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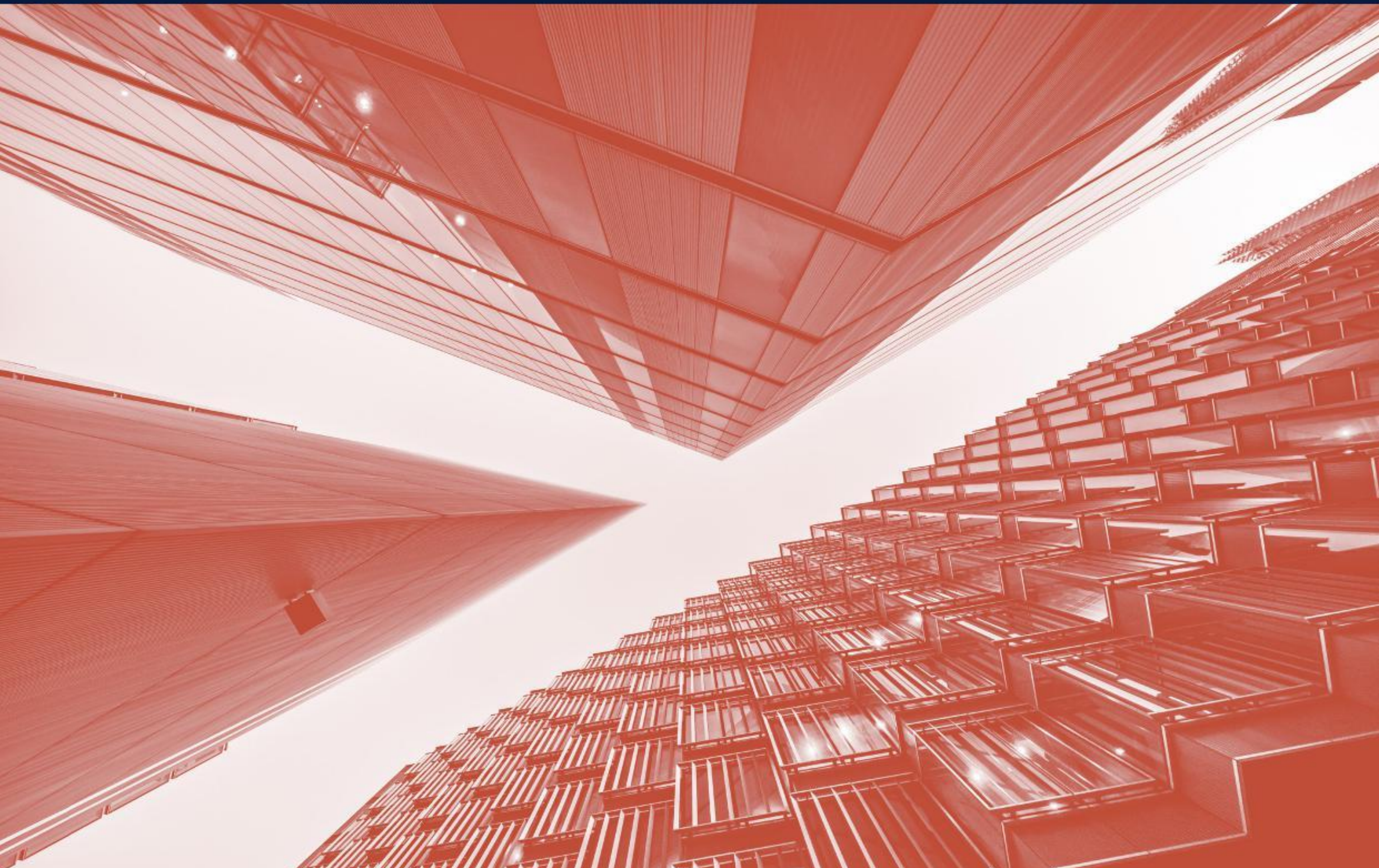
Wealth Management M&A
A guide to maximizing value in transactions



The wealth management sector has seen significant market activity in recent years, with M&A transactions taking place at all levels of the market.

FCA and PRA regulated entities in a variety of sectors use consolidation to drive growth, promote innovation or take advantage of cost synergies. Scale and diversification are key drivers in the wealth management sector, and acquisitions can be very helpful in expanding access to specific asset classes, geographical locations, clients, and the expertise of key managers.

In this guide, we look at a variety of aspects in M&A transactions which can affect value, for buyer or seller, and propose ways of addressing these in the commercial terms to enhance value.

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Section 1: Structuring acquisitions around value

We look at a range of aspects in M&A transactions which can affect value, for buyer or seller, and propose ways of addressing these in the commercial terms.

Price

Price is clearly a critical element of the structure of a transaction. There are a number of different bases of valuation, including a multiple of EBITDA, percentage of AUM, discounted cash flow or other suitable metrics. Different methodologies will suit different situations, and there may be good reasons to pay a premium (where the target is of greater strategic importance) or offer a discount (for opportunistic acquisitions or where there are commercial or regulatory risks associated with the business). Specific valuation advice should be sought in each case, as the starting point of any transaction is a detailed review of the financial information of the target.

