"I was in my early 60s and had promised our clients that we'd serve them over multiple generations," he recalls. "We had a really good team of senior professionals and needed to figure out how to transition ownership of the firm to ensure continuity for the client families."

He knew that attracting and retaining quality professionals is essential to success in the smart advisory business. "In order to do that, younger professionals need to be able to acquire equity. Equity has to be broadly distributed," he concluded.

PHOTOGRAPHY BY BRYCE VICKMARK

For that, though, he would need a bigger firm—a larger pie to split up. "We had really fabulous professionals in their late 20s and early 30s who needed a firm large enough, and growing fast enough, that they felt there were opportunities for them. So the notion came around that if we were going to achieve this continuity for the families, one way to do it was to team up with another firm and also do it in a way that would allow us to improve how we serve our clients and make us better for their benefit," LaPann says.

Spreading equity among staff was already a practice at Pathstone Family Office, based in Fort Lee, N.J., with offices also in Atlanta and Naples, Fla. Eventually, through a methodical process by both firms that included multiple considerations, the two joined forces as Pathstone Federal Street on January 1, 2016, with the shareholders from LaPann's outfit eagerly accepted as partners in the new organization.

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—JOHN ELMES

"Our goal is to make Pathstone Federal Street a career destination," explains Matthew Fleissig, the firm's president. "For us, the hardest part of growing from here is attracting and retaining talent. We want to have long-term partners who are personally fulfilled and economically rewarded, and we've set up structures that allow that."

Invitations to buy into the firm are extended to the firm's top performers. "It's not just the advisors. Whether they're in research or operations or reporting, we have partners from all different walks of the business," Fleissig says. Of the firm's 107-person team, 32 are partners. The equity's value is formula-driven and there is a regular dividend.

The other side of the coin is that taking new owners from within the organization gives veterans such as LaPann, who is now 67, a way to cash out while keeping the firm independent.

"The equity is transacted between partners, approved by the board, from the older generation to the younger generation. That is the exit strategy," Fleissig says, adding, "Having a market for the equity inside the firm allows us to maintain our independence as a private company. We want to be able to execute on what's best for the employees and the clients."

The firm's board consists of Fleissig and LaPann plus co-CEOs Steve Braverman and Allan J. Zachariah, both of whom had successful stints at Harris myCFO along with Fleissig.

CONVERGENT IN CRISIS

Pathstone Federal Street morphed into its current state on November 1 with an asset purchase that was also driven by a need to share equity. Yet the deal involving Convergent Wealth Advisors might never have occurred were it not for the October 2014 suicide of its CEO, David Zier, who had been suspected of fraud relating to a side fund he managed away from the firm.

The tragedy plunged Convergent into a tailspin. "Clients had left and the firm's great talent was at risk of walking out the door. If you don't keep the talent, you're not going to keep the clients," says John Elmes, who was brought in as president of the struggling operation in May of 2015.

At the time, Convergent was owned by City National Bank in Los Angeles, known as the "Bank to the Stars" for its Hollywood clientele. "City National recognized that they had an affiliate in trouble and wanted somebody with experience to issue-spot, be open-minded and to see what could be done to make it successful," says Elmes.

He certainly had the background for the task. He was part of the GenSpring Family Offices team that was mandated to double the firm's size every five years, and did. He'd also been a partner at Arthur Andersen in the private client group and a managing director at J.P. Morgan Private Bank.

When Elmes took over at Convergent, first on his agenda was figuring out how to hold onto the personnel. "This is a talent-based business and it truly is a rush to get the best talent. There is not an enormous inventory out there of credentialed professionals with in excess of 10 years' experience who know the ropes of advising complicated, multigenerational families," he says.

Elmes eventually concluded, like LaPann had, that to retain key employees they would have to own a piece of the business. "That's how you really align it with the clients. But there was no way to do that with the bank owning 95-plus percent," Elmes knew. The way forward would have to be transformational.

With the help of key executives at City National and the executive team at Pathstone Federal Street, a transaction was crafted with both the talent and the clients in mind, with the deal establishing an evergreen referral relationship between the bank and the advisory. City National wanted to retain the ability to partner with a family office as an option for its biggest, most sophisticated clients, which is the way it had used Convergent since acquiring it in 2007.

"A lift-out of the Convergent advisory team and the clients" is how Elmes describes the move to Pathstone Federal Street in late '16. It brought $4.4 billion in assets under advisement, plus 30 people in three offices (Potomac, Md.; Los Angeles; and Portland, Ore.) and created nine new Pathstone Federal Street partners. Elmes became Pathstone's executive managing director, with responsibility for growth.

In transactional terms, the deal was structured as an asset sale, trade publications reported at the time, so that Pathstone Federal Street wouldn't assume any liability stemming from the Zier case. Indeed, on December 19 the U.S. Commodity Futures Trading Commission levied an $800,000 fine against the remnants of Convergent.

MORE TO IT

Sharing equity may have solved some problems, but it wasn't the firms' only reason for uniting. Each one's strengths satisfied the other's needs.

For instance, Federal Street sought a partner that was technology-savvy, which Pathstone Family Office was. Pathstone wanted to further enhance its investment program; Federal Street excelled at manager research and had expertise in impact investing, a growth area for advisors. (See sidebar.)

