Scaling new heights

M&A integration in wealth & asset management

EY

Building a better working world

Contents

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Foreword

Confronted by market volatility, increasing competition and an uncertain economic outlook, wealth and asset managers have actively pursued M&A to build scale, develop new specialisms and confront the threat posed by new entrants, including nimble FinTech companies. The pressure to deliver the returns expected from these transactions is intense.

This is the context in which we undertook our second global financial services M&A integration study *Scaling new heights*. While across the wealth and asset management sector, artificial intelligence is increasingly playing a key role in many business processes, planning and delivering the integration of an acquisition remains a very human challenge.

Encouragingly, many businesses have risen to the challenge, with well-prepared integration plans designed to begin delivering returns on investment from day one, while simultaneously ensuring ongoing operational stability. Our research reveals that wealth and asset managers engaged in M&A are planning their integration strategies early, developing operating models that can be implemented as soon as the transaction closes, and focusing on communication with key stakeholder groups at every stage of the deal process.

In addition, the executives from leading wealth and asset managers interviewed for this research have ambitions to do even better. Many stress the importance of building more robust governance policies that enable the business to track integration performance at a granular level and to hold the executives to account.

This attention to detail will be vital to future integration plans and the experiences shared by respondents to this research provide key new insights about exactly where the spotlight should now fall for all those focused on successful integration following an M&A transaction.

We would welcome the opportunity to share more details about these findings and discuss their implications for how your organization approaches M&A integration. Please get in touch with one of the key contacts listed at the end of this report or your regular EY Wealth and Asset Management contact.

Key findings

In this survey, we analyze a number of similar areas to our survey on M&A integration in the financial services sector, conducted in 2015. We have used the results to identify key trends and delve deeper into a number of areas, identifying new insights for those undertaking integration in the wealth and asset management sector.

Key developments since the 2015 survey

Integration planning pre-signing is no longer just best practice, it's become a minimum requirement: 90% of respondents say they start integration planning pre-signing, compared with only 60% last time.

Almost half of wealth and asset management (WAM) deals involve a transitional services agreement (TSA), whereas only 18% were carve-outs in 2015. These agreements can help expedite getting to deal closing, but add complexity to the integration approach.

More value is being created: 57% say they now generate cost synergies of more than 30% of the target's cost base, compared with only 20% last time. We believe this is primarily driven by the significant uptick in the number of domestic deals (85% this time compared with 26% last time).

Only 3% of respondents have more than 50 internal integration resources, compared with 56% last time round. As deal sizes were similar in our last survey, this may point to greater outsourcing or a general lack of resources for dealmaking.

New findings in this survey

Operational stability on day one and in the first 100 days is a priority for WAM executives (ranking the top three). However, starting to generate synergies is the highest ranking overall priority.

Even though 52% say they leave the target to operate on a stand-alone basis, no-one is taking out less than 10% of cost synergies.

In only 3% of deals did the target move to the acquirer's digital platforms.

Significant focus and attention is now on managing the customer experience and protecting innovation levels in the business, particularly in light of wealth and asset managers using M&A to acquire new or enhanced capabilities.

WAM businesses expect new technologies such as enhanced data analytics, artificial intelligence and robotics to dominate future integrations and target operating model design.

On average, 82% of respondents say they left 50% or more of the target's IT systems in place in the target operating model, suggesting value is potentially being left on the table.

Over a quarter see having greater discipline over synergy planning and tracking as the number one factor they need to improve.

On average, 70% to 30% is the split between internal and external resources on integration.

Not many WAM respondents have an integration playbook (25%), but the majority (70%) think they should have one.

Preparing to integrate

Early planning, a keen focus on operational stability and an emphasis on communications are the keys for wealth and asset managers at the beginning of the integration process.

As wealth and asset managers proceed toward completion on a transaction, they are naturally anxious to begin executing on their deal drivers from day one. At the same time, they're acutely aware of the need to ensure the business is able to continue functioning effectively following the change of control. Integration planning is no longer just best practice, but a minimum requirement during M&A.

This research suggests wealth and asset managers are at a good stage of readiness by the time they complete transactions. They have planned ahead for the integration stage and beyond. Ninety percent begin integration planning before signing, compared with only 60% the last time this survey was carried out, in 2015.

More than half the respondents (53%) say they had already developed a high-level operating model design by the time the deal was signed, while almost as many (48%) had defined integration strategies in place. Half say they had developed a case for exploiting potential synergies (50%).

Wealth and asset managers are also at pains to keep key stakeholders informed of their progress and plans; almost two-thirds (63%) say they have a communications strategy in place at deal signing. This is encouraging, given the importance of reassuring and supporting key constituencies such as employees and clients.

The bottom line is that it's never too early to start planning. "Even as the deal was announced, we had an integration strategy in place, including a very high-level

Wealth and asset managers warn that organizational design is their single biggest issue as they ensure people readiness on day one after a transaction closes: 54% say the risk of a failure of planning is one of their top two concerns.

Figure 1: Which of the following did you have in place at signing or deal announcement? (All that apply)

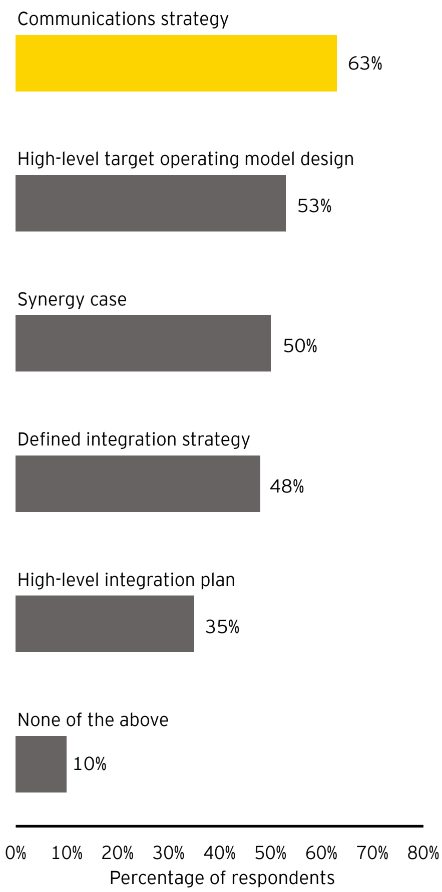


Figure 2: When planning for day one and the first 100 days post-closing, what were the key priorities? (Rank from one to three, where one is most important and three is third most important.)

