Berkshire Capital

2017
FINANCIAL SERVICES
INDUSTRY REVIEW

CONTENTS

INSTITUTIONS SEEK OUT ELUSIVE RETURNS

Singapore's **Government Investment Corp.** is one of the world's largest sovereign wealth funds, with an estimated $350 billion in assets and a diversified portfolio by geography and investment that spans both traditional and alternative assets. But in recent years, even the savvy investors at GIC have found decent returns difficult to achieve. In its latest annual report released last July, GIC disclosed that it had generated a 3.7% return over five years, 90 basis points below its reference portfolio and well below its 20-year return of 5.7%. And the future? Chief Investment Officer Lim Chow Kiat, citing the "uncertainties" created by the low interest rate environment, said: "These difficult investment conditions can stretch for the next 10 years."

The Singaporean fund isn't alone. For the five years through 2015, the world's 300 largest pension funds delivered annual growth averaging just 3.5%, according to the latest *Pensions & Investments* and Willis Towers survey, and in 2015 total assets declined 3.4% to less than $15 trillion. **Calpers**, the largest public pension fund in the U.S. with nearly $300 billion in assets, reported a 0.6% return in the fiscal year through June 2016 after delivering a 2.4% return the previous fiscal year, both well below the 7.5% target. The understated assessment from CIO Ted Eliopoulos: "We are cognizant that this is a challenging period." Accordingly, Eliopoulos and others have proposed a gradual reduction to 7% by fiscal 2020.

In Norway, a government committee last October urged the nation's $880 billion sovereign wealth fund to increase its exposure to equities from 60% to 70% to improve real returns that the group projects will otherwise average just 2.3% annually over the next 30 years. In the UK, pension funds already grappling with yawning funding shortfalls have warned the Bank of England about the impact of continued low rates on their ability to meet future obligations. "Any downward pressure on gilt yields will feed through in the form of an ever-bigger black hole in final salary schemes," Tom McPhail, head of pensions research at **Hargreaves Lansdown**, told the *Financial Times*.

In Japan, the **Government Pension Investment Fund** cut its target allocation for safe but enervated Japanese bonds from 60% to 35% in 2014 while adding Japanese and global equities. The nation's banks are also clipping their holdings of Japanese bonds and replacing them with global stocks and bonds, among other investments. In the 12 months through September 2016, **Bank of America Merrill Lynch** figures Japanese institutions bought 70% more non-Japanese securities than they did in the prior period.

McKinsey summed up the concerns of institutions worldwide in a 2016 report warning that investment returns in the U.S. and Western Europe over the next 20 years "could be considerably lower" than those of the past 30 years. McKinsey suggests equity returns could range from 4.5% to 6%, well below the 7.9% that prevailed between 1985 and 2014. Bonds, which delivered average annual returns of 5% and 5.9% in the U.S. and Western Europe, respectively, could drop to zero to 2%. McKinsey cites a number of factors in its assessment, among them a particularly favorable investment climate beginning in the 1980s that included a taming of inflation, strong global economic and profit growth aided by favorable demographics, productivity gains, and the emergence of China. Noting that the above-average returns over the past 30 years "were lifted by an extraordinarily beneficial confluence of economic and business factors," the consultant writes: "Some of these trends have run their course."

Institutional investors are in a quandary: They have lots of capital, few ways to generate easy returns and plenty of bills to pay — notably to an increasing number of retiring baby boomers. Bond yields worldwide are meager, global growth and trade are slow, corporate profit growth in aggregate has been weak, debt has continued to climb as low rates make borrowing for both private and public entities attractive, and valuations are elevated. On top of all that, there's the overhang from the market crashes of 2000 and 2008, with investors of all stripes checking the rearview mirror for risk as they ponder the who, what, where and when of the next crisis.

LOWER EXPECTATIONS

U.S. Public Pension Plans

	Median Assumed Rate of Return	Funding Ratio
2016	7.50%	73% *
2013	7.75%	69%

Asset Allocation	Equities	Alternatives	Fixed Inc.	Cash
2016	49%	24%	23%	4%
2013	49%	23%	25%	3%

* Projected

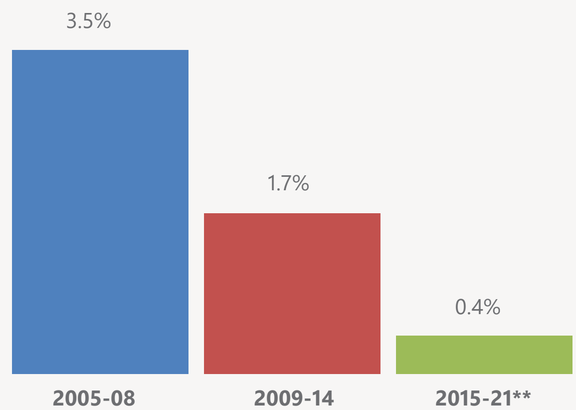
Source: Milliman 2016 Public Pension Funding Study: 100 largest plans; fiscal year data through June

The election of Donald Trump and his pledge of aggressive infrastructure spending, tax cuts and a business-friendly climate has some investors adopting a more hopeful outlook on U.S. economic growth, if not the world at large, along with the potential for a Ronald Reagan-style rebound in financial markets. Others aren't convinced, noting that stock valuations were just nine times earnings for the Standard & Poor's 500 when Reagan took office in 1981. U.S. interest rates were also starting their long-term decline from the inflationary 1970s, thereby making stocks attractive. By contrast, the S&P 500 was trading at 24 times earnings last December and the Federal Reserve could hike interest rates at a somewhat faster pace than anticipated.

SLOWER FLOW

Global Asset Management

Net Flows as % of AUM*



* Beginning of period, ex-China ** Projected
Source: Casey Quirk, "Survival of the Fittest: Defining Future Leaders in Asset Management," Dec. 2016

Asset managers are in the thick of this conundrum. On the one hand, institutions are more demanding about performance vs. fees, with alternative managers facing particular pressures on their charges. On the other hand, institutions have been shifting to passive investments and simultaneously bringing more assets in-house to reduce costs. This includes making direct private investments traditionally handled by alternative managers.