Pathstone also needed more professionals. It was growing, after all. Fleissig says, "We needed that next generation of advisors to join us to keep that multigenerational promise to our clients. As we met the advisors of Federal Street, we were like, 'Wow.' You couldn't have found people like John [LaPann] had if you were trying to hire 10 or 12 advisors one by one."

In conjunction with growing, Pathstone wanted to strengthen its C-suite. Elmes and LaPann certainly bolster those ranks. They, in turn, saw

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benefits for their clients in Pathstone's bountiful suite of family-office services, everything from family-governance meetings to handling aircraft acquisition, with bill paying, property management, background checks on dog walkers and just about anything else a client can imagine in between.

THE TOUCHSTONE TO MERGING AND BEYOND

Ultimately what enabled the firms to come together is the intangible that is so often mentioned as essential to a business combination: culture. They sensed a similarity.

LaPann observes, "What's really made Federal Street's merger with Pathstone and the acquisition of Convergent work is that the cultures are aligned. Everybody at Pathstone Federal Street, no matter how they got here, is committed to putting the clients first and foremost, to doing really high-quality work and to building a single firm that benefits both them and the clients. For advisors who are thinking about combining, it's got to be about culture first."

Elmes' experience includes a ringside seat to what can happen when cultural fit is lacking. "What if you bought a practice that you wanted to integrate into your firm to create a great brand, and the leaders of that firm didn't agree with some of the things you were doing—your model portfolios, your market views, how you're executing? Then every day the leaders are trying to convince this other leader to do what they want. It is an enormous waste of time when instead, if you're aligned, it's, 'All hands on deck, get to work and build,'" Elmes says.

Still, finding a soul mate doesn't mean things will be the same after the union is consummated. To ensure from the get-go a common culture, Fleissig, who is responsible for the firm's day-to-day operations, did a lot of work before the firms formally tied the knot.

"The house has to be built before you close" the transaction, Fleissig says. "Mapping out operations to understand where things are, finding the best practices and quickly getting to adoption of those practices throughout the firm, getting people on the same systems, and not having businesses inside of businesses are very important so that on the day you close, you have the culture of the one firm."

As Pathstone Federal Street moves forward, maintaining the culture is woven into Elmes' game plan for growth. "You have to grow in a way that doesn't adjust your culture. You want opportunities that line up with what your firm does well and

THE IMPACT OPPORTUNITY

IMPACT AND ENVIRONMENTAL, social and governance (ESG) investing is growing fast and it's one of Pathstone Federal Street's specialties. Molly Betournay, the firm's director of impact research, and *Private Wealth* recently discussed clients' ESG needs and how advisors can meet them.

PW: *Beyond depth of experience, why do clients choose your firm for impact investing?*

Betournay: Clients often appreciate our ability to listen and understand their concerns about ESG issues in a way that advisors who do not focus on ESG may not.

PW: *Your firm is known as an innovator in investing. What are you doing in impact that's innovative?*

Betournay: Many of our clients access ESG investments through our UMA [unified management account] program. It enables them to invest with flexibility to accommodate specific interests, such as climate change, and they can hold multiple investments in a single account to potentially achieve lower management fees, higher after-tax results and improved efficiencies. The UMA also includes ESG scoring, which offers clients insight into the ESG strength of their investments. Holdings may consist of separately managed accounts, mutual funds, exchange-traded funds or single stock positions across a variety of asset classes.

PW: *If a planner wants to begin advising in this area, where should they start?*

Betournay: The first thing to do is learn about it. Check out the US SIF [Forum for Sustainable and Responsible Investment] Trends Report at www.ussif.org, read the academic literature on performance, attend some industry events, and start learning about managers and strategies in the space. There are fewer ESG managers than traditional managers, but they run the gamut in terms of quality. The real value-add of an ESG and impact advisor is in manager selection. It also helps if you pick a thematic focus to start, such as social justice, and build out the universe over time, rather than all at once.

PW: *Who would make a good impact advisor?*

Betournay: Impact presents an opportunity to engage with clients more deeply. So advisors who value strong client relationships, enjoy digging deeper to understand client interests and values, and are committed to helping clients achieve their objectives will excel in this space. Alternatively, advisors who aren't interested should consider partnering with a firm that can provide this service to its clients, because clients will walk away from an advisor if they don't get the ESG and impact investments they seek. We have seen that on a number of occasions.

"**Impact presents an opportunity** to engage with clients more deeply. Advisors who understand client interests and values will excel in this space."
—Molly Betournay

PW: *Looking ahead, where are the opportunities for advisors?*

Betournay: The next generation is a driving force of growth in this space, and many of them are expected to change advisors when they inherit their wealth. Advisors who successfully align themselves with the next generation's needs will see expanded opportunity.

what your talent wants to spend their time on. If they really want to work on the sophisticated families with comprehensive needs, then you don't want to have them work on narrow and small assignments," Elmes says.

The seven-office advisory firm finished 2016 with $12 billion in assets under advisement. It's too soon, perhaps, to assess success at the recently reconfigured organization. On paper it certainly looks poised to contend in the increasingly competitive private-wealth marketplace.

"We bring to it a lot of people with great understanding of the industry, the clients and the business," LaPann says proudly of his new, bigger organization. "We have half a dozen people who have been either presidents or CEOs of firms." PW