Price is one thing, but how and when it is paid is another. It is crucial that at the same time as agreeing price, the wider costs and strategic aims of the parties are thought through and factored into the price and the deal structure. For example, post-deal integration and client and asset retention are often cited as key risks in M&A, and if these are considered early the pricing structure can be used to apportion the risk.

Structuring consideration payments in wealth management acquisitions can be complex, especially where value for the buyer is dependent on successful completion of client transfers and ongoing client retention.

A key protection for buyers involves structuring the price using deferred consideration or an earn-out, where the price paid is contingent on certain milestones of the target business following completion. This helps de-risk the overall price (and reduce the up-front consideration) by allowing a proportion of value to be conditional upon certain post-completion metrics being achieved.

Deferred consideration can therefore be based on the AUM / clients which actually transfer to the buyer's control but also which remain as clients for a particular period following the acquisition. This structure is usually defensive, to ensure retention of existing clients, but can also be accretive, by reference to additional new clients and AUM post-completion. This may reflect the seller's own business plans and projections, especially if these form part of the buyer's rationale for making the acquisition. There is a great deal of flexibility in structuring these arrangements, but at their core they are often aimed at providing a financial incentive to ensure that the value of the acquired business remains post-deal, and to mitigate risk and the wider costs of the transaction.

These "earn-out" arrangements can also be attractive to buyers where cash is tight, as the target business can effectively be used to fund future consideration payments. However, earn-outs must be carefully structured in financial services transactions, as common metrics of valuation are often highly exposed to market volatility. By way of example, an earn-out linked to AUM could be heavily distorted by market factors outside of the "core" performance of the business. A seller may feel that they have little ability to influence business performance after the sale and may therefore seek contractual controls following completion.

Focused on realisation of value and a "clean break", sellers will typically push for a larger guaranteed payment. In order to achieve this, they may be willing to agree to more onerous assistance undertakings, both prior to and following completion, to assure buyers of the likelihood of deal success.

Transactions will often require regulatory consent, and therefore the time from agreeing the heads of terms (and price) to completion can be significant. Given this unavoidable time lag, the pricing structure should reflect this. "Collars" (setting a minimum price for the transaction) and "caps" (setting a maximum price) are used to provide greater certainty to buyers and sellers alike. For example, where the deal is a percentage of AUM, this may well increase or decrease over the period and pose an issue for buyer and seller as the final position will not be known when the deal is struck. The buyer may not want to buy at all if the AUM drops below a certain value, or the deal may not have the same strategic value if the business is smaller (and therefore the buyer may still want to proceed but not on the same price structure).

The seller will want to receive the benefit of any additional AUM up until completion, but there may be a critical point, if AUM falls, where the deal ceases to be attractive to them. Caps or collars, in combination with appropriate conditionality, can help mitigate these issues.

Linking value to key assets

Certain transactions will require active client consent in order to transfer to the buyer. Even if this is not required, in many transactions there is a large administrative burden on the buyer, such as onboarding the new clients and moving them onto the buyer's standard terms. Recognising these practical points, it is possible to link them to price to de-risk the position:

- By adjusting the price on a sliding scale if AUM / revenue is less or more than a specified minimum level of the value agreed at the start. This can be used both to calculate the price at completion but also as a factor of any deferred consideration, so that client retention for, say, 12 months after completion becomes a seller risk.

- By not paying full value for those clients that do not promptly (before or after completion) agree to move over to the buyer's terms and conditions. This will encourage the seller (who has the main contact with these clients) to help with this process and reduce internal costs and time for the buyer (and therefore risk).

It will often be useful to set out the basis of calculating the price and the other core expectations in the term sheet at the start. This allows the parties to focus on the core areas of value in the subsequent stages of the transaction, and also sets out softer expectations which can be used as the basis for any future re-negotiations if circumstances change.

There may be other deal-specific reasons for reviewing the upfront price, and a buyer will want to keep in mind the overall rationale for the deal. If certain key clients (or types of client) are central to the rationale for the transaction, their failure to transfer could affect the commerciality of the deal, which might be reflected in a price adjustment. Such matters might even become conditions to completion of the deal if they are sufficiently significant to the overall rationale of the buyer.

Due diligence

Proper identification and understanding of any significant liabilities is crucial. A well-run due diligence process should focus on areas of significant risk which could go to value. Where liabilities are identified, the buyer has various structural options to mitigate the liabilities it will take on, including deal structure, price and contractual protections.

Where liabilities are defined and non-contingent, a price adjustment may be appropriate. Alternatively, retentions can be considered for specific liabilities, such that the buyer retains an amount of the completion proceeds as surety for the crystallisation of a defined liability.

Warranties and indemnities serve to apportion risk between buyers and sellers, whether identified at the time of exchange or not. Indemnities will be key in allocating liability for legacy product risks. In this context, the position of the seller following completion is a key consideration for the buyer – to ensure that the buyer has an entity of substance giving the warranties and indemnities, which can stand behind any future claim.

A due diligence exercise concerning a regulated M&A transaction would typically cover (amongst other matters):

- Corporate and constitutional issues;
- Regulatory compliance matters, including any complaints made to or investigations by the FCA and other regulators, a review of the seller business' standard terms of business with clients, and any pensions advice issues;
- Key commercial contracts, including IT contracts for investment platforms;
- Data protection issues concerning client personal data; and
- Employment and remuneration issues for key staff, including pensions liabilities.

