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Bigger is better: four issues to address as sponsor consolidation deals increase

With sponsor consolidation mergers on the rise, firms need to consider complex restructurings, LP engagement, bespoke pricing challenges, and additional regulatory requirements.

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Consolidation among asset managers involves dealing with a host of complex legal issues.
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In the second half of 2023, voices in the private equity industry forecasted that asset manager M&A and consolidation would become increasingly commonplace, but few would have predicted the wave of transformative transactions recently announced, including BlackRock's deal for Global Infrastructure Partners, and General Atlantic's acquisition of Actis.

Navigating such complex deals is often challenging, with deep experience as well as cross-practice and cross-border legal expertise required to close successfully.

Structuring transactions

Acquisition structuring for these deals is rarely simple. The purchase of shares in a single parent company would be the ideal, but is rarely the norm. Transactions often involve a carve-out or spin-out of different verticals from an existing platform, as buyers may only be interested in acquiring certain funds, strategies, asset classes, and/or teams.

Unpicking a group to facilitate the acquisition of wish-list assets is complicated, so business separation and post-closing integration planning and expertise are critical. For example, early evaluation of change of control triggers in key contracts or financing facilities, and tag-along or pre-emption rights of other stakeholders will be key. Careful thought needs to be given to employee and HR issues to ensure key personnel are not lost, with incentivisation plans and workforce integration considered early in the process.

LP engagement

Thoughtful communication with the sellside's investor-base is important as the transaction may be conditional on investor consents. This includes implementing a clear and bespoke LP engagement strategy and presenting a persuasive transaction rationale to investors, without which consents may be withheld.

Sponsor consolidation transactions can disrupt interest alignment between sponsors and investors. Investors will focus on

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ensuring that investment teams are appropriately incentivised (via sponsor business potential carried interest receipts) and diligently invest and manage capital. Reallocation of carry rights to any purchaser materially diminishes the impact of fund-level incentivisation and alignment. Similarly, the investor requirement for "skin in the game" through a GP commitment creates clear interest alignment. If GP commitments will no longer be contributed by those closest to a fund's investment and management, investors may view this lack of alignment negatively. Thought should be given to whether existing fund carry and GP commitment arrangements should be left undisturbed.

Pricing

Latham & Watkins' 10th private M&A Market Study of more than 340 European transactions found that 55% of deals surveyed provided for a locked box mechanism, while 28% provided for completion accounts. However, asset management deals typically feature a more bespoke price adjustment mechanism than the standard locked box or net debt/ net working capital completion accounts adjustments seen in other types of M&A - with factors that adjust the price including regulatory capital levels, investor consents, or transferred fee income. We have seen sponsor acquirers favour earnouts as a method to align pricing expectations and accommodate bespoke metrics - consistent with an overall trend towards growing use of earnouts, particularly in financial services.

Regulatory considerations

Acquiring (or spinning-out) another asset manager's business may place the purchaser within the scope of new, and possibly unfamiliar, regulatory regimes. Careful analysis is needed to ensure that the purchaser understands, and is able to put in place the necessary regulatory permissions without adversely impacting existing purchaser operations, if such permissions do not automatically travel with the target business.

Further, acquiring direct or indirect interests in a large number of underlying portfolio assets across multiple industries and geographies requires a pragmatic approach to address foreign direct investment/ national security, foreign subsidies, antitrust, and other restrictions that could be triggered. Detailed information (which may not be readily available) on underlying portfolio assets will be required to assess the necessary regulatory filings, so early preparation and data gathering will be important to avoid delays. If information is not available, parties should consider how to mitigate the risk of missed notification, including allocating such risks between the parties.

In conclusion, consolidation is a growing trend and the associated complexities require expert, crosspractice legal advice.

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