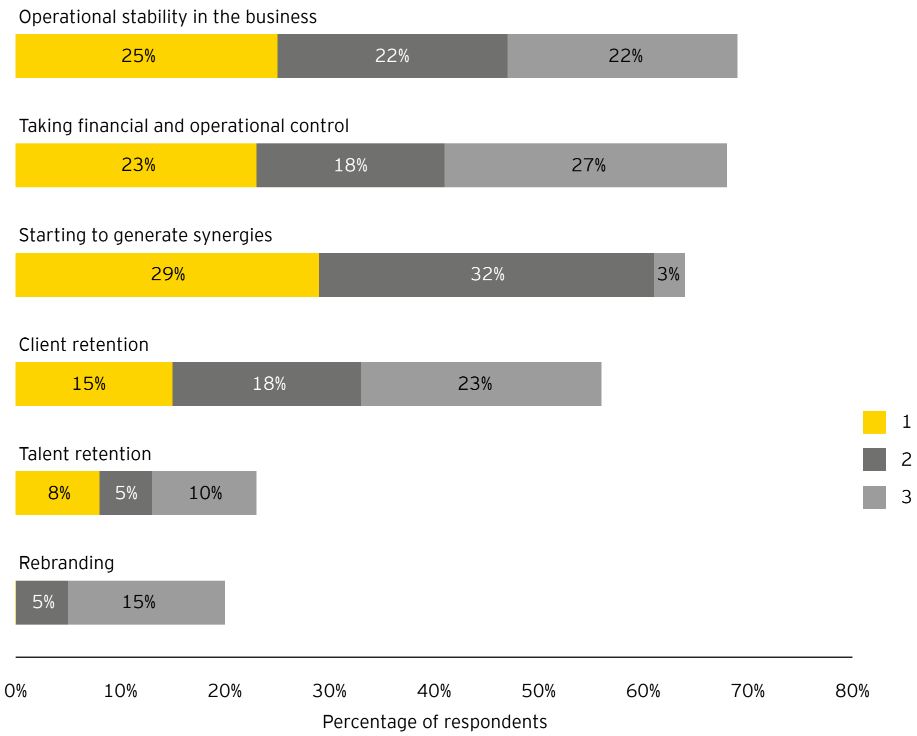
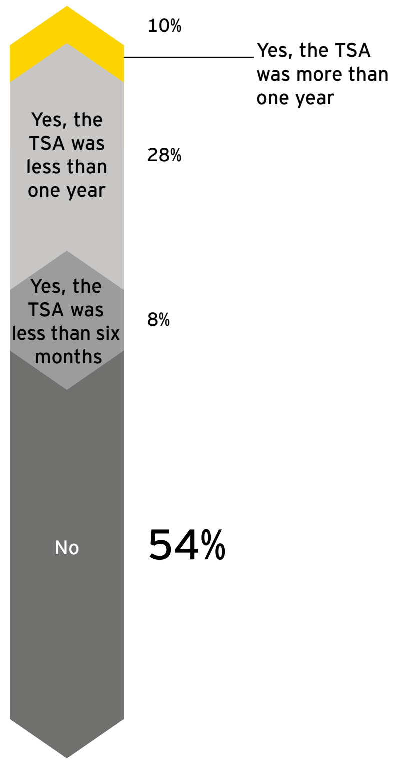


Figure 3: Did your acquisition involve the target being carved out of a parent group and, therefore, transitional services between the seller and you as the buyer?



operating model design," says the chief strategy and investment officer of a European wealth management business. "We wanted to identify all the synergies we could create really early on; we then had a very flexible integration plan in place, in order to deal with the risk of unexpected developments."

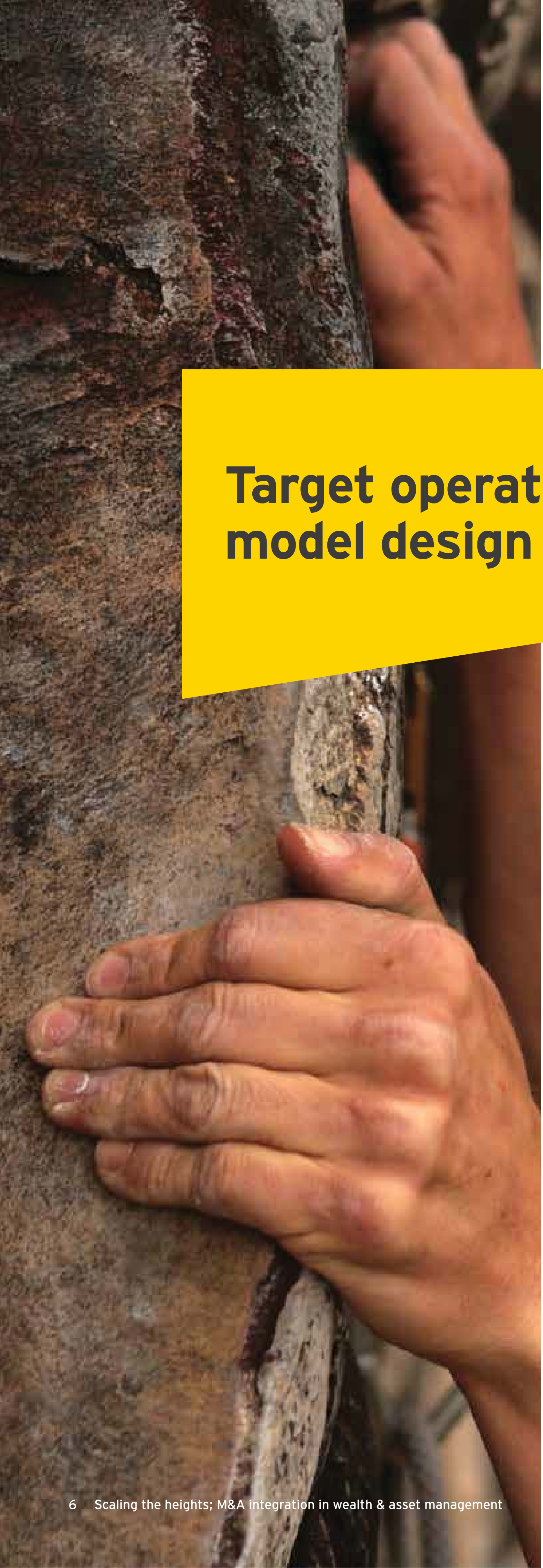
Wealth and asset managers are acutely aware of the need to balance operational stability with pursuing their growth ambitions. That dual sense of purpose can be seen in Figure 2. More than two-thirds (69%) of respondents say ensuring operational stability is a priority from day one and in the 100 days following the close of a transaction; almost as many (68%) point to the importance of taking financial and operational control. After these, come the deal drivers: close to two-thirds (64%) stress the need to start generating synergies, while more than half (56%) cite client retention.

Ensuring operational stability may not be straightforward, particularly where the business acquired is being carved out of a larger group. Away from its parent, the business may lack the basic infrastructure and support it needs to function.

In this context, significant numbers of transactions feature TSAs, enabling the business acquired to continue sourcing key services from the seller until it is integrated into the acquirer. Such agreements can help get the deal over the line, though they do add complexity to integration.

In fact, close to half the respondents in this research (46%) put such a TSA in place most commonly for up to a year following completion.

However, the nature of the industry means that the number of respondents who say they did not have a TSA is higher than in other areas of financial services (Figure 3).



Target operating model design

The majority of wealth and asset management firms leave their targets as stand-alone businesses. And, more than any other financial services sector, the target's digital channels are often left untouched.

The most common transaction process in financial services M&A is for the acquirer to move the target business on to its operating model as soon as possible, in the interests of integration and synergy realization. In wealth and asset management, by contrast, more than half the respondents in this research (52%) say they opted to leave their target operating on a stand-alone basis following the transaction.

