

Reward and retention become key to M&A strategy

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The growing number of individual incentive arrangements has made remuneration and retention arrangements of critical importance to M&A strategy



Tim Wright

PwC (UK)
+44 20 7212 4427
tim.wright@uk.pwc.com

Over the past few years the number of individual incentive arrangements in asset management has increased substantially, making due diligence exercises far more complex than before. Historically, the idea of 'special arrangements' was the privilege of sales teams in the form of commission plans but it is now not uncommon to see targeted bonus arrangements for executives, individual portfolio managers and investment teams, together with multiple long-term incentive plans operating within a single business.

While these may have evolved in a sensible fashion for the business, they can all prove to be major headaches for both vendors and purchasers when a business is acquired (see previous article: M&A's route to growth). Subtle differences in the minutiae of design come to the fore, including whether an arrangement is discretionary or contractual and whether the plan carries special provisions on a change of control. In addition, the arrangements will highlight differences in incentive arrangements between those operating for the acquired executives and those of the acquirer. These differences can lead to major issues, particularly if the business is to be integrated.

'Change of control' events

Added to this, any acquirer can bet good money that the articulation of change of control events for the purposes of reward schemes, together with the subsequent treatment, has been high on most management teams' list of priorities. As we continue to emerge from the financial crisis, many captive asset management businesses have become increasingly uncertain about their future ownership structure and have introduced measures

to provide maximum comfort and certainty for their employees.

In some cases, this has driven a move away from generic change of control provisions to elaborate definitions, including the sale of all or part of a business, corporate restructuring, reallocation of parent company assets to other providers and a change of control at the parent company level.

On triggering a change of control, full vesting of outstanding incentive and equity awards is not uncommon. This can cause problems for an acquirer where the value of the business it is buying is tied up in the existing management team and other key employees. This is a time at which the new shareholders want maximum retention value in the hands of these key people – yet it is precisely the time where large, often life-changing, sums of money crystallise, leaving zero retention value on the table.

In most cases, this means 'double payments' are unavoidable, as substantial new retention arrangements need to be implemented immediately, whether in the form of brand new arrangements or tempting offers to entice individuals to 'reinvest' some of their proceeds.

On the flip side, this might work in the favour of a purchaser looking to take on a business where the value lies in the asset books rather than the people. Crystallisation of benefits can easily be quantified and will have a direct impact on the transaction price. This then leaves the new acquirer free to give retention awards to specific individuals who may be critical to integration.

There is also an emerging trend to increase protections for employees in the event of redundancy or termination under a new regime – i.e. the corporate event itself can unlock more generous provisions than would be the case had the business continued unchanged.

All of this complexity means that due diligence on remuneration arrangements, together with the associated thinking around the future structure of rewards, must be a priority for any acquirer.

Global Asset Management contacts

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Global Asset Management Leadership Team



Barry Benjamin

PwC (US)
Global Leader, Asset Management
+1 410 659 3400
barry.p.benjamin@us.pwc.com



Kees Hage

PwC (Luxembourg)
Global Leader, Real Estate
+352 49 48 48 2059
kees.hage@lu.pwc.com



John Parkhouse

PwC (Luxembourg)
European, Middle East & Africa Leader,
Asset Management
+352 49 48 48 2133
john.m.parkhouse@lu.pwc.com



Pars Purewal

PwC (UK)
UK Leader, Asset Management
+44 20 7212 4738
pars.s.purewal@uk.pwc.com



Brendan McMahon

PwC (Channel Islands)
Private Equity Leader,
Global Asset Management
+44 1534 838234
brendan.mcmahon@je.pwc.com



Robert Grome

PwC (Hong Kong)
Asia Pacific Leader, Asset Management
+852 2289 1133
robert.grome@hk.pwc.com



Will Taggart

PwC (US)
Global Tax Leader, Asset Management
+1 646 471 2780
william.taggart@us.pwc.com



Mike Greenstein

PwC (US)
Global Leader,
Alternative Investments
+1 646 471 3070
michael.s.greenstein@us.pwc.com

Territory Leaders

Argentina

Diego Sisto
+54 11 4850 4715

Australia

Andrew Wilson
+61 2 8266 3337

Austria

Thomas Strobach
+43 1 501 88 3640

Bahamas

Dawn Jones
+1 242 302 5300

Belgium

Emmanuèle Attout
+32 2 710 40 21

Bermuda

Andrew Brook
+1 441 299 7126

Brazil

João Manoel dos Santos
+55 11 3674 2224

Canada

Rajendra Kothari
+1 416 869 8678

Cayman Islands

Graeme Sunley
+1 345 914 8642

Channel Islands

Brendan McMahon
+44 1534 838234

Chile

Roberto Villanueva
+56 2 940 0070

China

Alex Wong
+86 21 2323 3171

Cyprus

Costas Mavrocordatos
+357 22 555 202

Czech Republic

Glen Lonie
+420 2 51 152 619

Denmark

Mikael Sørensen
+45 39 45 9269

Finland

Tuukka Lahkela
+358 9 2280 1333

France

Alain Le Barbanchon
+33 1 5657 1084

Germany

Peter Seethaler
+49 69 9585 3436

Gibraltar

Edgar Lavarello
+350 200 73520

Greece

Mary Psylla
+30 210 6874 543

Hong Kong SAR

Robert Grome
+852 2289 1133

Hungary

Arpad Balazs
+36 1 461 9163

India

Gautam Mehra
+91 22 6689 1155

Ireland (Republic of)

Damian Neylin
+353 1 792 6551

Isle of Man

Michael Simpson
+44 1624 689 689

Italy

Elisabetta Caldirola
+39 2 778 5380

Japan

Takeshi Shimizu
+81 90 6515 1754

South Korea (Republic of)

Jae-Hyeong Joo
+82 2 709 0622

Luxembourg

Didier Prime
+352 49 48 48 2127

Malaysia

Mohammad Faiz Azmi
+60 3 2173 0867

Malta

Joseph Camilleri
+356 2564 7603

Mexico

Jose Antonio Quesada
+52 55 5263 6000

Netherlands

Fred Gertsen
+31 10 407 6614

New Zealand

Paul Mersi
+64 4 462 7272

Norway

Geir Julsvoll
+47 95 26 05 40

Pakistan

Rashid Jafer
+92 21 2424500

Poland

Adam Celinski
+48 22 523 4330

Portugal

António Assis
+351 213 599 000

Russia

Richard Gregson
+7 495 967 6327

Singapore

Yeow Chee Keong
+65 6236 7298

Slovakia

Christiana Serugova
+421 2 59 350 614

South Africa (Republic of)

Pierre de Villiers
+27 11 797 5368

Spain

Enrique Fernandez Albarracin
+34 91 568 4504

Sweden

Susanne Sundvall
+46 8 555 332 73

Switzerland

Thomas Huber
+41 58 792 2436

Taiwan

James Huang
+886 2 2729 6666

Thailand

Anothai Leekitwattana
+66 2 344 1100

United Kingdom

Pars Purewal
+44 20 7212 4738

United States of America

Barry Benjamin
+1 410 659 3400

If you would like to receive copies of this newsletter or would like further information about PwC's asset management publications, please contact denise.cook@uk.pwc.com

Editor: Rupert Bruce

www.pwc.com/assetmanagement

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