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5 WHITEPAPER

Accelerating Success in Asset Management Acquisitions

Considerations for Large-Scale Transitions of People and Assets

Recent years have seen a wave of strategic acquisitions and partnerships in the asset management world – and no wonder. Large enterprises are actively shopping for complementary companies to gain scale, differentiate, and diversify their offerings, broaden their geographic distribution, and enhance valuations. The combined entities stand to benefit from economies of scale, increased efficiencies, shared resources, and a cross pollination of talent and expertise. Realizing these benefits, however, is not easy and never a given at the outset of a transaction. The measure of success of an acquisition is often how quickly and smoothly the acquiring company can assimilate the assets and operations of the acquired entity and start delivering on the expected benefits for stakeholders. The goal is to get to "business as usual" with minimal internal disruption – and virtually no apparent disruption in the end client experience. This piece is an abstract from a larger work, intended to help strategic acquirers to clear a path to a smooth transition, no matter how large the transaction. The full-length version is available here.

Operational Integration: People Processes Technology

A major driver behind nearly all business combinations is to unlock and leverage the inherent synergies that presumably exist across the two organizations – the much talked about but difficult to realize "1 + 1 = 3" effect. In the asset management industry, realizing economies of scale often proves extremely difficult. The effort brings to light the major challenges – as well as opportunities – involving people, proceseses, and technology.

People

The combined organizations may have significant cultural differences, which can profoundly affect human capital management and the everyday working environment. Melding disparate cultures is just the first step in realizing the anticipated benefits of efficiencies and economies of scale. Moreover, a resource overlap in front- middle- and back- office support functions is virtually inevitable, given the high degree of uniformity of organizational structures and operating models across the asset management industry. Arriving at the optimal staffing adjustments will entail some hard decisions.

Processes

A major factor in achieving the desired benefits of the transaction is examining the front-to-back operating model of each entity and identifying best practices that can be gleaned from each for the new organization. An unbiased, fresh look is essential to determine the optimal organization structure, identify significant areas of improvement

needed, and develop a comprehensive plan to execute the necessary changes. A phased approach will help avoid major disruptions to operations, end users, and especially external clients.

Technology

The integration of two entities from a people and process perspective will quickly surface major technological redundancies across the front, middle, and back offices. Even before the acquisition, one or both of the entities may have multiple portfolio accounting or trade order management systems. Imagine how that issue will be compounded when the organizations are combined. Given the proliferation of systems, you can expect huge challenges in managing pro forma Investment and Accounting Books of Record (IBOR/ABOR), as well as data and interface costs.

Investment Accounting

When one company acquires another's assets, the nature of each entity's business will have a big impact on investment accounting in middle- and back- office systems. Asset managers running portfolios for third-party clients will typically be concerned only with the Investment Book of Record (IBOR). When the decision is made to consolidate the investment platform, a point-in-time conversion will occur, bringing along any needed history to calculate historical performance returns. The acquired asset manager will also be concerned with the Accounting Book of Record (ABOR). Depending on the geographic dispersion of the client base, this may impact multiple accounting books for U.S. Insurance Statutory, Generally Accepted Accounting Principles (GAAP), and International Financial Regulation Standards (IFRS), along with tax forms or Foreign Taxing Authorities.

> "Smooth operational and technology integration is one of the biggest challenges. It behooves the parties to work with an independent solutions provider."

Substantial IT support will be required. Technology integration is among the foremost challenges to a successful transition. Consolidation is essential. To determine which technology platforms must stay and which can go, you will need to consider the degree of overlap or variation in investment mandates and asset types between the two entities, and the back-end accounting and reporting requirements for clients. Combining two domestic fixed income shops, for example, is relatively straightforward from a technology standpoint, while combining a manager focusing on the MBS/ABS sector with one specializing in international equity markets is not. Similarly, the accounting and reporting requirements for pension funds is far more straightforward than those of an insurance company – the former relatively basic, the latter far more complex due to the need for: 1) General Account requirements for U.S. GAAP, Statutory and Tax accounting and reporting, which requires multiple accounting bases or books. 2) Statutory accounting and reporting associated with Separate Accounts. Once again, a phased implementation approach to technology consolidation will be critical to minimize disruption for staff and clients.

When ABOR is in the picture, the acquiring entity must establish the appropriate cost basis for pro forma accounting purposes. For example, when a U.S. insurance company's assets are acquired, the accounting forth investment portfolio is typically treated as a going concern for STAT purposes, with the assets retaining their original acquisition dates and amortized cost, whereas GAAP and IFRS will establish a new cost basis for the assets at fair value as of the closing date of the deal. In GAAP terms, the step-up to fair value is referred to as Purchase GAAP or "PGAAP". Another major consideration from an ABOR perspective are the adjustments that will be necessary to record the "financial impact" – affecting both the balance sheet and income statement – resulting from converting assets from one accounting system to another.