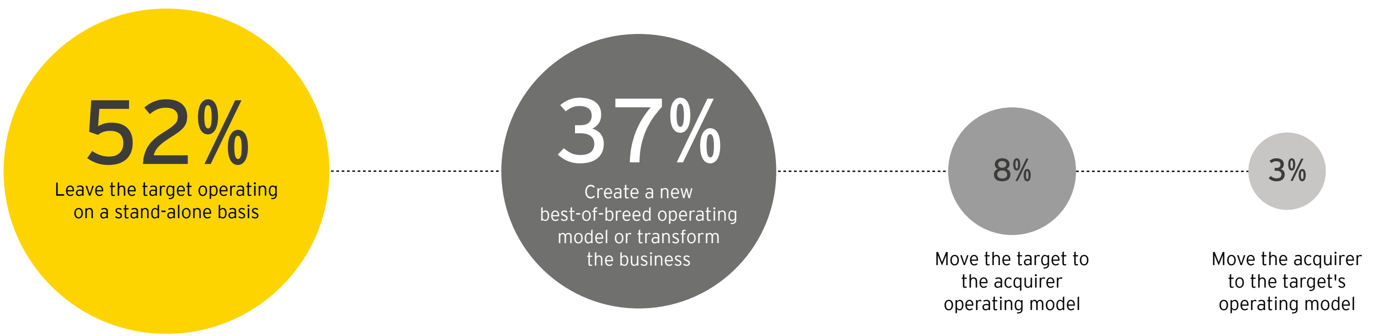
This is likely to reflect the rationale for the deals in question – it may be, for example, that a significant number of transactions in the sector were made to plug gaps in the market or product coverage. Leaving businesses with existing and functional operating models in such cases may make more sense, though it will also mean that synergies are harder to realize.

Equally, however, M&A is often undertaken as part of a transformation process, particularly in an industry now seeing significant disruptive threat from trends such as digitalization and FinTech growth. More than a third of respondents (37%) say they cherry-pick elements of both operating models following their transactions, to create a new "best-of-breed" model ready for future challenges and opportunities (Figure 4).

Digital dynamics

This desire to move towards a new approach was particularly evident in the digital arena, with more than a third of respondents (34%) opting for a new core product platform for their digital channels following the transaction. A further 47% say they opted

Figure 4: What was your overarching approach to target operating model design?



to retain the platforms of both acquirer and target (Figure 5).

In Asia, for example, the head of strategy and development at one asset management business says its most recent transaction was largely predicated on the need to acquire new digital capabilities.

"We wanted to better target digital channels and the acquisition gave us access to up-to-date, secure technologies that were far more advanced than ours," the executive explains. "We retained some of our systems, but took the best of theirs."

Nevertheless, the financial services industry has a long history of legacy IT issues when integrating technologies following deals, and the research suggests that problem is continuing.

More than three-quarters of respondents (82%) say that over half their target's IT systems remained in place following their post-deal integrations, including 47% who say three-quarters of this infrastructure had been retained (Figure 6).

This is potentially problematic for businesses challenged by new entrants to the wealth and asset management sector, who aren't typically saddled with legacy IT issues and are therefore often able to respond quickly and flexibly to changing market dynamics. As digitalization continues, IT complexity may dull the response of some businesses in the sector.

Indeed, while it may feel easy to leave systems in place, it makes sense to decommission and eradicate as much legacy technology as possible. There may be regulatory considerations around data retention – and it may save time and cost not to migrate this data to new systems – but it's important to not leave unnecessary complexity in the organization.

Despite the significant numbers of wealth and asset managers opting to leave targets operating on a stand-alone basis, respondents point to a significant degree of functional integration following transactions. In the areas of investment management (79%), investment operations (71%) and sales and distribution (69%), respondents all say integration had been complete or close to it. Only in the finance, treasury and tax function was integration seen as less thorough (Figure 7). These numbers imply that, while wealth and asset managers may indeed be leaving some elements of their acquisitions to continue operating on a stand-alone basis, in many cases, there will be at least partial integration.

Figure 5: Which core product platforms did you select for the end-state target operating model?

	Digital channels	Core banking system
Acquirer system	3%	26%
New solution	34%	26%
Retained both	47%	43%
Target's system	16%	5%

While wealth and asset managers may be leaving some elements of their acquisitions to continue operating on a stand-alone basis, in many cases there will be at least partial integration.

Figure 6: Indicatively, what percentage of the target's IT systems remained in the end-state target operating model?

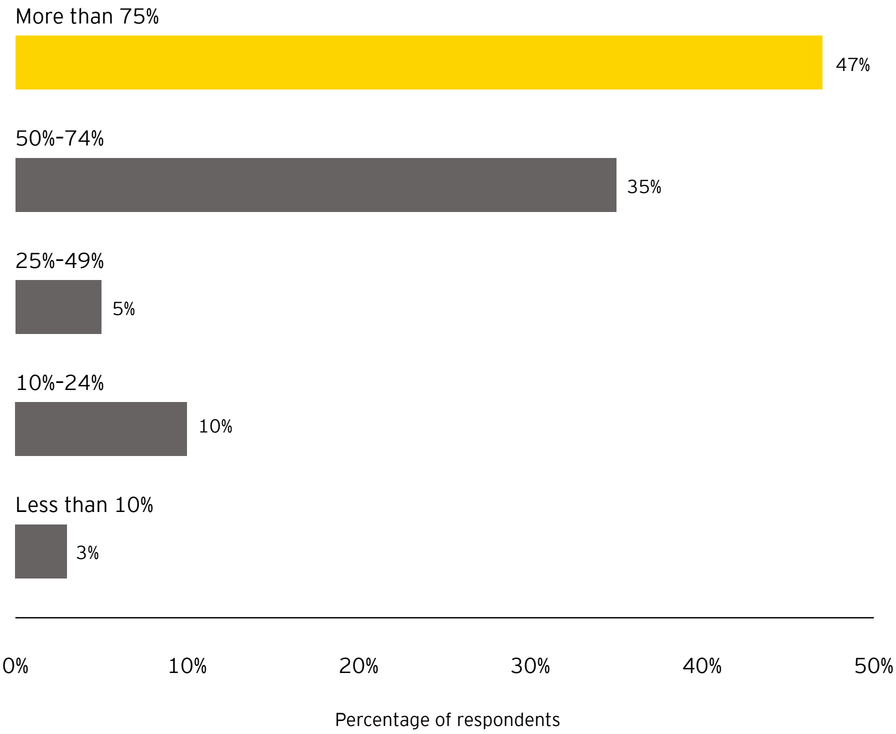
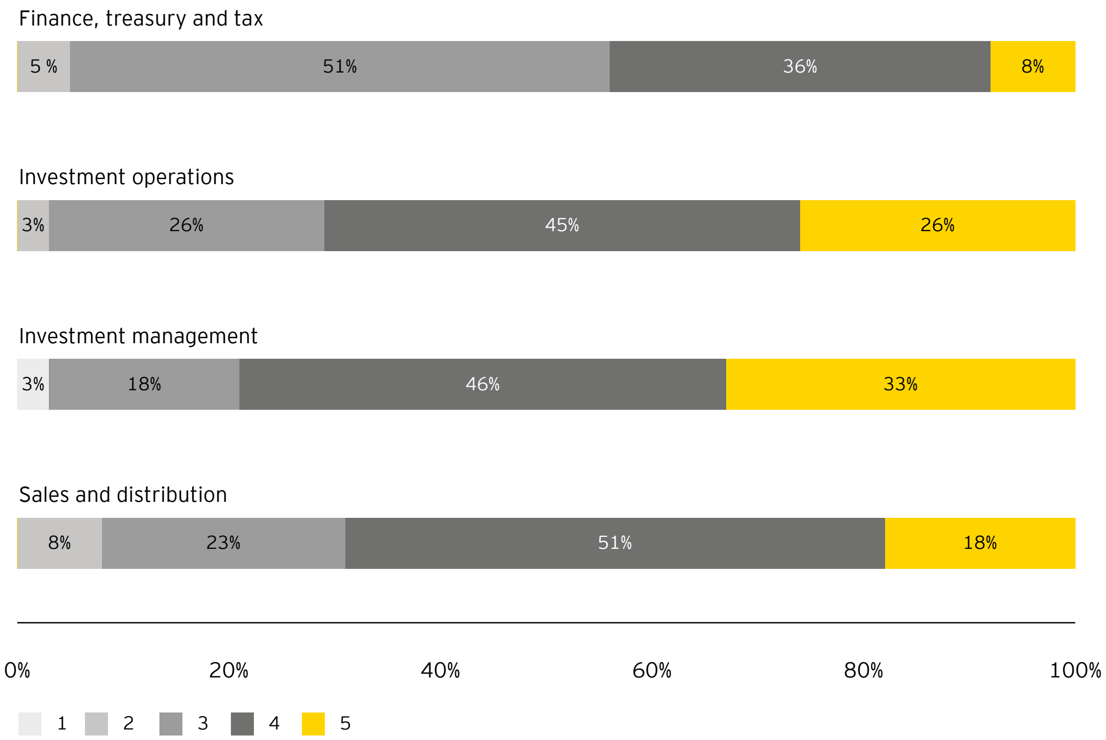