SMART GROWTH

U.S. Smart Beta ETF Assets $billions

	AUM	Net Inflows
2011	$160	$22
2012	$211	$32
2013	$333	$65
2014	$417	$63
2015	$461	$67
2016	**$559**	**$53**

Source: Morningstar

The profit outlook for the industry reflects these challenges and associated ones in the retail space. Casey Quirk & Associates' most recent survey in the U.S. for 2015 showed that AUM, revenue and operating margins dropped for the first time since 2008-2009, with median margins off two points from 2014 to 32%. A McKinsey study done last year for FTfm says the rise of passive investing and volatile markets — combined with operating costs that have climbed 50% since 2007 — could cause industry profits worldwide to drop by one-third by 2018. In a July 2016 report, **Moody's** expressed "concerns over the future of traditional active management" in noting recent downgrades to the ratings of such firms. "Looking ahead, absolute fund performance will be a more important consideration than a fund's performance relative to its peers, given that the majority of funds underperform the indices," Moody's wrote.

The demands of investors, the apparently unstoppable momentum of passive investments, the pressure on profits from regulation and costs, and the continued stresses on

STEADY VOLUME, LOWER VALUE

Mergers & Acquisitions Worldwide

Number of Announced Deals	2016 (vs. 2015+/-)
Worldwide	46,055 (+0.8%)
U.S.	11,027 (+7.2)
Europe	15,298 (-3.3)
Asia-Pacific (ex-Japan)	13,334 (+2.5)
Value of Announced Deals ($B)	**2016 (vs. 2015+/-)**
Worldwide	$3,666 (-16.1%)
U.S.	1,670 (-16.8)
Europe	756 (-12.6)
Asia-Pacific (ex-Japan)	896 (-21.7)
Of which (by $value 2016, worldwide)	
Acquisition by Private Equity	12%
Cross Border	38%
Emerging Market Targets	32%
Financials	10%
Real Estate	10%

Source: Thomson Reuters

European banks provided the ingredients for a third year running of robust merger and acquisition activity. These included several billion-dollar deals that could produce significant cost savings, the largest two of which involved European buyers and had a U.S. element in whole or part: **Amundi**'s €3.6 billion ($3.8 billion) year-end acquisition of the **Pioneer Investments** unit of **UniCredit** and **Henderson Group**'s merger with **Janus Capital Group**. **EFG International** followed with the CHF 1.1 billion ($1.1 billion) purchase of fellow Swiss wealth manager **BSI**. The seller, Brazil's **BTG Pactual**, was forced to divest BSI — a firm it had only just acquired in 2015 — to raise capital. UniCredit, itself under intense pressure to raise capital, had responded to the collapse of a complex 2015 four-party deal involving Pioneer by placing the business on the sale block.

In a related and sizable transaction, **Santander** bought back the 50% share of its asset management business held by U.S. private equity firms **Warburg Pincus** and **General Atlantic**.

While terms were not disclosed, the *Financial Times* reported that the private equity firms expected to achieve a 30% annual internal rate of return on the sale. Warburg and General Atlantic paid €1 billion for their original stake in 2013, when **Santander Asset Management** had €152 billion in AUM, or €28 billion less than in September 2016. All three of the parties were involved in 2015 with UniCredit in an ultimately failed bid to merge the Spanish and Italian banks' asset management units.

INVESTMENT MANAGEMENT TRANSACTIONS

	2012	2013	2014	2015	2016
Majority Equity	127	129	126	138	**160**
Minority Equity	29	20	14	21	**22**
Management Buyout	13	10	3	6	**9**
Total	**169**	**159**	**143**	**165**	**191**
Total Transaction Value ($B)	12.6	14.8	26.4	21.2	**24.0**
Total AUM Changing Hands ($B)	1,132	1,636	1,980	1,837	**2,443**

Source: Berkshire Capital Securities LLC

In another transatlantic megadeal that drew several interested parties, Boston's **HarbourVest Partners** agreed to pay £807 million ($1 billion) for the private equity portfolio of London's **SVG Capital**. SVG's fund of funds business has exposure to eight private equity managers on both sides of the Atlantic. The securities industry weighed in with two major transactions that underline the toll wrought by competitive pressures on commissions: **TD Ameritrade**'s $2.7 billion purchase of **Scottrade Financial Services** and **E*Trade Financial Corp.**'s $725 million deal for **Aperture New Holdings**, the parent of online derivatives broker **OptionsHouse**.

Affiliated Managers Group slipped just under the megadeal radar, paying $800 million for the minority stakes in five hedge fund managers held by **Goldman Sachs** in one of its private equity funds. AMG also took a minority interest in a large Asian private equity specialist, **Baring Private Equity Asia**, continuing a recent tilt toward adding alternative managers to its affiliate network. **Legg Mason** made three deals last year to bolster its boutique structure, including two for alternatives, paying $585 million for an 83% stake in New York-based real estate advisory firm **Clarion Partners** and $400 million in cash as well as equity for fund of hedge funds **EnTrust Capital**. Canada's **Fiera Capital Corp.**, which has set a goal of doubling AUM to C$220 billion ($170 billion) by 2020, cut two deals for alternative managers last year and set up two joint ventures focused on infrastructure and agriculture.

There were five deals involving U.S. exchange traded fund firms focused on the faster-growing smart beta and actively managed parts of the market, with an impressive list of buyers, including **Columbia Threadneedle** and **Hartford Funds**. The largest target by assets was New York's **Global X Management** (AUM: $3 billion), in which **J.P. Morgan Asset Management** made a minority investment. Global X has a lineup of 50-plus products, including its flagship Global X Super Dividend fund. The ETF market itself continued to go from strength to strength, setting a record pace as it garnered $224 billion in net inflows in the U.S. in the first 11 months of 2016, according to ETF.com. In total, there have been more than a dozen ETF deals done since 2014, with most of the buyers being large, traditional asset managers.

Among deals involving active managers, there remained a tilt toward niche players or those pursuing differentiated strategies. One example was **Eaton Vance**'s bid to meet the growing demand for socially responsible investments via its acquisition of **Calvert Investment Management**, an established player in that arena with $12 billion in AUM. A second much smaller deal saw **Touchstone Investments** acquire large company growth and global growth funds from **DSM Capital Partners**, which has a concentrated strategy and remains as subadvisor. In the UK, **Liontrust** bought two European income-oriented equity funds from **Argonaut Capital Partners** and a sustainable investment specialist, **Alliance Trust Investments**.