The required adjustments are due to the inevitable differences in amortized cost or "Book Value" methodologies between the two accounting systems. The underlying calculations are extremely complex, while the related accounting guidance (for example., FAS 91/ASC 310-20, EITF 99-20/ASC 325-40.) is often subject to broad interpretation. The net effect is differences in the manner in which the guidance is interpreted and implemented in the two accounting systems – often concentrated in the more complex asset types such as MBS/ABS securities and

related variants. In addition to quantifying the required adjustments, it is critical to do a deep dive to understand the root causes and to rationalize and support the proposed adjustments to key accounting stakeholders including senior management and the auditors.

Implementation with Minimal Disruption

As noted earlier, smooth operational and technology integration is also one of the biggest challenges. It behooves the parties to work with an independent solutions and services provider with a track record in managing asset management acquisitions and transitions, with the overriding goal of ensuring no adverse impacts on client relationships. A successful integration starts with a key process and system architecture review that paves the way to a multi-phase implementation roadmap, each phase designed with the desired end state in mind.

Early phases focus on due diligence, knowledge transfers, key process documentation, technology assessments, and corporate infrastructure integration. The later phases of the project would include system development, process redesign and reengineering, third party integration, user acceptance testing, and parallel processing. Strong governance and project management throughout the process will ensure open communication among all parties involved, timely identification and resolution of issues, and ultimately an on-time, on-budget implementation.

Gain from an Objective Outside Perspective

The factors covered here underscore the sheer complexity of a large-scale transition of people and assets from an integration and accounting standpoint. There are many significant considerations such as data integration from legacy systems, risk management, tax impact, and more – all covered in detail in the full-length piece. Each demonstrates a common thread: the need for deep technology and operations expertise specific to asset management. Rather than trying to resolve these issues on your own, it pays to engage an experienced solutions and services provider at the earliest stages of the transaction. Along with the latest technology, the right partner should also bring an understanding of the nuances of complex investment instruments and asset classes, as well as knowledge of global accounting standards, tax requirements, and regulatory regimes. The benefits of an acquisition may be clear, but the path to achieving them is far less so.

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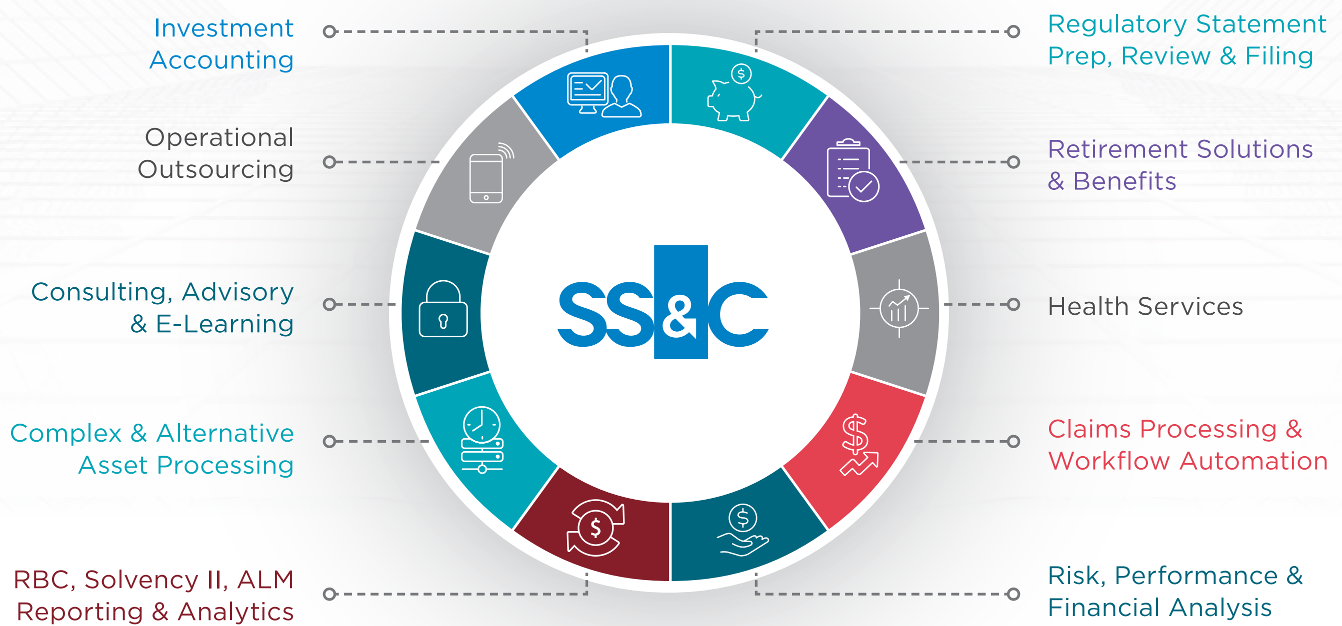

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