Figure 7: What were the achieved levels of integration for each of the following functions or teams in the end-state operating model? (On a scale from one to five, where one is not at all integrated and five is completely integrated.)



79%

say that integration of the investment management function was complete or close to it in the end-state operating model.

71%

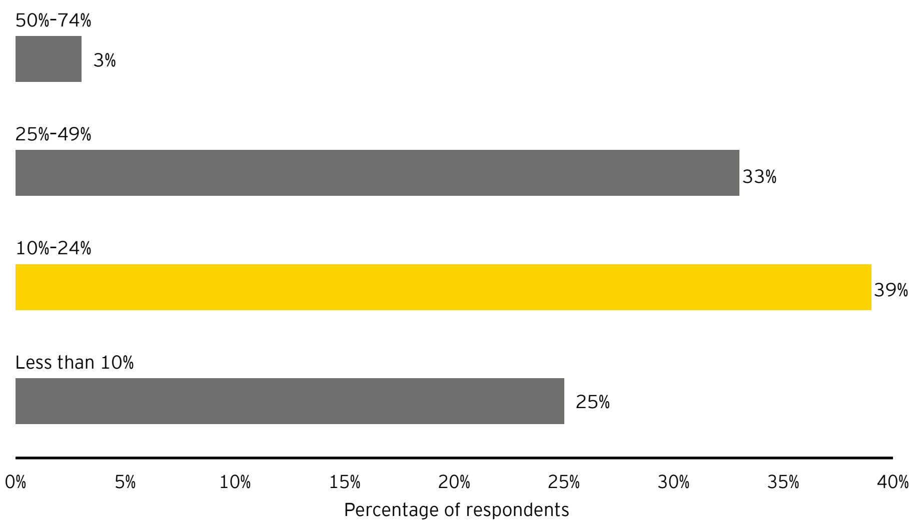
say this was also true of investment operations in the final operating model.

Managing the integration

When it comes to managing the integration process, wealth and asset managers are improving client relations via integration, but it is a different story for employee retention.

Given the value of human capital in the wealth and asset management sector, retaining talent is very often a priority for businesses making acquisitions. Some losses may be impossible to avoid — and even desirable, where cost synergies are planned for — but employee and management retention strategy should be an important element of pre-completion planning and post-deal integration.

Figure 8: What percentage of employees in the target company left within the first year following the transaction?



However, according to our survey, 36% of respondents say that at least a quarter of the target's employees left the firm in the first year following the deal's completion, while a further 39% say between 10% and 25% of staff had departed. Those figures may have disappointed some firms — it may be that they are not yet doing enough to ensure employees remain committed to the group following a transaction (Figure 8).

The chief strategy officer of a North American wealth and asset management company says the key is to address these issues at the earliest stage possible.

"One major priority in our most recent transaction was to handle the target's employees and its management very carefully, to ensure no-one would feel uncomfortable working with us," the executive says. "We worked closely with our HR team to develop policies that would help retain those employees and improve the office environment."

Clients stay onside

More positively, wealth and asset managers report good success in ensuring clients are not unnerved by transactions. Half of the respondents (50%) say the client experience at the target company had actually improved during the integration process, with that figure rising to almost three-quarters (72%) once the integration was complete (Figure 9).

36%

say that at least a quarter of the target company's employees left within the first year following completion of the deal.

39%

put this figure between 10% and 25% of staff.

The number of people — and their quality — will be the crucial determinant in how quickly and smoothly the integration process will move forward.

The figures suggest respondents have worked hard to communicate with customers during transactions, taking the opportunity to build strong and enduring future relationships.

Still, while acquirers are confident about their ability to deliver customer value through the integration process, the proof of this will lie in their ability to retain customers and deliver on their growth objectives. Importantly, this issue has been a primary focus for most acquirers, with action taken to mitigate the risk of eroding customer goodwill because of a transaction.

Figure 9: What impact would you say the integration had on the client or customer experience of the target company?

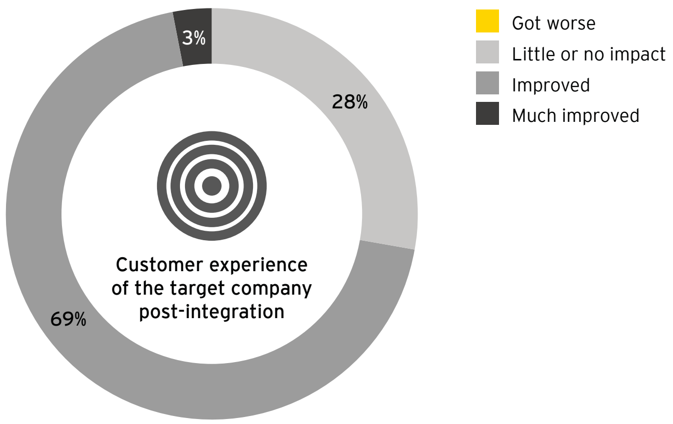
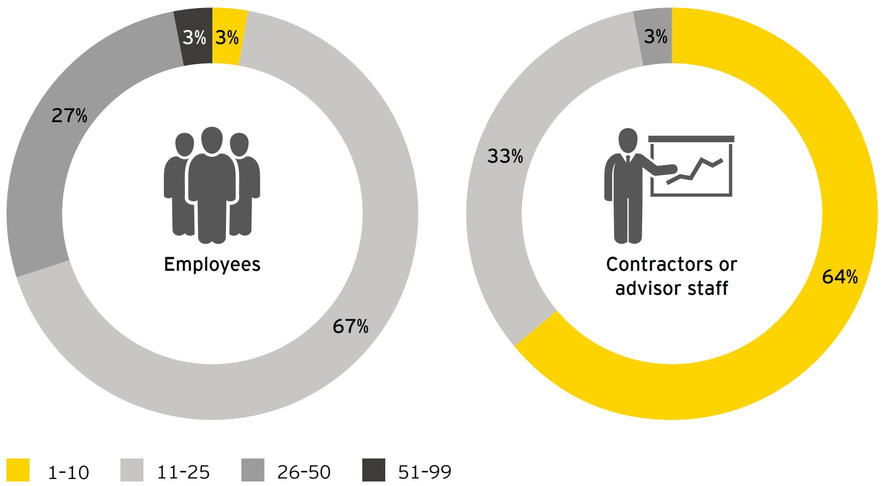


Figure 10: Please indicate the number of people on your dedicated (i.e., more than 50% of their time spent on integration) integration team.