Historic liabilities in a highly regulated sector can be a real issue, whether relating to structured products, DB pensions or otherwise, and the diligence will need to focus on these in particular. Remediation can be costly and management time-intensive, and may bring reputational risk. These issues may ultimately affect price or even whether the deal proceeds, and thought will need to be given to whether it is possible to structure around them.

W&I insurance

Warranty and indemnity insurance can be a helpful tool for both buyers and sellers and is increasingly prevalent in financial services transactions. Buyers may have concerns about the substance of the seller post-completion, and it can be reassuring to know that an insurance policy stands behind the seller's warranties and indemnities. Alternatively, the seller might wish to achieve a clean exit with limited continuing liability – and be willing to pay for, or contribute to, the cost of the W&I

policy. A seller may also want to structure this so that the buyer takes out the W&I policy and the seller's liability is limited to a nominal sum. W&I insurance can be particularly helpful in the regulated sphere where liabilities can quickly become very financially significant.

In this context, W&I insurance merits consideration by both parties and the costs addressed at an early stage. While W&I insurance may not cover all relevant risks, including significant known risks thrown up in due diligence, it can give useful assurance to buyers and help to limit ongoing claims for sellers. Note that taking out a W&I policy is not a substitute for proper due diligence, and indeed the insurer will require that a full due diligence process is carried out.

Contractual protections

Pre-completion undertakings should be provided in the purchase agreement to govern the way that the target is run in the interim period and to prevent the management of the target from doing anything outside of the ordinary course of business. It is also worth re-assessing the basis of the calculation of the price.

A material adverse change clause could also be sought by the buyer to ensure that the business acquired on completion is not materially different to the business agreed to be purchased at exchange. However, these provisions are unlikely to be easily accepted by sellers, particularly where the transaction is made public at an early stage. It can be difficult to define what is material in this context, and there are often fairly protracted negotiations around the risk allocation brought about by these clauses.

Conclusion

Pricing structure will be a heavily negotiated element of any deal, and the outcome will likely reflect a commercial compromise. Valuation will need to be considered in the round, taking account of the apportionment of liabilities and the potential effect of any identified or suspected risks on the value of the deal.

In all cases, pricing and the rationale for the transaction should be closely aligned. Judicious use of deferred valuation can help align pricing with the key deal drivers. Caps and collars can be used to give additional certainty to deferred consideration structures.

Section 2: Key deal structure considerations

Following on from valuation considerations, we consider other key structural issues to be considered at the outset of wealth management M&A.

Share sale or asset sale?

A key question for both sellers and buyers will be whether to structure a transaction as a share sale, where the seller disposes of its equity (for instance, shares or partnership interests) in an entity, or as an asset sale, where the individual assets and liabilities of the business are transferred separately.

A variety of considerations feed into this decision. In some circumstances, the choice may be curtailed in practice, for example where the seller is divesting one part of a larger business and an asset sale is therefore the natural structure. Even here, however, there are options if the structure is important, such as a pre-sale restructuring to hive-down the relevant business and assets into a new company which is then sold.

The choice of a share / asset sale will have ramifications for tax treatment and will depend on the need to transfer clients and customers, the ability to leave behind surplus assets and unwanted liabilities, and the regulatory consents and notifications required (and associated timelines).

Below we identify some of the key factors that will influence this decision, and touch on some of the advantages and disadvantages of both structures. The process can affect value for buyers or sellers, so we advocate considering the implications of the relevant process at an early stage and factoring any relevant issues into the commercial terms agreed at the start.

Transfer of assets

Share sales are normally considered to be simpler transactions than asset sales. As the whole corporate entity is transferred, whether that is a company or partnership, there is no need to identify specific assets and deal with transfer requirements for each asset individually.

By contrast, in an asset sale each specified transferring asset must be transferred individually. The ease with which this can be done depends on the individual asset. A key focus, and often one of the more important, is likely to be client relationships embodied in the terms of business / client agreement between the target and its clients.

Another key issue is the presence and drafting of the transfer provision, and whether a transfer of the rights and obligations of the client agreement is included and on what terms. Where the buyer holds client money or assets, again, the position needs to be assessed carefully to ensure any transfer mechanism is consistent with the FCA's rules. It Is also critical that the buyer has a valid client agreement in place with the transferred clients.

Communications with impacted clients need to be handled sensitively, to maximise client retention on transfer. Typically, the parties will agree a client communication and (if applicable) a consent plan, which will involve close collaboration between the buyer and the seller, usually between exchange and completion, and often beyond. The approach and cooperation of the seller's front office can make a significant impact on the success rate and should be considered in the wider approach to employees at the seller (more on this in our forthcoming briefing, Employment and incentivisation). The price paid for the transfer may also be impacted, and it is common to see value structures where completion is conditional on a certain percentage of clients transferring, with further deferred consideration achievable on future milestones.

