DOL, Elections Tamp Down 2016 M&A Activity

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The level of M&A activity in the asset management industry declined in 2016, with 126 deals, down from 144 in 2015, according to PwC. This drop was led by diminished hedge fund and wealth management transactions, according to a report the firm released this week. However, despite the decrease in the number of deals, the disclosed deal value amounted to $10 billion, slightly up from $9.7 billion in 2015.

"2016 was a relatively volatile year," says Sam Yildirim, U.S. asset management M&A leader at PwC. "There was a lot of movement of assets… and… all of that sort of volatility reduced the number of transactions that were completed during the year." PwC considers mergers, acquisitions, shareholder spin-offs, capital infusions, consolidations and restructurings in its M&A report and uses data from Thomson Reuters and S&P Global Market Intelligence.

Many deals were characterized by managers seeking to protect their turf.

"Across all the sub-sectors within asset and wealth management the key theme in deal activity was consolidation, and – I would say – somewhat defensive consolidation," Yildirim says.

The defensive group included small- and mid-sized asset and wealth managers looking to gain economies of scale to safeguard their businesses from fee pressures and margin compression resulting from the new Department of Labor (DOL) fiduciary rule, expected to go into effect in April.

Another group of managers sought transactions that would expand their product lines, distribution reach and geographic footprint, according to PwC.

The year was marked by two multi-billion deals, which amounted in a combined $6 billion, compared to three such deals which contributed to $6.2 billion in 2015.

One such transaction was the $2.6 billion merger of Janus Capital and Henderson Group. The deal, expected to close in the second quarter of 2017, creates Janus Henderson Global Investors, a $320 billion asset management firm, as reported.

The firms' global ambitions, rather than some of the drivers of M&A activity in asset management identified by PwC, fueled the transaction, execs at the company have said.

"The deal does not represent a defensive move and has nothing to do with the growth of passive management," said Andrew Formica, the CEO of the new entity said in October, when the deal was announced. "Both organizations have great growth potential… but we might have lost ground with big clients if we were not a global supplier."

The drivers of M&A are expected to remain in place, fueling stronger activity in the years to come, consultants say.

"We expect to see a very active M&A scene in the industry for the next couple of years," says Yariv Itah, managing principal at Casey Quirk, a practice of Deloitte Consulting. "There are several catalysts for M&A but I would say the number one is the search for truly differentiated products."

Indeed, the growing demand for socially responsible investing fueled the acquisition of Calvert Investments, a $12.3 billion provider of environmental, social and governance (ESG) and impact investing strategies, by Eaton Vance, as reported.

Poor performance in the hedge fund market led to the lowest level of M&A activity in the space in the past 10 years, as measured by PwC. In 2016, there were 13 announced deals, compared to 18 in 2015. "With significant portion of revenues coming from performance fees, many potential sellers chose to delay any M&A-related ambitions until performance of their funds return to more healthy levels," PwC writes in the report.

Although the DOL's new fiduciary rule fueled transactions, the uncertainty surrounding it kept some firms in a wait-and-see mode, PwC's Yildirim says.

"The market is looking for the different players to evaluate the impact of DOL before they are comfortable in executing a transaction," she says. "Quantifying the impact of DOL seems like a difficult challenge right now, without really knowing with certainty if the new administration is going to defer and potentially repeal the fiduciary rule."

The wealth management space experienced a slowdown in deal activity in 2016, with 69 announced deals, down from 83 in 2015, driven by the uncertainty around the repercussions of the DOL fiduciary rule and the elections, according to PwC

"The market perceived [the] … new government being less keen on regulation [and] that boosted the share prices of companies which made the transactions a lot more expensive," Yildirim says.

Nonetheless, by other accounts, 2016 was a more active year in terms of wealth management M&A activity.

Meanwhile, Manhattan Beach, CA Investment Bank **ECHELON Partners**, recorded 138 deals amongst independent wealth management firms, a 10% increase over 2015, as reported.