Such impressive results reflect the significant resources now devoted to integration. The number of people — and their quality — will be the crucial determinant in how quickly and smoothly the integration process will move forward. That is likely to be a key factor in the extent to which employees feel moved to seek new opportunities elsewhere, or clients feel that the business is not prioritizing their needs.

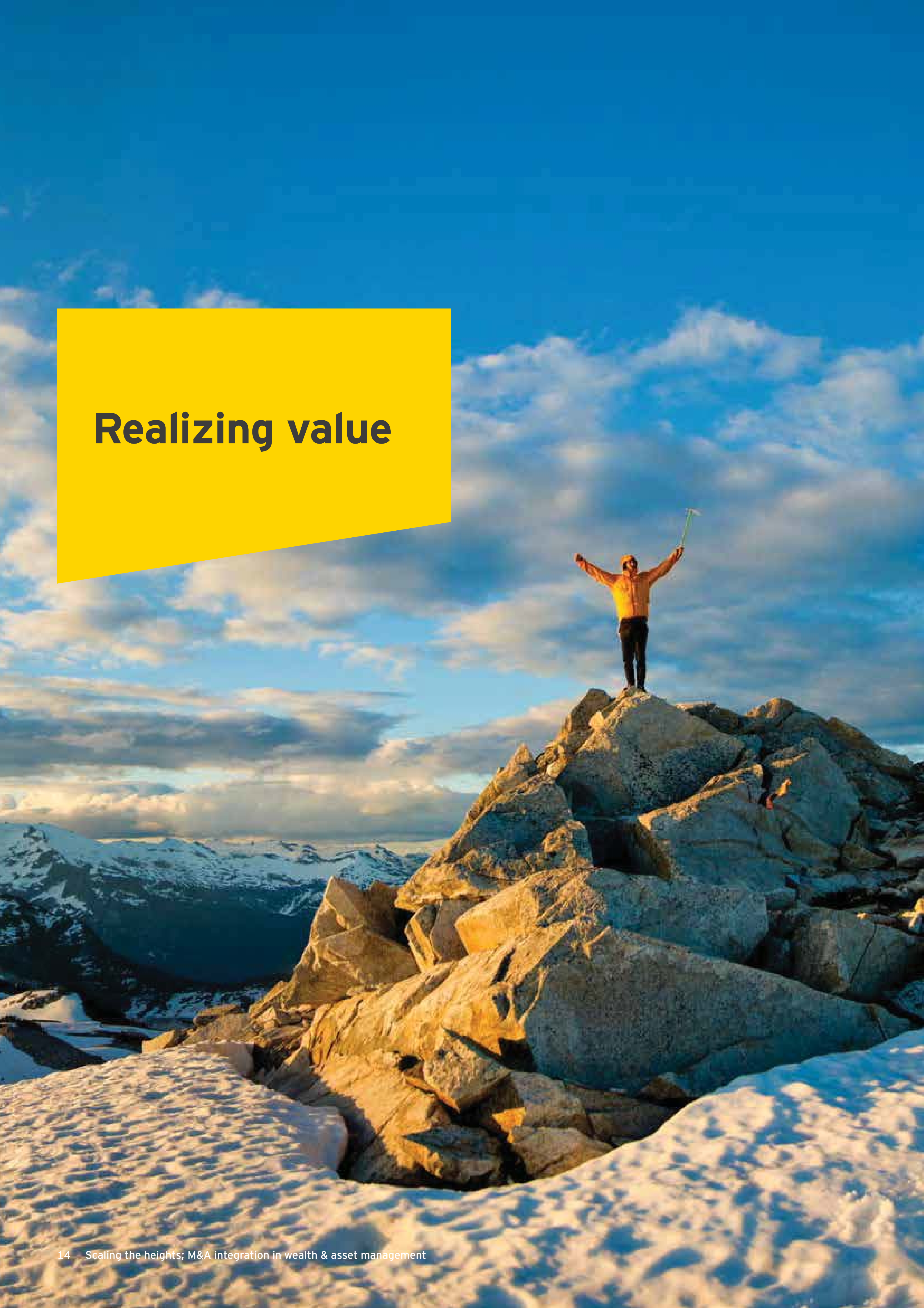
Most respondents in the wealth and asset management sector do now have dedicated integration teams set up to handle M&A work, though they remain relatively small compared to other parts of the financial services industry.

Just over two-thirds of respondents (67%) say they have integration teams numbering between 11 and 25 employees, with a further 30% having greater numbers. These teams may be supplemented by contractors and advisors — almost two-thirds of respondents (64%) have up to 10 such consultants (Figure 10).

Not that it is numbers alone that make for an integration team capable of delivering the high quality of work required. Asked to pick the characteristics required from a high-performing integration team, respondents say they value experience, leadership, punctuality, communication and teamwork above all (see Figure 11).

Figure 11: What words best describe a high-performing integration team? (Free-form response)

Realizing value



Wealth and asset managers state that financial synergies create the most value – unfortunately, they are also the hardest to realize.

Wealth and asset managers look to derive a broad range of benefits from M&A transactions, including several different types of synergy. These may include bottom-line savings from cost reductions and improved efficiency, as well as revenue gains that will drive top-line growth.

Finding new opportunities to grow revenues through distribution synergies – and expanding digital distribution capabilities – will be vital to asset managers, as organic growth remains a challenge for many industry players.

There can also be a number of valuable financial synergies. These include enhanced capital efficiency following post-deal integration and restructuring; the reduced borrowing costs that may accrue from a better credit rating or an improved tax profile courtesy of relocation or reorganization.

In fact, respondents see financial synergies as having the greatest potential to deliver value of the three, significantly ahead of cost and revenue synergies, where the value available is seen as broadly similar – however, realizing that potential will not necessarily be straightforward. Wealth and asset managers are more likely to find it easier to secure cost synergies than financial or revenue gains (Figure 12).

In North America, the head of strategy at one wealth management firm suggests the key is to take synergies step-by-step. "Tax synergies were the first thing we managed to get from the integration particularly through our real estate acquisitions," he says. "Revenue synergies have been difficult to generate, especially in the short run, but we are slowly focusing on these. We also have an ongoing program to reduce costs and squeeze our further returns from our acquisition."

There is certainly plenty of value in focusing on cost. Almost a fifth of respondents (18%) say they were able to achieve cost synergies worth more than 40% of their target's cost base by the end of the integration process.

Respondents see financial synergies as having the greatest potential to deliver value, significantly ahead of cost and revenue synergies, where the value available is seen as broadly similar.

Figure 12: Please rank the factors that created value in your transaction and the ease with which that value was realized. (Ranked from one to three, where one is least value created or hardest to realize and three is most value created or easiest to realize – mean shown.)