While this client transfer process is less complex in a share sale, it is still important to communicate to clients that the service they receive will not be detrimentally affected by the transaction, and to ensure that the transaction does not cause clients to terminate their contracts with the seller before, or with the buyer after, the transaction. Voluntary notifications should be made to clients, and clients may also need to be made aware of changes to custody arrangements. A share sale will also typically avoid the buyer having to obtain new consents from clients to receive electronic marketing, which can be important if the buyer wants to use the client database to market and sell a wider range of its own products and services. There may however be practical issues following completion, such as the need to move the target's clients over to the buyer's standard terms of business. While this may not directly affect the transaction, it may mean a fairly involved post-transaction integration process.

At all stages, clients (including non-responding clients) must be treated fairly and, where retail clients are involved, consistent with the Consumer Duty requirements. It is important that a communications plan is carefully planned and carried out to meet these requirements.

Apportionment of liabilities

While asset sales are more complex in terms of asset transfers, the associated benefit is that asset sales give the buyer and seller considerable flexibility to transfer only the desired assets and, significantly, to leave behind liabilities (latent or otherwise). This is particularly beneficial where liabilities may be significant and difficult to quantify.

A classic example is a defined benefit pension liability. Buyers are typically very wary of taking on such liabilities, and it is often not possible to factor them into the price, as the potential exposure is uncertain. Asset sales allow such liabilities to be left behind, with consideration based on the acquisition of assets without any accompanying liabilities.

Such liabilities are therefore left in the selling entity post-completion, and the approach to them will depend on whether the selling entity contains assets outside of the transaction scope (such that it will continue to trade post-completion), or whether the selling entity will be wound up following completion. Run-off insurance can be considered if the selling entity is to cease trading following the transaction.

Transfer of employees

The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) may apply, depending on the nature of the transaction. Where the purchase is structured as a share sale, TUPE will not apply, as there will be no change in the identity of the employing entity. Instead, the same entity (albeit owned by different shareholders) will continue to employ the employees post-sale.

Where the transaction is an asset sale and TUPE does apply, employees assigned to the relevant undertaking being sold will transfer with that undertaking under the "automatic transfer principle" on their existing terms of employment and with their continuity of service intact. Additionally, any purported variation to a transferring employee's contractual terms is void if the sole or principal reason for the variation is the transfer (subject to certain limited exceptions). As a result, moving transferring employees onto equivalent terms as the buyer's existing employees (often referred to as "harmonisation") is unlawful.

In practice, if the changes are beneficial to the transferring employees, they are less likely to object, particularly if there is a meaningful consultation process. However, in some cases, the buyer may wish to introduce detrimental changes, such as more onerous restrictive covenants for key senior employees. One option in such cases is to enter into settlement agreements with the relevant individuals, under which their employment is terminated, and they are re-engaged under the new (more onerous) terms. As part of any arrangement, there will obviously also need to be some incentive for the relevant employee, whether in the form of a one-off benefit or advantages to some of their other terms of employment.

Where the settlement agreement route is being considered, the parties to the transaction will need to agree who is responsible for any payments to the employees as consideration for agreeing to those new terms. Payments falling due to employees after the transfer will be the responsibility of the buyer under TUPE (assuming TUPE applies). If that does not reflect the commercial agreement, it will need to be accounted for in the sale documents. For these reasons, we suggest that the wider process is thought through at a very early stage and the commercial agreement in the heads of terms should reflect the allocation of cost and liability between buyer and seller.

TUPE also provides for enhanced protection against dismissal, where an employee has two or more years' service and any dismissal is again by reason of the transfer. Compensation for any such claims consists of, in broad terms, a basic award of £571 or £856.50 per year of service (depending on the employee's age in each year of service) and a compensatory award of up to the lower of 52 weeks' salary and £93,878.

Tax treatment

Tax is a key driver when structuring a deal. The route which secures the best tax treatment for the party in the strongest bargaining position will often prevail.

The tax advantages of a share sale are usually more significant for the seller for the following reasons:

- A share sale is likely to allow the seller to claim either Substantial Shareholding Exemption (SSE) or Business Assets Disposal Relief (BADR) which would reduce tax payable on the sale of the shares. SSE can give total tax exemption on a capital gain

made by a corporate seller. BADR can entitle an individual seller who works in the business to pay tax at a discounted rate on the first £1m of gain, with a similar relief (Investors Relief) potentially available to certain non-employees.

- Even where these reliefs do not apply, a share sale can enable the seller to defer the payment of tax on chargeable gains where the purchase price takes the form of shares or loan notes in the buyer company. This deferral is not available on an asset sale, although a similar result can be achieved on an asset sale if the proceeds of sale are reinvested in certain qualifying replacement assets.

- From the buyer's perspective, a share sale means accepting responsibility for any unpaid tax liabilities of the company (although contractually this would be treated as a seller liability under the tax covenant in the sale agreement) whereas an asset sale offers the buyer a clean break, with the tax liability structurally left as an obligation of the seller.

- An asset sale involves a potential double tax charge for the seller. This is because the selling company could suffer corporation tax on chargeable gains on the sale of the assets and the individual shareholders would then suffer income tax when dividends representing the sale profits are paid out. This is not an issue where the target company is owned by another UK company, as most dividends are exempt from corporation tax, but may be more of an issue in an owner managed business.