SECURITIES & MARKET STRUCTURE TRANSACTIONS

	2012	2013	2014	2015	2016
Majority Equity	75	75	95	75	**68**
Minority Equity	8	11	21	12	**6**
Management Buyout	1	1	0	1	**0**
Total	**84**	**87**	**116**	**88**	**74**

Source: Berkshire Capital Securities LLC

The UK's wealth management industry continued to consolidate, with many of the deals being driven by regulatory changes that have added costs and complexity to these businesses. In the largest, **Tilney Bestinvest** paid £600 million ($860 million) for **Towry** to nearly double its assets to £20 billion. Tilney also acquired a smaller London wealth manager, **Ingenious Asset Management**. In a deal between two venerable names in British wealth management, **Cazenove Capital Management** acquired family-run **C. Hoare & Co.**, while **Standard Life** cut multiple wealth deals directly and through a subsidiary. In the U.S., smaller banks made their presence felt in the wealth market as a part of broader strategies to expand businesses that are light on capital and less sensitive to interest rates. These included an East Coast transaction in which **People's United Bank** acquired **Gerstein**

Fisher and one in Virginia featuring **Union Bank & Trust of Virginia** buying **Old Dominion Capital Management**. Independent wealth managers in the lucrative San Francisco Bay Area remained a target, drawing buyers **Aspiriant**, **BNY Mellon** and **Tiedemann Wealth Management**.

In Asia, two Singaporean banks made opportunistic purchases from retrenching competitors, with **Oversea-Chinese Banking Corp.** acquiring **Barclays**' Singapore and Hong Kong wealth and asset management business and **DBS Bank** buying the Asian wealth business of Australia's **ANZ** as part of a larger retail banking deal. Australia also played host to multiple deals, including **CI Financial**'s purchase of a majority stake in **Grant Samuel Funds Management**. In 2015, Asia-Pacific passed North America to become the leader in high net worth wealth, according to Capgemini.

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Just when investors had divined a future of continuing low interest rates and tepid economic growth, the American people elected Donald Trump to be president on a platform that included aggressive pump-priming and threw a new variable into investors' models. Immediately, bond king Jeffrey Gundlach of **DoubleLine Capital** — one of the few investors to early on predict a Trump victory — suggested stronger economic growth and inflation could send the yield on the 10-year Treasury to 6% within five years. The way bond investors began heading for the exit doors — the yield on the 10-year Treasury rose 56 basis points from the end of October to December 1 to reach 2.49% — it would appear they're anticipating a similar trend line. "The idea that inflation and interest rates can never go up is a very tired narrative, born of years of stability in both," Gundlach told *Barron's*.

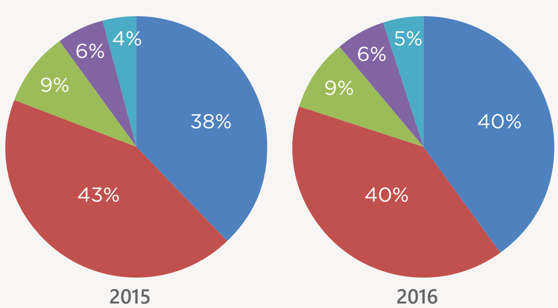
The populist surge in the U.S. and in Europe — where the "Brexit" vote in the UK and the rise of candidates such as Marine Le Pen in France and Norbert Hofer in Austria have shaken establishment voices and assumptions — is a predictable, if delayed, reaction to decades of deindustrialization and globalization that have marginalized millions of working-class citizens in the developed world. The rise of algorithms that threaten to displace white-collar jobs could add a new class of discontented citizens in the decades ahead, if we are to believe some of the dystopian visions advanced by tech futurists. (Indeed, this very Review — created through the toil of multiple partners — could one day be compiled by a software program!)

The asset management industry has been undergoing its own populist revolt for years as investors of all stripes give up in varying degrees on the wisdom of stock pickers

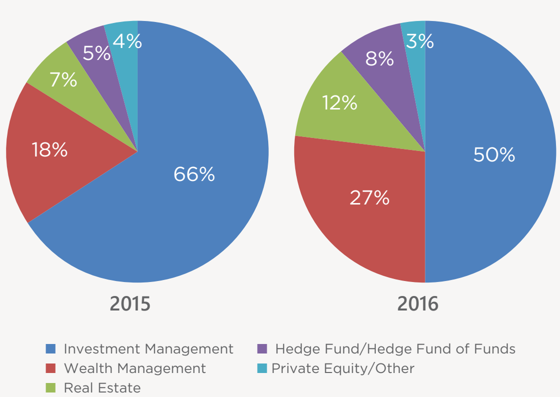
INVESTMENT MANAGEMENT

Who's Selling

Number of Transactions by Sector as % of Total



Value of Transactions by Sector as % of Total



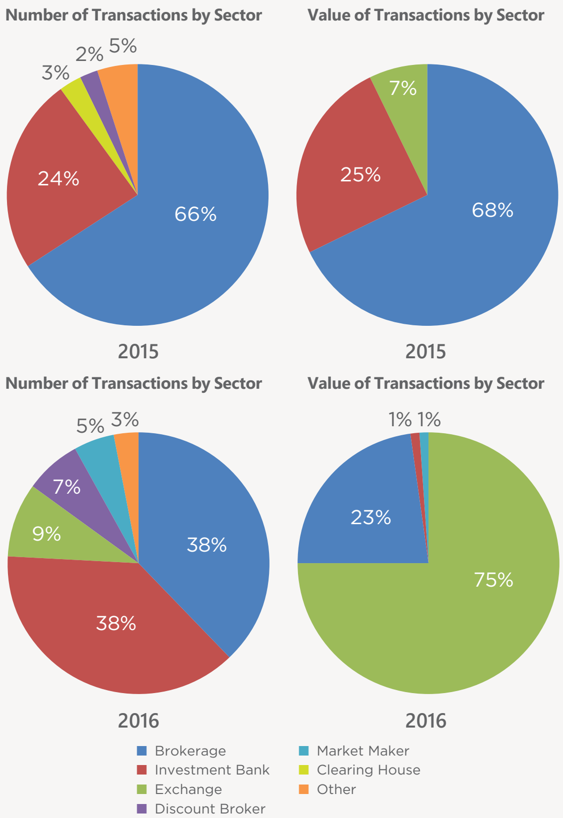
Who's Buying

	2012	2013	2014	2015	2016
Investment Management	36	36	31	45	**46**
Financial	24	32	16	27	**36**
Wealth Manager	23	13	21	20	**32**
Insurance Company	13	9	16	13	**20**
Bank	26	24	17	19	**19**
MBO	13	10	3	6	**9**
Securities Firm	9	9	14	16	**6**
Trust Company	2	6	4	4	**6**
Real Estate Manager	5	4	7	7	**5**
Other	18	16	14	8	**12**
Total	**169**	**159**	**143**	**165**	**191**