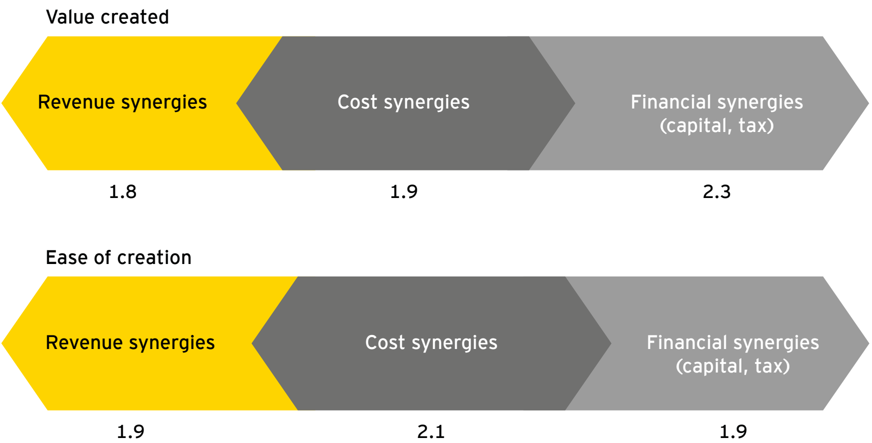
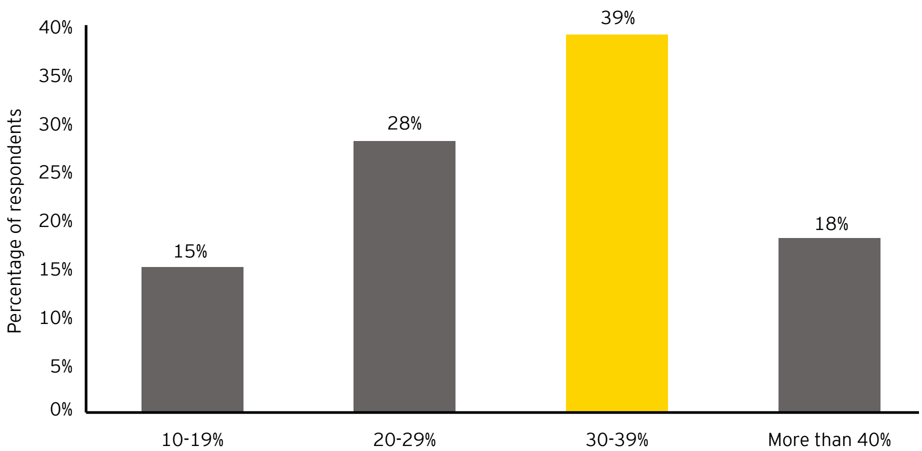


Figure 13: As a proportion of the target's cost base in dollar terms, what were the annual cost synergies achieved in the end-state, post-integration?



63%
say that they ensured every synergy is linked to a trigger point in the integration plan that can be tracked.

40%
of respondents believe product and service innovation accelerated during their post-deal integration work.

A further 39% say they delivered synergies worth between 30% and 39%. Clearly, plenty of value is being realized from cost synergies, even before the more difficult challenges of financial and revenue returns are confronted.

Such success partly reflects the commitment made by many respondents to driving through and monitoring the realization of synergies during the integration process. Almost two-thirds of respondents (63%) link back each synergy target to a specific integration deliverable and track progress toward it. More than half (58%) commission independent audits or reviews of what has been achieved.

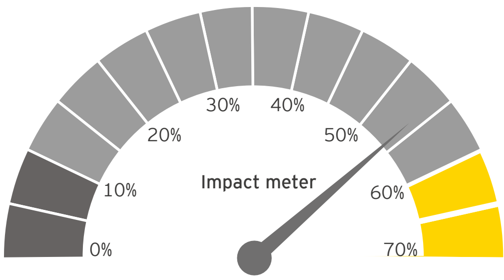
Many companies are also working hard to ensure they hold executives accountable for delivering the synergies promised during the deal. For example, half the respondents (50%) have built synergy targets into the individual performance management plans of their executives. That may result in an impact on executive remuneration if such targets are not met.

At some firms, however, there is room for improvement. More than a third of respondents (40%) say they do not track synergy plans distinctly once a transaction has completed; instead, they merge these targets into the business plan. This lack of transparency could make it more difficult to drive through the expected gains and to hold those responsible for delivery to account (Figure 14).

It's also important that integration teams do not get overly fixated on one set of deliverables — objectives other than synergies will be important. In this context, it is encouraging that 40% of asset and wealth managers say product and service innovation are accelerated during the integration process following a deal. This suggests that businesses hoping for transformational benefits from their M&A are beginning to get results (Figure 15).

This speaks to an important challenge for the sector — particularly for businesses that see revenue synergies as tough to obtain during integration. Innovation can be the key to unlocking further growth — and therefore contributing to those revenue strategies — so acquirers need to focus on this value-adding activity.

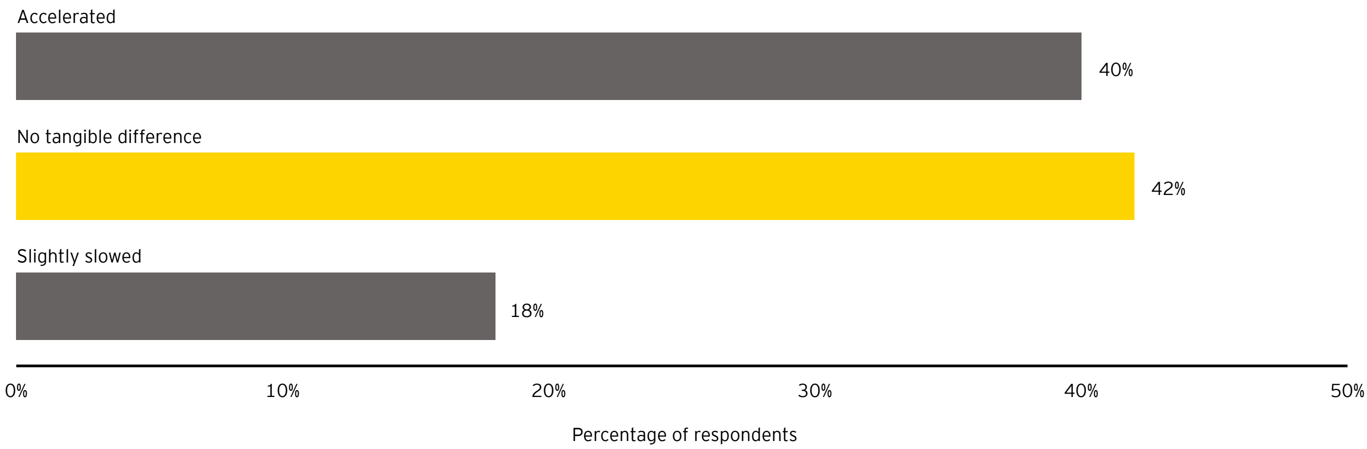
Figure 14: Which of the following methods did you use for driving and monitoring synergy realization? (All that apply)



Every synergy linked to an integration deliverable or milestone and tracked by the Integration Programme Management Office (PMO)	63%
Commissioned independent audits or reviews of benefits realization	58%
Targets built into executive management's individual performance plans	50%
Merged into the business plan post-deal completion and not tracked distinctly thereafter	40%
Not specifically tracked or monitored	3%

Many acquisitions are all about acquiring new capabilities — to improve distribution, for example, so leveraging these capabilities for innovation and growth will be vital.