Conversely, an asset purchase tends to be more tax efficient for the buyer for the following reasons:

- The buyer can usually claim amortisation relief on the price paid for intangible fixed assets (excluding goodwill and customer-related intangible assets) whereas for a seller who has claimed capital allowances, the sale of assets can trigger a balancing charge and the disposal of intangible assets can give rise to a charge to tax on income.

- An asset sale may be subject to VAT if it does not meet the "transfer of a going concern" requirements. This might be the case if the buyer will not continue to carry on the same kind of business as the seller or if the buyer "cherry picks" assets. A VAT charge would only be an absolute tax cost to the buyer if it cannot recover all of its input VAT.

Finally, individual factors can push the pendulum either way. For example, it may be tax efficient for the buyer to purchase a company where the buyer or the company has trading or capital losses which can be carried forward or surrendered.

This can also benefit a seller as they may look to be paid for those losses. Likewise, where valuable real estate assets are included in the sale, the buyer may save tax by purchasing the company, since a share purchase attracts stamp duty at the rate of 0.5 per cent, which compares favourably with the higher rates of stamp duty land tax payable on property purchases.

Regulatory consent

Where the sale is structured as a share sale, it will be necessary to obtain change in control approval from the FCA, and in a small number of cases the PRA, depending on how the target business is regulated. The impact of UK financial services regulation is addressed below, but by way of brief summary, any person intending to acquire "control" of a UK regulated target must apply to the relevant regulator(s) for approval. Broadly speaking for private banks and the majority of wealth managers, a person acquires "control" where they come to control, directly or indirectly, 10 per cent or more of the shares or voting power in the target. Therefore, companies in the buyer's group all the way up the chain of control are potentially caught.

Regulatory change in control approval is a task that should not be underestimated in terms of management time and cost. It also has a potentially significant impact on the timetable of the transaction, as the regulators have 60 days from the receipt of a completed application to consider approvals and have considerable flexibility to "stop the clock" to seek further information.

By contrast, an asset sale will not require a change in control application as control of the regulated entity does not change. This is often seen as an advantage and reason to structure the transaction as an asset sale but should be assessed taking into account the mechanism to transfer clients to the buyer, including whether individual client consent is needed, which can involve significant time and resource cost.

Section 3: Key regulatory considerations

We look at some of the key regulatory considerations in wealth management M&A

Change in control approval and regulatory notifications

Often, the main regulatory consideration on a share sale (especially for a buyer) is whether change in control approval is required in order to acquire the relevant business, not least because approval can take upwards of four months to obtain.

An entity or individual is required to obtain change in control approval from the PRA and the FCA, or just the FCA (depending on how the target firm is regulated) where it acquires "control" of a UK-regulated entity (Target) and hence would be considered a "controller".

What constitutes "control" varies depending on the regulatory classification of the Target. Where the Target is a private bank or wealth manager, usually a person will be deemed to acquire control (and hence be a controller) when acquiring:

- 10 per cent or more of the shares or voting power in the Target or its parent, or
- Shares or voting power in the Target or its parent which gives one "significant influence" over the management of the Target.

This can encompass a large number of entities and individuals in the ownership chain. Change in control approval will be needed for each entity acquiring control, which can result in a large number of controller forms being filed with the relevant regulator(s). This is in addition to a number of supplementary documents such as financial statements, CVs and, where an entity is becoming a parent undertaking, a business plan.

In a Share Purchase Agreement, change in control approval is a condition to completion, meaning that a split exchange and completion is required. As noted above, this can significantly impact the deal timetable as well as (from a buyer's perspective) necessitate the imposition of gap controls on the seller and the underlying business.

The regulators have 60 working days to assess a change in control application from the date of receipt of a complete application which can be interrupted by a period of up to 30 working days. The clock starts ticking from the date of receipt of a complete application. If the regulator deems the application to be incomplete, this assessment period will not commence, pushing the timeline out even further.

For asset sales, as the buyer is not acquiring shares or voting power in the Target, change in control approval is not typically needed. However, on an asset sale:

- UK-regulated buyers and Targets typically notify the regulators in advance that the transaction will occur under the PRA's Fundamental Rule 7 and / or the FCA's Principle 11, as such a sale is generally considered to be something of which the regulators would expect notice, and
- The Target must ensure that it has in place valid client agreements with those clients who transfer. The transfer mechanism followed will depend on a variety of factors, including the presence and drafting of transfer provisions in the seller's standard terms, whether client money and / or assets are being transferred (and if this is permitted in the seller's standard terms) and the buyer's preferred approach.

Regulatory due diligence

As noted earlier, thorough but targeted regulatory due diligence is vital given the potentially significant financial impact of needing to fix regulatory issues post-acquisition, and the potential financial and reputational impact of a regulatory penalty or other sanction. Warranty and indemnity (W&I) insurers will also typically require that a thorough due diligence exercise is undertaken on a Target.

Buyers should (among other things) look to flush out any conduct of business issues with particular attention to retail client business, for example suitability failings, mis-selling or defined benefit pensions issues as well as any failures to implement, or implement on time, new regulatory requirements. If a Target acts as a UCITS management company or as an AIFM, buyers will want to check that the fund documentation is compliant and up to date.