Source: Berkshire Capital Securities LLC

SECURITIES INDUSTRY & MARKET STRUCTURE

Who's Selling



Who's Buying

	2012	2013	2014	2015	2016
Investment Bank	7	14	26	33	**22**
Brokerage	41	33	57	32	**15**
Exchange	6	4	5	3	**7**
Market Maker	2	1	1	-	**7**
Private Equity	4	5	8	4	**6**
Bank	5	6	9	4	**4**
Other Non-Financial Services	3	4	3	6	**3**
Insurance Firm	2	1	-	1	**3**
Discount Broker	5	2	-	-	**2**
Investment Manager	-	-	-	-	**2**
Clearing House	3	3	-	1	**-**
Other	6	14	7	4	**3**
Total	**84**	**87**	**116**	**88**	**74**

Source: Berkshire Capital Securities LLC

and their related value-added fees and simply go with the flow in passive investments. As we note in the Investment Management section, 2016 proved to be another active year for M&A in the ETF space. In an industry where three giants account for 70% of the global market, the deals are necessarily bolt-ons. But for the traditional asset managers that have been engaged in these transactions the investments are significant, providing either entry to the market or adding or enhancing a particular niche, with smart beta firms in particular demand last year.

In one of the more symbolic maneuvers on the active vs. passive front last year, Legg Mason parted ways with Bill Miller via the sale of its half share in the legendary value investor's company, **LMM**, while investing on the flip side in an ETF firm. It is instructive that the Baltimore asset manager's two other deals in 2016 involved alternative managers that are in such high demand among institutions. One of the largest deals of the year was in part driven by the impact of ETFs, as two prominent active managers on both sides of the Atlantic, Henderson Group and Janus Capital Group, teamed up to create a more formidable entity.

The post-2008 populist revolt also continued to play out in the increased regulation of the financial services industry on both sides of the Atlantic, with the new "fiduciary rule" in the U.S. set to commence this year and the Europe Union's MiFID II (Markets in Financial Instruments Directive) put off for a year until 2018. In the U.S. at least, the Trump administration appears determined to release some of that pressure — a disposition that is likely to set off some acrimonious debates as Democrats jockey for a populist edge of their own ahead of the 2018 Congressional elections. For asset managers and broker-dealers who spent much time, effort and money in 2016 preparing for the fiduciary rule, the posture of the new administration could usher in a period of uncertainty.

On that note, we wrap up by highlighting two new sections in this year's Review — Securities Industry & Market Structure and Regulatory Developments — which take their place alongside the traditional comprehensive coverage of asset management sectors. This change reflects the evolution of our business to incorporate a growing securities practice that last year included our participation in five deals for broker-dealers and investment banks. We hope you will find these sections as informative and readable as those covering asset management. As we prepare for what appears to be an adventurous 2017 worldwide, we wish all of you a prosperous and healthy year ahead. We look forward to working with many of you as you determine your most profitable options for navigating that stage of risk and reward.

TRADITIONAL INVESTMENT MANAGEMENT

As exchange traded funds have exploded into a $3.4 trillion global industry, products have evolved from plain-vanilla index trackers to incorporate hybrids that promise lower volatility, exposure to steady dividend payers or plays on momentum stocks, among others. Assets in these "smart beta" products have mushroomed in the U.S. from $160 billion in 2011 to $559 billion by 2016, according to **Morningstar**.

For the firms that create the products, the payoff comes from an expanded ETF platform to lure investors with and the higher fees that are missing in traditional index trackers. Take **BlackRock**'s **iShares** Select Dividend ETF, for example. The 13-year-old product, with more than $16 billion in assets, a beta of 0.65 and a yield above 3%, charges a fee of 39 basis points. By contrast, the iShares Core S&P 500 ETF (AUM: $76 billion) has a fee of just 4 basis points following the firm's aggressive fee cutting last October. BlackRock itself had $67 billion in 96 smart beta ETFs as of the first quarter of 2016 and expects assets in such products industrywide to more than double by 2020.

TRADITIONAL INVESTMENT MANAGEMENT *

	2012	2013	2014	2015	2016
Number of Transactions	67	61	67	63	**76**
Combined Value ($B)	$7.3	$9.0	$20.5	$13.9	**$12.1**
Total Seller AUM ($B)	$762	$1,061	$1,430	$1,408	**$1,827**
Average Deal Size ($M)	$109	$148	$306	$221	**$159**
Average Seller AUM ($B)	$11.4	$17.4	$21.3	$22.4	**$24.0**

Source: Berkshire Capital Securities LLC
** Includes traditional institutional and mutual fund managers*

Investors embrace smart beta products for the diversification and risk management they provide at a lower cost than actively managed funds. But there are critics. A noted one is Burton Malkiel, economics professor at Princeton University, chief investment officer at robo advisor **Wealthfront**, and author of the best-selling "A Random Walk Down Wall Street." He echoes other skeptics who credit smart beta managers with being shrewder marketers than investors. "My sense is that the factors behind smart beta are not dependable," Malkiel told Bloomberg last May. "Where they work, they undoubtedly involve more risk. When I examined the smart-beta ETFs that have been in existence, I did not find that — after expenses — they have given investors a better risk-reward tradeoff."

The criticism from pundits like Malkiel notwithstanding, five significant buyers gave their own vote of confidence to the products by concluding transactions for U.S.-based smart beta or actively managed ETF specialists last year: **American Beacon Advisors**, **Columbia Threadneedle**, **Hartford Funds**, **J.P. Morgan Asset Management** and **Legg Mason**. The deals continued a trend of aggressive buying in the ETF space, mostly by traditional fund managers, that saw some eight such transactions done in 2014-2015.