Figure 15: During the integration, was there an impact on the level of product or service innovation in your business?



Looking ahead

There are a number of areas ripe for improvement in integrations, according to our survey, from communicating with stakeholders to synergy planning and tracking.

With M&A activity continuing in the wealth and asset management sector, respondents are keen to learn the lessons of each transaction so they can improve the integration process in each subsequent deal. For example, the head of finance at a North American wealth manager says: "Based on our previous transactional experience, we made changes to improve and speed up decision-making in our most recent transaction, which helped us realize the gains we expected from the deal more quickly than in previous cases."

Survey respondents cite a range of areas where such improvements might be possible. There are two areas picked out most frequently. Almost three-quarters (73%) suggest they could do a better job of communicating with stakeholders, while almost two-thirds (65%) highlight the need for effective governance, decision-making and program management.

Figure 16: What factors could your firm improve upon in future integrations? (All that apply and most important)

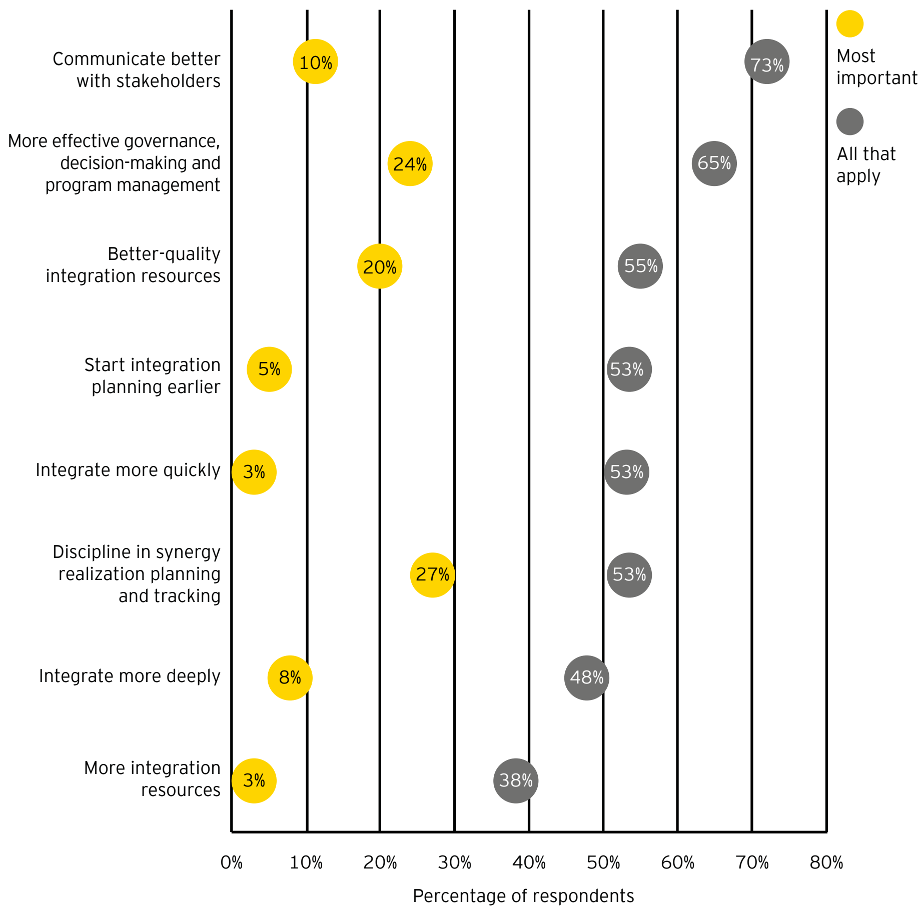


Figure 17: Do you have either of the following in-house?

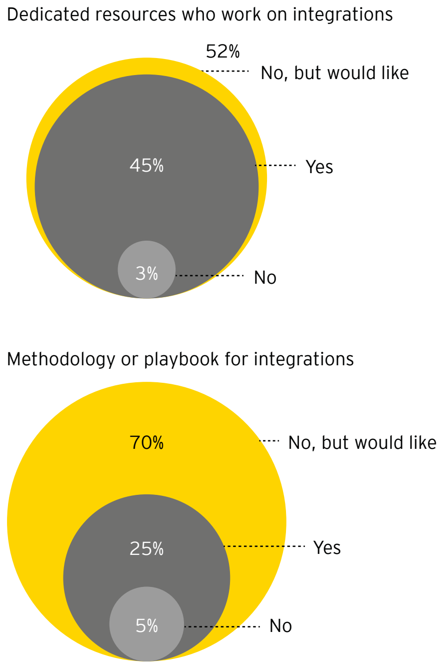
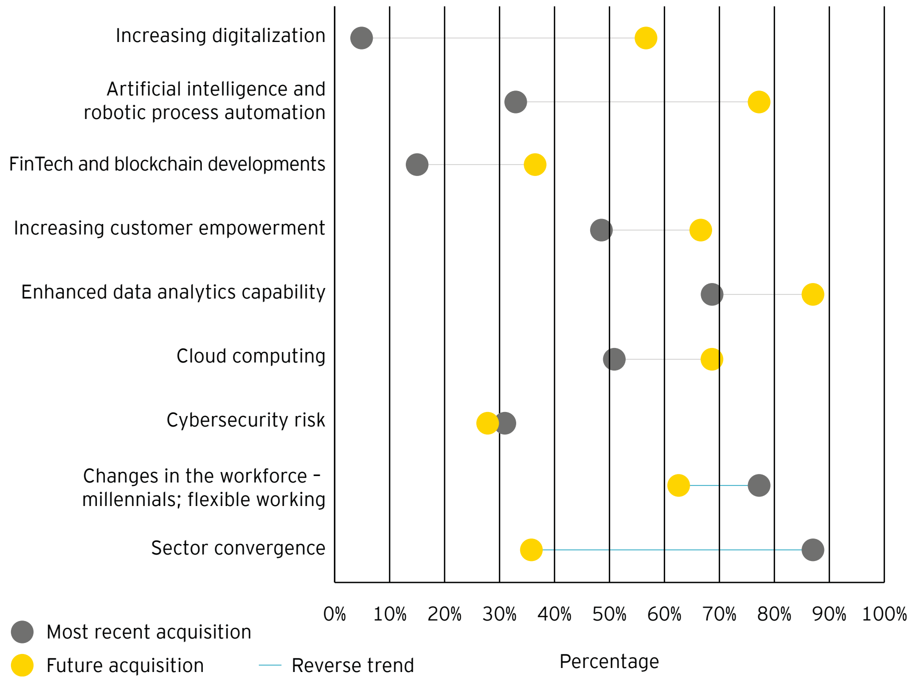


Figure 18: Which of the following trends had an impact on your most recent integration? Which of these trends do you expect to impact the integration of future acquisitions?



Executives also cite their determination to do more work prior to the deal completion – to put in place well-developed target operating model designs and to drill down into the detail of synergy realization. Preparation is everything.

Inevitably, priorities will need to be agreed according to where the impact is likely to be greatest. Nearly a quarter of respondents (24%) suggest governance is of critical importance, but more than a quarter (27%) point to the need to be more disciplined in planning and tracking the realization of synergies. With synergy goals featuring so highly among the drivers of many deals, this area is especially important (Figure 16).