Where the Target is a private bank carrying on regulated lending, buyers should assess the Target's

historic compliance with the complex regulated lending regime. If the Target carries on regulated consumer credit lending, failure to comply with the information and agreement requirements can impact the enforceability of the credit agreements and hence the value of a Target to a buyer.

Other important areas include compliance with AML and other financial crime requirements.

Other considerations will be relevant to the scope of regulatory due diligence dependant on the factual circumstances.

Regulatory capital and prudential consolidation

Private banks and wealth managers are subject to extensive prudential requirements. Whilst an exhaustive consideration of the regulatory capital issues associated with regulated M&A is beyond the scope of this briefing, important issues include:

- **Prudential consolidation**: Where a buyer is looking to purchase a Target, that buyer, the Target and other subsidiaries can become "prudentially consolidated". This effectively means that the buyer, the Target and other subsidiaries are treated as a single regulated entity, with regulatory capital requirements applied to this theoretical (but potentially very large) regulated entity. This can result in a notable increase in the regulatory capital which needs to be held, potentially affecting the profitability of the Target and a combined group post-completion.

- **Cash and gap controls**: In some transactions, the buyer will permit the seller to distribute excess cash from the Target or the Target's group instead of paying for such cash on a pound for pound basis. Both parties need to be careful that such a provision does not inadvertently cause the Target to breach its regulatory capital requirements.

- **Structuring and timing**: More generally, if a Target (or an entity with which it is prudentially consolidated) is to issue shares or takes on debt, this needs to be done in a way that does not inadvertently cause a breach of regulatory capital requirements. In addition, for certain Targets, prior permission is required if the Target intends to issue financial instruments which it wishes to classify as regulatory capital, which will need to be factored into the deal timetable.

Remuneration codes and financial incentivisation

This is covered in more detail later but, by way of summary, private banks and the majority of wealth managers are subject to one or more "Remuneration Codes". These Codes govern the award of remuneration by UK regulated firms, including any guaranteed variable remuneration and retention bonuses.

In a transactional context, therefore, and depending on the regulatory classification of a Target, the Codes can restrict how much and in what form, say, retention bonuses can be paid to key employees. They can also require a Target to have arrangements to exercise malus and clawback in respect of such awards. Buyers and their advisers should therefore be aware of these Codes and how they may restrict the retention of key employees going forward.

Section 4: Retention and incentivisation of key personnel

We look at the retention and incentivisation of key personnel in M&A

Retention of key employees

Many businesses in this sector are "people" businesses, and the quality and engagement of employees is a critical part of ongoing business, and this becomes especially so when M&A is involved.

Getting key employees of a target on side is vital to integrating successfully and retaining clients. Failure to do so can lead to a target with unmotivated employees and quickly departing clients.

The first step is for the buyer to analyse who the “key employees” are from its perspective, which will be linked to the rationale for the deal. In general, those with relationships with key clients will be important to a successful transition. This is particularly important for an asset sale where the role of the front office can have a significant impact on client retention and client consent where this is needed.

Once this decision has been made, key employees should be incentivised under transitional and future plans, subject to the regulatory considerations set out below. Within the confines of confidentiality, they should be notified early on if possible. This incentivisation may be a combination of financial reward for completion of the transaction (and a successful transition of clients), which may be paid for by seller or buyer (or a combination), and future remuneration packages, which may also be linked to client retention over the period following the transaction. Usually, it is in both the seller’s and buyer’s interest to incentivise a successful transition and therefore there is scope for funding to be made available for this as part of the commercial deal.

Diligence should be undertaken to understand the seller’s wider incentive package (on an asset sale, this may need to be analysed in detail in respect of what must be offered to any employees who transfer under TUPE) to allow a buyer to offer something attractive to the key employees. These financial incentives should be factored into any decisions about price. Buyers should be careful when handling salary, bonus and other remuneration information regarding the target’s employees, although sellers will usually only make this data available subject to NDAs or with all non-essential information redacted.

Thought should also be given to integrating the core team of the buyer’s existing business with the key employees of the target as early as possible once a deal has been agreed. Where cost rationalisation is part of the transaction, understanding what this means for a deal structure, the timing, and the cost is important, as it too may have a bearing on the price structure early in the transaction.

Owners and key employees

Buyers that are acquiring smaller wealth managers should consider whether the sellers are also the key employees. In such a situation, the sellers will profit from the deal and may therefore be harder to incentivise during the interim between exchange and completion (when a sense that the deal is “done” may set in) and following completion.

Any issues following exchange can be mitigated by clear and well-defined controls on what can or cannot be done during the interim period in the transaction documents. These should be structured to provide contractual protection to the buyer against any decline in seller performance, and buyers may wish to negotiate a more hands-on role for themselves or a representative in the event of significant concerns about seller motivation.

Any more hands-on approach should be careful not to give control to the buyer pre-completion as that may cause a breach of the regulatory change in control regime. Therefore, these provisions should be carefully considered.

Following completion, deferred consideration payments linked to the performance of the key employees, or the business as a whole, should be used to incentivise those sellers who will remain employed. Taking on sellers in a consulting capacity may allow a buyer to provide bespoke incentivisation to sellers while retaining their expertise for a set period.