The raid on smart beta and actively managed ETFs, while involving a small amount of assets in aggregate, was a notable trend last year in an investment management sector whose second-largest deal — the transatlantic merger between **Henderson Group** and **Janus Capital Group** — also reflected the challenges facing active managers. Meanwhile, one of the larger and more complex investment management deals of 2015 — the merging of **Pioneer Investments** and **Santander Asset Management** — collapsed last year, a victim of multiple factors, including management changes and the UK's Brexit vote. Pioneer parent **UniCredit**, engaged in a capital raising and strategic overhaul of its operations, responded by selling the firm to France's **Amundi** for €3.6 billion ($3.8 billion). *(See Cross Border for more on the Henderson and Amundi deals.)* In another potential bid by a European bank to raise capital, **Deutsche Bank** was reviewing the flotation of a minority stake in its large asset management unit. That business recorded €1.2 billion in pretax profit in 2015 and has more than €700 billion in AUM.

Among the smart beta ETF deals, two involved controlling stakes, the larger one being Columbia Threadneedle's purchase of **Emerging Global Advisors**. Based in New York and founded in 2008, EGA is an emerging markets specialist with $900 million in AUM and nine funds that span single countries, regions and sectors. One, India Infrastructure (AUM: $40 million), was launched in 2010 and provides exposure to some 30 firms in areas such as construction, mining and energy. Part of **Ameriprise**, Columbia said the acquisition "will complement our existing actively managed product lineup.... and accelerates our efforts as we build our smart beta capabilities." The company also indicated it would expand EGA's mandate beyond emerging markets. In 2011, Columbia acquired Grail Advisors, an actively managed ETF provider.

A smaller deal saw Hartford Funds acquire **Lattice Strategies**, a San Francisco firm with $215 million in AUM and four risk-oriented equity ETFs spanning the U.S. and non-U.S. developed and emerging markets. Established in 2007, Lattice rolled out its first ETFs in 2015. Hartford said the acquisition enables it "to enter a fast-growing category that will serve as a foundation for growth in the future." In a second investment management transaction, Hartford "adopted" 10 diverse U.S. mutual funds run by **Schroders**. The funds (AUM: $2.2 billion), rebranded under the Hartford Schroders name, will be subadvised by the British asset manager and give Hartford additional exposure to fixed income and emerging markets equity products and Schroders the opportunity to "accelerate our growth plans in the U.S. intermediary market." Although a small part of **Hartford Financial Services Group**, the mutual fund business (AUM: $74 billion) provides the parent with the highest return on equity of all its businesses (36%), as well as consistent dividends.

The three other U.S. ETF deals involved minority investments, with Legg Mason taking a 19.9% stake in New Jersey-based **Precidian Investments** but holding the option to acquire a majority. The investment, which Legg described as "modest," followed the company's launch in 2015 of four smart beta ETFs in tandem with affiliate **QS Investors**, as well as the hiring of two ETF executives from **Vanguard**. Precidian creates its own subdadvised ETFs and works with financial services firms to develop solutions for investors. Significantly, the company is also seeking SEC approval for its nontransparent actively managed ActiveShares ETFs. Several major asset managers, including BlackRock and **Capital Group**, have agreed to license Precidian's structure. Legg said active ETFs — a tiny part of the market with $38 billion in assets — are "the best ETF solution for the active management industry." Last July, the SEC signed off on new listing standards designed to accelerate the approval process for actively managed ETFs. In a reflection of Legg's ongoing effort to diversify its product lineup, the company acquired a real estate advisor and fund of hedge funds manager *(see Real Estate and Hedge Funds; see sidebar this section for an additional Legg deal)*.

J.P. Morgan Asset Management made a minority investment in **Global X Management** of New York, the largest of the ETF sellers with $3 billion in AUM. Founded in 2008, Global X offers more than 50 products, the dominant one being Global X Super Dividend (AUM: $837 million), an index of 100 of the highest dividend-yielding companies worldwide, with real estate investment trusts comprising nearly half the holdings. JPAM entered the smart beta market in 2014 with the launch of a global equity product, but ETFs remain a minor part of its business. In a 2015 interview with the *Wall Street Journal*, George Gatch, head of JPAM's global funds business, said the company sees "a good opportunity to ... deliver our insights into active mutual funds in the ETF market."

American Beacon Advisors rounded out the minority buyers by taking a stake in **ARK Investment Management**, a specialist in actively managed and index ETFs focused on "disruptive innovation." It marked the first acquisition by Texas-based American Beacon, which said the investment is a step toward creating a new multi-boutique holding company. Soon after, the company acquired Florida-based **Crest Investment Partners**, a quantitative firm that pursues equity, index and multi-asset strategies for institutional and retail clients. In the ARK deal, American Beacon said the firm's thematic approach was a bigger driver than the ETF element. Founded in 2014 by Catherine Wood, a former CIO of global thematic strategies at **AllianceBernstein**, ARK targets such areas as robotics, 3D printing, cloud computing and DNA sequencing. For example, the 2-year-old ARK Innovation ETF is highly diversified, with investments in some two dozen areas involving technology. The fund is also typical of the small size of the company's products, with just $7 million in AUM. The company said American Beacon provides "a platform for ARK to grow its business to the next level." In a sixth deal outside the U.S., state-owned **China Post** acquired **Royal Bank of Scotland**'s small European ETF portfolio. Finally, publicly traded ETF provider **WisdomTree Investments** accelerated the buyout of the minority stake it did not own in its European unit. **WisdomTree Europe** has seen its AUM climb from $50 million to $940 million since 2014.

Several deals last year underlined the appeal of active equity managers operating outside the challenging large-capitalization arena, where in the first half of 2016 fewer than one in five U.S. managers had beaten their benchmark, according to **Bank of America Merrill Lynch.** In areas ranging from small caps to emerging markets, however, institutions and individuals continue to bet that active managers can add value through canny stock picking and managing risk. For example, California's **Pacific Asset Advisors** acquired **Cadence Capital Management** of Boston, an established global equity investor with $4 billion in AUM. Cadence manages a range of equity strategies, including long/short, for mutual funds, institutions and high net worth investors, but PAA highlighted the "strategic beta solutions" that provide "distinct investment opportunities" for clients. In its beta portfolios, Cadence focuses on four main factors — value, yield, momentum and quality — that can "stand alone, be integrated into an existing portfolio, or be bundled to provide a comprehensive and consistent global investment." Cadence management did a buyout from majority owner **Allianz Global Investors** in 2005, with asset management investor **Rosemont Partners** assuming a 49% stake it sold in 2014. PAA is part of **Pacific Life Insurance**.