In practice, the responsibility for delivering improvements of this type is likely to fall on the dedicated integration teams; many wealth and asset managers have now set up to provide specialized resource during M&A transactions. Almost half the respondents (45%) now have such teams in place, while almost all of those that don't say would like to follow suit.

Another strategy also employed by significant numbers of respondents is to have an agreed process in place for dealing with integration. A quarter of respondents (25%) say they have a deal "playbook" that sets out the methodologies to be followed during integration work. Most respondents that have yet to develop such a resource would like to do so.

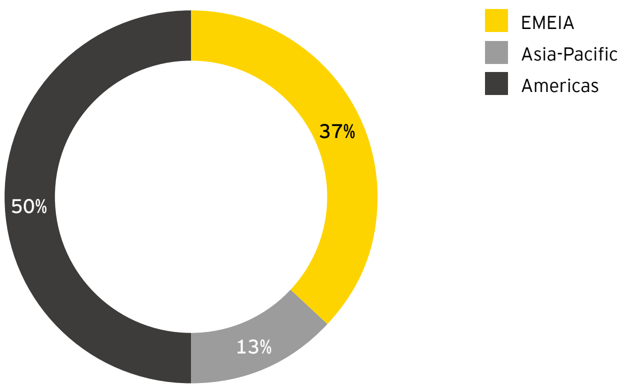
Future trends impacting integration

The big advantage of having resources such as dedicated integration teams and deal playbooks is that the business does not come fresh to each transaction. Experienced integration teams follow the practices that worked well on previous deals, while seeking to improve on areas where the outcomes were more mixed. However, this is not to suggest that a one-size-fits-all approach is the right way to tackle integration – in practice, every deal will be different, according to its nature and the prevailing market dynamics.

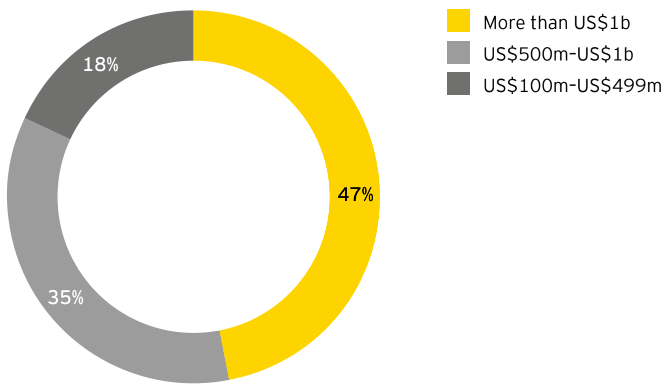
Respondents point to trends such as sector convergence, changes in the workforce, and enhanced data analytics as having the biggest impacts on their most recent transactions (see Figure 18). But, while the latter trend is expected to remain important, respondents suggest different themes will become more significant in future integration processes. More than three-quarters (77%) see artificial intelligence (AI) and robotics as likely to impact future integrations, while 69% cite cloud computing. That will require dedicated integration teams to shift their approach in future transactions – and to deploy playbooks in a way that is appropriate to the prevailing themes.

Demographics and methodology

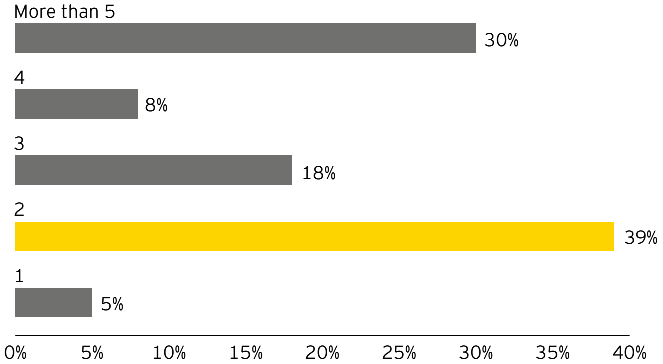
Region



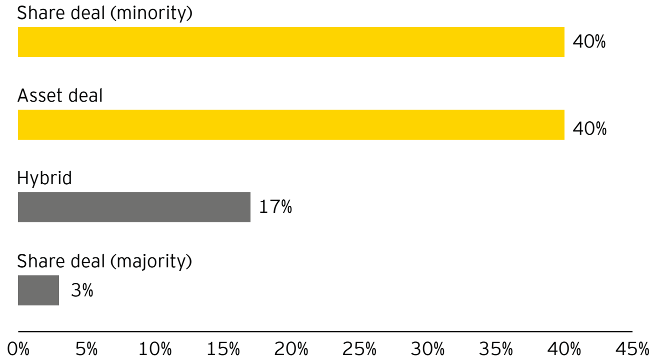
What was the value of the acquisition? (Please select only one option.)



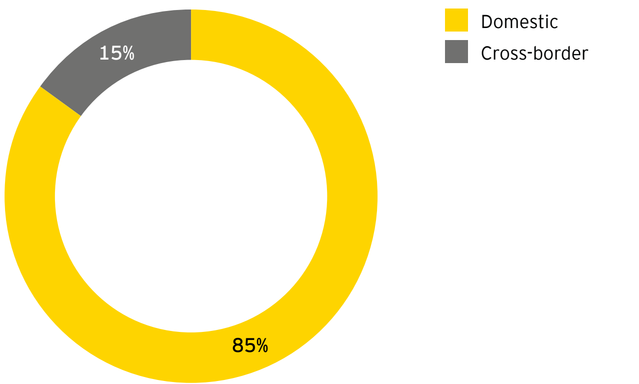
How many financial services acquisitions has your firm undertaken in the past 36 months?



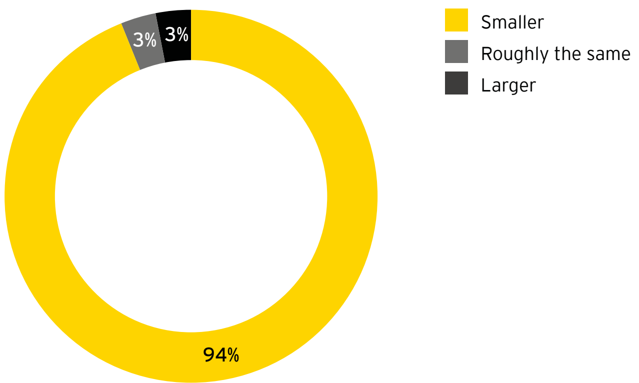
What type of deal structure was it? (Please select only one option.)



In terms of geography, how would you categorize your transaction? (Please select only one option.)



In comparison to your existing business, what size was the target? (Please select only one option.)



About the research

In December 2016, Remark, the market research division of the Mergermarket Group, surveyed 200 C-level executives on behalf of EY. All of the financial services companies included in the survey had conducted a recent acquisition.

Those surveyed occupy a range of senior roles, such as CFO, strategy director, head of M&A and integration director. To be eligible for the survey, companies in the banking sector required revenues (defined as net interest income, fees and commissions, and other income) greater than US$8b.

The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone by appointment, with the results analyzed and collated by Mergermarket. All responses are anonymized and presented in aggregate.

About Remark

Remark, the events and publications arm of The Mergermarket Group, offers a range of publishing, research and events services that enable clients to enhance their own profile and to develop new business opportunities with their target audience.

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