Financial incentivisation

A number of UK regulated firms (including private banks and the majority of wealth managers) are subject to the provisions of one or more "Remuneration Codes". Such Codes are likely to affect the incentivisation of certain key employees, and the Codes contain rules around bonuses paid to certain employees. These include provisions that any guaranteed variable remuneration and retention bonuses should be exceptional, one-off, relevant within the context of the acquisition and, in certain cases, notified to the FCA. The payment of a retention award may also be made dependent on the individual meeting certain performance criteria that have been defined in advance.

Buyers will also likely need to ensure that there are arrangements for malus and clawback in place for guaranteed variable remuneration and retention bonuses, which may lessen the attractiveness of such incentivisation packages for key employees. Finally, buyers must ensure that they have considered the interests of all stakeholders, including shareholders, clients, and the regulator(s) as well as employees in their decision-making around remuneration. Consequently, buyers should ensure that any payments to employees are permissible under the relevant Remuneration Code(s), and advisers should be aware of this as a potential issue.

Post-termination restrictions

As part of any incentivisation offer, it is also worth considering the adequacy of any existing post-termination restrictive covenants in key employees' contracts of employment. For example, if there is a wish to further bolster any such restrictions, it may be possible to do this as a quid pro quo for any incentivisation payment being made.

Particular care will, however, need to be taken in the context of any TUPE transfer. This is because under TUPE any variation to a transferring employee's contractual terms is void if the sole or principal reason for the variation is the transfer (subject to certain limited exceptions). As a result, in a TUPE situation, if any changes to existing restrictive covenants are to be made and are to be valid, they are likely to need to be implemented via settlement agreements with the relevant individuals under which their employment is terminated, and they are then re-engaged under the new terms containing the bolstered restrictions. The settlement agreement can then, at the same time, provide for payment of any relevant incentivisation payment.

Section 5: Business integration

We look at business integration.

This is an area of M&A that can often be overlooked, but it is a critical component of a successful deal and can affect value and client retention if not factored into the M&A process at the start.

Interim committee

The Share or Business Purchase Agreement (SPA) often provides for the formation of a committee populated by senior representatives of the buyer and seller. This committee serves as a forum at which issues relating to the fulfilment of any conditions to completion can be discussed, any issues with the transaction's progress towards completion can be shared and, crucially, any complex operational decisions can be addressed. The role of the committee will often be to focus on the customer-facing and back-office IT of the target, to ensure that the client migration on completion and continued client support happens smoothly.

This process allows senior people at the buyer to become familiar with the target while also overseeing anything which could affect value in the interim period. It may also assist with the integration of key employees at the target. As a matter of good governance, it is important to ensure that such a committee is populated by a mixture of sufficiently experienced and senior people who can provide oversight and new perspectives (likely including C-suite executives) and ideally too those who have been more deeply involved "at the coalface" of the deal.

Data migration and operational resilience

Transferring data to the buyer is a complicated but crucial element. Both parties (particularly the buyer) may need to access the information in the various databases and datasets during the migration period, and proper planning around the mechanics of data migration is essential. Ideally the project timeline for migrating data will allow for small-scale rehearsals using test data, including a "dress rehearsal" using a larger amount of live system data that has been backed-up elsewhere, ahead of the actual switchover / data migration date(s). These typically take place over a weekend to minimise the impact of data being temporarily unavailable. Bear in mind that migration of large datasets (terabytes rather than gigabytes) can take several days rather than mere hours, depending on network speeds, etc.

The FCA's and the PRA's fines for TSB (totalling almost £50 million) in late 2022 were in relation to a series of operational resilience failures in a large-scale IT outsourcing project. The data migration phase of the project had, in and of itself, been successful, but ultimately the failures that followed post-migration stemmed from poor planning, weak governance and a lack of organisation to implement adequate risk management systems. For example, TSB's planning was not on a sufficiently "left-to-right" basis (taking one step at a time, testing and signing off one part of the process before moving to the next). Some of the data migration-related reviews were too limited in scope, or were expressly stated to be "point-in-time" reviews which the TSB board did not revisit at crucial junctures, and business continuity procedures were inadequate, failing to reflect the genuine experience of TSB's customers.

Client onboarding, data processing and marketing

It may be necessary for the buyer to refresh "know your client" (KYC) information and / or to run new anti-money laundering (AML) checks on clients, and that may be done with or without post-completion assistance from the seller. There will also be some steps to take to comply with GDPR rules concerning data protection (most notably, so that the buyer has provided the clients with a copy of its privacy notice explaining how their personal data will be processed following competition of the transaction). In particular, where the deal is structured as an asset sale, there will be further steps in respect of the direct marketing rules (if the buyer needs to obtain new consents from clients in order to lawfully send them direct marketing emails, or if the buyer wants to establish its own "soft opt-in" with clients, which involves the clients being given an opportunity to object to marketing emails at the time their contact details are first collected by the buyer, and an unsubscribe link being included in each subsequent email).

Transitional services

Any operational issues which remain outstanding at completion (or where there is a period after completion where the buyer will need to rely on the seller for IT and related services) should be dealt with by a Transitional Services Agreement (TSA). It is very likely that the interim committee will have identified services which the target will need to access on day one following completion which cannot be set up immediately. A TSA should be put in place to give access to services such as custody services for less liquid assets, IT support and access to client files. The TSA governs the extent to which the seller supports the buyer and both parties provide resources to give effect to the deal. Care will also need to be taken to ensure that the entity providing the transitional services is permitted to do so under the applicable regulatory rules.