Teton Advisors gained an established small- and mid-cap equities value investor as well as greater scale in acquiring **Keeley Asset Management**, a Chicago firm with $2.5 billion in AUM. Teton, an over-the-counter stock, is based in New York and has $1.5 billion in AUM in a mix of internally managed and subadvised funds under the Teton Westwood brand, including small- and mid-cap products; it was spun off from **Gamco Investors** in 2009. Teton CEO Nicholas Galluccio called the deal a "transformational combination of two well-established active asset managers into a preeminent investment firm" that would capitalize on their combined resources in areas such as research.

A third example of the hunt for more specialized equity shops involved **Eaton Vance**'s acquisition of **Calvert Investment Management**, an established socially responsible investor with more than $12 billion in AUM in a mix of active and passive funds. The deal provides Eaton Vance with entry to the SRI universe, which has emerged as an increasingly significant component in the portfolios of institutions, family offices and individuals. (Last year, Morningstar released sustainability ratings for some 20,000 mutual funds worldwide.) In an interview with the *Wall Street Journal* in early 2016, Calvert President and CEO John Streur called 2015 a "transformative year" for SRI, as managers began to shed traditional industry-focused screens and instead pursued a more nuanced process of mining data to assess individual companies.

In a small deal, **Hennessy Advisors** paid more than $11 million to acquire the two mutual funds managed by **Westport Advisers**. The deal, driven by the retirements of Westport's two fund managers, adds $640 million in AUM from established mid- and small-cap funds, bringing Hennessy's total AUM to more than $7 billion. Hennessy will wrap the two funds into Hennessy Cornerstone Mid Cap 30, which with $1 billion in AUM is the firm's second-largest fund. Mid Cap 30 is a value fund that targets stocks with "above-average growth potential" while pursuing a rules-based buy-and-hold strategy that involves reconstructing the portfolio every fall. Publicly traded Hennessy has made numerous acquisitions over the years, but Westport represents the first since 2012.

Within the large-cap space, firms that avoid "closet" index tracking and pursue a unique and often concentrated approach — or whose assets can simply be folded into similar vehicles managed by a buyer — remain attractive. In one such small deal, Cincinnati-based **Touchstone Investments** added $208 million in AUM by acquiring the three mutual funds run by **DSM Capital Partners**. Touchstone will wrap the growth-oriented funds into two new Touchstone-branded Large Company Growth and Global Growth funds, retaining DSM as subadvisor. Touchstone praised DSM's "concentrated portfolios" and said the deal "will boost our lineup of highly active strategies with holdings that are differentiated from their benchmarks." DSM said the link to Touchstone's large distribution platform provides growth opportunities and economies of scale. Touchstone, with some $16 billion in AUM, employs a subadvisory model providing investors with access to institutional managers; it is part of insurer **Western & Southern Financial Group**.

One of the largest U.S. investment management deals involved a mix of traditional and alternative products: **Virtus Investment Partners**' $513 million purchase of **RidgeWorth Investments**. RidgeWorth nearly doubles Virtus' AUM to $87 billion, adding three affiliates that

LEGG MASON PARTS WITH A LEGEND

Last August, when legendary value investor Bill Miller bought out **Legg Mason**'s 50% stake in their **LMM** joint venture, it served as another potent symbol of the decline of star active managers and the rise of passive investing. Miller built a stellar record with Legg's Value Trust fund, beating the Standard & Poor's 500 index for 15 consecutive years. In the process, he became as closely identified with the firm he worked for as Peter Lynch was with **Fidelity Investments** during his legendary 13-year run with the Fidelity Magellan fund.

But Miller was undone by the financial crisis, with Value Trust dropping 55% in 2008 and enduring a subsequent run of underperformance. In 2012, he stepped away from the fund, whose assets by then had dropped to less than $3 billion from $21 billion in 2007. Miller continued to run Legg Mason Opportunity Trust, a mid-cap value fund launched in 1999, and started up Miller Income Opportunity Trust in 2014.

Both of those funds, with a combined $1.8 billion in AUM, comprise the portfolio of LMM, which was formed in 1999 and has three portfolio managers and one analyst. In a statement, Miller said the transaction affirmed his commitment to the funds and its investors and said his team "is dedicated to our long-term, value-driven approach and to true active management." Whether that approach will draw investors is another matter. The larger Opportunity Trust fund has delivered solid returns, but began to falter last year and faces the headwinds posed by index funds and ETFs in all their guises.

In 1991, when Miller began the outperformance streak that led **Morningstar** to name him the mutual fund manager of the decade, the robust investment climate helped even obscure managers deliver relatively strong returns, making fees an afterthought for investors. But in the current environment of lower return expectations, outperformance doesn't guarantee a rush of new money as investors scrutinize how costs eat into returns. For Opportunity Trust, fees range from 97 basis points to 1.98%, depending upon the share class, compared with index fund or exchange traded fund fees that can be as low as several basis points.

In a sign of the times, prior to parting ways with Miller, Legg made a minority investment in active ETF provider **Precidian Investments**, one of several moves it has concluded to bolster its ETF business. Chairman and CEO Joe Sullivan called Precidian "the perfect partner" to work with "on product development in the fastest-growing areas of the ETF market." (See this section for more on the Precidian deal.)

manage high yield/bank loans as well as value and growth equity. RidgeWorth also complements Virtus' tilt toward equities with a fixed income slant, as well as a large institutional client base (51% of AUM) vs. Virtus' retail focus (87% of AUM). Like RidgeWorth, Virtus pursues a multi-boutique structure. Pointing to the "highly competitive" asset management industry, Virtus President and CEO George Aylward said the deal "will give us increased scale, a wider range of strategies for institutional and individual investors, and broader distribution and client service resources, particularly for institutional clients." Virtus paid approximately 10 times trailing EBITDA (earnings before interest, taxes, depreciation and amortization), or 6.5 times including fully phased-in annual cost synergies of $25 million, and expects the deal to be 15% accretive to earnings per share in 2017 and 2018. RidgeWorth management, in conjunction with private equity firm **Lightyear Capital**, acquired the firm from **SunTrust Bank** in 2014.

The echoes of the financial crisis continued to reverberate in a second major U.S. investment management deal, as **State Street** agreed to pay around $485 million for **GE Asset Management**. Since 2015, General Electric has divested some $180 billion in assets from **GE Capital**. GEAM, which was not part of GE Capital, manages $110 billion for more than 100 institutional clients, including GE's $46 billion U.S. pension plan. In an interview with *Pensions & Investments*, **State Street Global Advisors** President and CEO Ronald O'Hanley emphasized the outsourced CIO (chief investment officer) aspect of the GEAM's business. "As more defined benefit plans decide to outsource rather than have large in-house investment staffs, we think this trend will continue to accelerate." State Street, which has 80% of its $2.2 trillion in AUM in passive investments (including ETFs), has targeted a 90% retention rate for GEAM's assets.

As **Goldman Sachs** refashions itself in the post-crisis environment into a more retail-friendly entity, it made a play for small investors by acquiring a fledgling online provider of individual retirement accounts, **Honest Dollar**. Based in Austin, Texas, Honest Dollar creates and maintains retirement accounts for small and medium-sized businesses and sole proprietors employing low-cost ETFs from Vanguard. In additional plays for the consumer market, Goldman began an online lending service for individuals in 2015 and online savings accounts through its **GS Bank**. Honest Dollar will be wrapped into Goldman's asset management arm.

Although the fixed income market remained robust for most of last year — in the first eight months of 2016 bond mutual funds in the U.S. had net inflows of $105 billion, according to the Investment Company Institute — the deal market for traditional fixed income specialists was subdued. Europe accounted for the largest such deal: Allianz Global Investors' acquisition of a global bond specialist with £34 billion ($50 billion) in AUM, **Rogge Global Partners**. AGI said the deal enhances its fixed income capabilities and strengthens its presence in the UK, where Rogge is based. In the U.S., **Tortoise Investments** acquired majority ownership of an established Los Angeles institutional firm, **Bradford & Marzec** (AUM: $4.3 billion), with Tortoise supporting a management buyout of 37%. Tortoise, with $13 billion in AUM, is part of Kansas-based **Mariner Holdings**. On the structured credit side of fixed income, there were multiple transactions for firms and assets, in a continuance of the consolidation trend that began after the financial crisis *(see Credit)*.

In the UK, **Liontrust** cut two deals for specialized capabilities, with the first for two European income-oriented equity funds from **Argonaut Capital Partners**, comprising £300 million ($425 million) in AUM. London-based Argonaut maintains £1.1 billion in three alpha and absolute return funds. Liontrust, which cited the rising demand for "income investing," subsequently relaunched the funds under its brand name. In the second deal, Liontrust could pay as much as £30 million for a sustainable asset manager, **Alliance Trust Investments** (AUM: £2.3 billion). Liontrust cited the "strong demand for sustainable investment in the UK and internationally" that it said "will only grow with the rise of millennials." With the two transactions, Liontrust has more than £8 billion in AUM in a variety of equity and multi-asset funds, primarily for retail investors. Listed on the London Stock Exchange, Liontrust recorded six straight years of net inflows through fiscal 2015.

In another UK deal involving two small firms, **MitonOptimal** acquired **Coram Asset Management** following the passing of Martin Gray, a longtime CEO of MitonOptimal who co-founded Coram in 2015 and brought part of the MitonOptimal team with him. Coram adds three funds with around £60 million in AUM (as of June 2015) to the £500 million MitonOptimal already managed. Almost all of Coram's assets are in its Global Balanced fund, which includes an alternatives component in addition to traditional fixed income and equity.

WEALTH MANAGEMENT

For decades, wealth management was a staid and predictable affair. Clients were loyal and quick to defer to the advice of learned advisors. Clubby, wood-paneled offices embroidered that sense of security and exclusivity. A 1960s Christmas print ad from the former Chase Manhattan Bank summed up the traditional relationship. It depicted an individual driving a sleigh with a human-sized egg in the accompanying seat. "Incongruous as it may seem, many otherwise well-organized people of means carry their investment problems with them wherever they go," the ad read. "Why be bothered with endless nest egg matters when you can delegate professionals?"

As the ads gained in sophistication over the decades, that reassuring message of trust, security and professionalism remained consistent. Then the 2007-2008 financial crisis intruded, including the Bernie Madoff and Wall Street scandals, and the tidy relationship between clients and advisors was knocked for a loop. The industry has been facing a series of challenges ever since. Initially, many clients reviewing their diminished portfolios lost faith in their advisors' acumen while also questioning their client vs. fees loyalties. In a world wealth survey by **Merrill Lynch** Capgemini done at the time, nearly half of millionaires said they were losing trust in their advisors and firms.

Although the numbers on trust have improved since, clients have also become more risk averse following that second stock market crash in less than a decade, sending many toward less profitable positions in cash, bonds and passive products. To this list of challenges for wealth managers, add in costly regulations formulated in the wake of the financial crisis that are pinching profits. Then there is Switzerland, the traditional symbol of wealth management and distinction. Since the crisis, the U.S. has been in the forefront of a legal assault on Swiss private banks that has cost the industry billions of dollars in fines, inflicted reputational harm, and forced greater transparency. Europeans followed with their own treaties.

WEALTH MANAGEMENT TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	60	57	49	71	**76**
Combined Value ($B)	$3.6	$3.3	$4.0	$3.9	**$6.5**
Total Seller AUM ($B)	$240	$371	$412	$206	**$298**
Average Deal Size ($M)	$60	$58	$81	$54	**$86**
Average Seller AUM ($B)	$4.0	$6.5	$8.4	$2.9	**$3.9**

Source: Berkshire Capital Securities LLC

If all that weren't enough, wealth managers are confronting a new tech-age competitor known as the robo advisor. While initially geared toward a younger high net worth clientele and those starting to save and invest, the low fees and other benefits such as automatic portfolio rebalancing also hold appeal for older investors. In the face of this particular challenge, wealth managers will likely prove resilient, with many embracing change. In a 2016 survey by PwC on wealth management trends, 46% of wealth managers agreed that robo advisors will be a "critical tool for engaging millennials" while only 8% disagreed. Another 79% agreed new technology such as mobile and social "will transform the industry."

Last year, **UBS** adapted to the robo future by introducing its SmartWealth platform in the UK, with further expansion planned for the rest of Europe and Asia. **Legg Mason** took the acquisition route, buying an 82% stake in Utah-based **Financial Guard**. Legg will wrap Financial Guard into its alternative distribution strategies business, which aims to combine technology with the investment capabilities of Legg's affiliates. Financial Guard selects both active and passive funds for its platform. **Eaton Vance** took the lead in a $40 million fund-raising for San Francisco robo advisor **SigFig Wealth Management**, joined by three other traditional giants: **New York Life Insurance, Santander** and UBS.