Transitional services are commonly provided for a period of six to 12 months following completion. There may be good commercial reasons to aim for a particular length of time. The buyer will want to move on from transitional arrangements to avoid excessive fees and to focus on other projects, while sellers will be keen to make sure that there is a determined point at which their obligations will cease. Either way, it will usually be sensible to agree a detailed project plan for the TSA, or at least to set milestones for the delivery of transitional services, and the points in time where functions will be completely handed over to the buyer.

The TSA should usually include, or be accompanied by, an IP licence which allows the buyer to use the seller's IP insofar as it relates to the target for a specified period following completion. In some cases, though, the buyer will purchase outright the target's business name, branding and other IP rights. The buyer may also purchase all the copyright in software systems, etc. that it needs to operate the target business post-completion, such that no IP licence is necessary.

It is good practice for a TSA to include detailed service descriptions and certain "key performance indicators" (KPIs) concerning the quality, speed, volumes etc. of the services that the buyer requires from the seller. This is typically an area where the buyer "gets what it pays for". As such, driving too hard a bargain with the seller in terms of the KPIs the buyer expects (and / or the fees or other consideration that the buyer will pay to the seller for its assistance) is usually not something we recommend. In the financial services sector, where regulated firms have duties to protect the consumer, this ought not to be overly contentious, but a good working relationship between members of the interim committee can be key to negotiating these more commercial points successfully.

Other key components of a TSA typically include liability, indemnity and insurance provisions, and it is worth thinking about who can cause more harm to whom if things go wrong (generally the seller as service provider can cause greater losses for the buyer as service recipient but that is not always the case). It is usually necessary to notify insurers to discuss whether they might perceive that the TSA arrangements could have a significant effect on a party's liability exposure for the period that transitional services are being provided.

Finally, regulated firms will also need to consider whether any TSA may constitute an outsourcing of "critical or important functions" for the purposes of the MiFID Org Regulation (the MiFID Org Reg). To the extent that it does so, Articles 30 and 31 of the MiFID Org Reg will apply. This would require certain provisions set out in Article 31 be included in any TSA, as well as imposing various general duties on the outsourcing firm. Regardless of whether the MiFID Org Reg is engaged, firms will also need to consider the general outsourcing provisions set out in SYSC 8 of the FCA Handbook.

Updating domain name and trade mark registers

Finally, there will be some other administrative tasks for the buyer post-completion, including the updating of domain name registries (contacting the relevant "registrars" which may require the co-operation of the seller and so is usually dealt with in the SPA or TSA) and trade mark registries (contacting the Intellectual Property Office, in the UK, and any other relevant operators of trade mark registries) to record the buyer's ownership of any domain names and registered trademarks which have transferred from the seller as part of the transaction. IP registers should also be updated post-completion to acknowledge the recording, or the clearing of loans secured against IP assets (for example, if the seller had taken a loan from a third party, secured against a registered trademark, and that loan was paid off as part of the deal).

Our team

Farrer & Co has market-leading expertise in complex, high-value transactional and advisory work for a wide range of financial institutions. We offer deep and comprehensive expertise tailored to the needs of a range of PRA and FCA regulated clients.

Our clients trust us with their most significant transactions, from a commercial, regulatory and people perspective. Our experience in the sector means that we understand the complex issues and practical concerns in regulated transactions. Our knowledge of the sector helps us to structure and execute transactions in a creative and efficient way within the regulatory framework.

Our legal experience in financial M&A transactions

We act for private banks, wealth managers and fund managers (amongst others) on a range of transactions, both buy-side and sell-side. We also advise founders and a range of growth companies, including fintech clients, on fund-raisings, investments and exits. Outside of transformational M&A, we advise on a wide range of business and regulatory matters, including equity-based incentive schemes and group restructurings. We work closely with our clients, their internal teams and external advisors to align our legal advice with business requirements.

Our financial services legal team

We draw on the expertise of our multi-service team, to provide pragmatic advice on all aspects of financial services transactions, both before and after completion.

- Our Corporate team advises on high-profile and significant regulated transactions, bringing top tier M&A capability to bear alongside our significant experience of this particular sector.
- Our Regulatory practice is well-versed in the regulatory aspects of transactions, from advice on regulatory consents to post-transaction integration.
- Our Employment specialists understand the importance of people in transactions and advise on the process of transferring employees, changes to terms and wider incentive structures.
- Our Intellectual Property and Commercial team help clients navigate commercial integration, including intellectual property and data protection issues.

Key contacts

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Anthony advises on the full range of corporate transactions, from M&A, complex structuring and equity investments to fundraisings and governance advice. Anthony has a great deal of experience advising clients on transactions in all aspects of the financial services sector, and he is recognised as a financial services specialist in The Legal 500.

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Andy is a well-regarded partner in our Financial Services team. He undertakes a wide range of general financial services work, as well as advising on fund formation and operation and securities law issues. His broad range of clients include asset managers, investment fund managers, non-financial sector institutions and private banks.

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