Those transactions aside, wealth management deals remained squarely focused on the traditional providers that, for the foreseeable future, will continue to dominate the industry. The deals involved generally small- to mid-size firms either tying the knot with similarly sized peers, teaming up with major players, or joining the ranks of the tight circle of aggregators. The largest deals took place in Europe, with the UK's ever-consolidating industry remaining a center of activity, drawing **Cazenove Capital Management**, **Standard Life** and **Tilney Bestinvest** as three of the higher-profile buyers.

But the major deal occurred in Switzerland, where Brazil's **BTG Pactual** began to rein in its global ambitions via a distress sale of Swiss wealth manager **BSI** for CHF 1.1 billion ($1.1 billion) to Swiss private bank **EFG International**. BTG, which had only just acquired BSI in 2015, sold the firm to raise capital after it was shaken by a domestic bribery scandal. A second opportunistic cross border deal saw **Oversea-Chinese Banking Corp.** capitalize on the global retrenchment of **Barclays** by paying $228 million for the British bank's Singapore- and Hong Kong-based wealth and asset management business *(see Cross Border for BTG and OCBC deals).*

In the U.S., there were noteworthy transactions in such hot markets as Silicon Valley and Seattle, as well as in the Midwest. Buyers included diversified national players such as **BNY Mellon**, which acquired Silicon Valley player **Atherton Lane Advisers**, and Los Angeles-based independent **Aspiriant**, which added two California firms. In Seattle, **Merriman Wealth Management**, part of aggregator **Focus Financial Partners**, bought **Summit Capital Management** to extend its presence in that market. In Milwaukee, **Johnson Financial Group** purchased an established local player, **Cleary Gull Advisors**. Community and regional banks also continued to snap up wealth managers in their quest to expand fee-based services *(see sidebar this section).*

As one of the fastest-growing areas for wealth creation, Silicon Valley has been attracting significant interest from wealth managers. Between 2013 and 2014, the high net worth population grew by 11.4% while assets among HNWIs increased 12.5%, according to Capgemini. The numbers in nearby San Francisco are similarly impressive. BNY Mellon, which opened a wealth office in Silicon Valley in 2014, strengthened that footprint last year by acquiring a local independent wealth manager, Atherton Lane Advisers. An 11-year-old firm, Atherton has $2.7 billion in AUM and handles $3 million per client on average; it will become part of BNY Mellon's wealth division. BNY called Silicon Valley "a key wealth market for our national and global expansion strategy." As part of that aggressive effort in the area, in 2013 BNY Mellon signed a 10-year sponsorship with the

San Francisco 49ers football team. Wealth management accounts for around 20% of BNY Mellon's total investment management fee revenue, which was $837 million in the third quarter of 2016.

New York's **Tiedemann Wealth Management** targeted another San Francisco Bay Area manager, **Presidio Capital Advisors**, to create a more formidable independent firm with $13 billion in assets ($4 billion from Presidio). In addition to their locations on the coasts, the combined firm has offices in three other core wealth markets — Dallas, Palm Beach and Washington, D.C. — with Presidio accounting for two. Referring to that enlarged presence, CEO Michael Tiedemann said, "We are now on the ground in the financial, technology, energy and political centers of the U.S." The firm will retain the Tiedemann name, with the 32 partners from both sides holding equity. Prior to the financial crisis, Michael Tiedemann made a noteworthy move by taking large cash positions for clients, built upon his experience sniffing out troubles in emerging markets in the 1990s. If there had not been a crisis, "we would have been massively underinvested — and likely fired for sitting on piles of cash," he explained to *Private Wealth* in 2015. Subsequently, the firm created its own partnerships to invest directly in master limited partnerships, as well as a value-oriented and opportunistic exchange traded fund.

Los Angeles-based Aspiriant, one of the larger U.S. independent wealth managers, acquired two established firms in its home state, including **Stanford Investment Group** in Silicon Valley. Although Aspiriant already had clients in Silicon Valley, Stanford provides a physical presence, along with $850

SMALLER U.S. BANKS EXPAND WEALTH UNITS

Four regional and community U.S. banks made investments in wealth managers last year, as smaller banks squeezed by negligible interest rates and expensive new regulations continue to expand fee-based services with low capital requirements. In a KPMG survey of community banks released in late 2014, more respondents (32%) cited asset and wealth management as the leading driver for near-term revenue growth than any other business category. Six in 10 respondents said they had seen a positive return on investment in wealth management while 37% said the return had been in the negative to zero range. KPMG opined that "there needs to be greater focus on driving ROI and an ongoing measuring capability (including cost accounting)."

The largest such deal in 2016 took place on the East Coast, where **People's United Bank** of Connecticut acquired New York's **Gerstein Fisher** (AUM: $3 billion), a wealth manager that also runs three quantitative mutual funds. The three funds — global real estate, multi-factor growth equity, and multi-factor global growth — have a total of $500 million in AUM. Gerstein Fisher founder and CIO Gregg Fisher said the connection with the distribution network of People's United "will allow us to help more people invest smartly" than the firm could "on a standalone basis." The deal gives People's United $20 billion in assets under administration and management.

In the company's 2016 second-quarter conference call, People's United President and CEO Jack Barnes said the transaction "complements recent investments in our fee-based business and will further diversify revenues with additional noninterest income." He also emphasized that Gregg Fisher will assume a "critical leadership" role at the bank in charge of quantitative research and portfolio strategy. In the third quarter, investment management fees comprised 13% of the bank's $91 million in noninterest income. A month prior to the July deal for Gerstein Fisher, People's United paid around $402 million for a Long Island-based bank, **Suffolk Bancorp**, as part of its New York expansion. People's United also has offices throughout New England.

A second transaction involved **Union Bank & Trust** of Virginia buying fellow Virginian **Old Dominion Capital Management** (AUM: $300 million). Union, with more than $2 billion in assets under management and advice, said a "key part of our company's strategic plan is to expand our wealth management business." Old Dominion, founded in 1989 by a couple of University of Virginia alumni, will operate as a separate boutique. Union Bank has indicated that it will continue to seek bolt-on acquisitions of wealth managers.

Oklahoma bank **BOK Financial** made its fourth wealth deal since 2012 by acquiring **Weaver Wealth Management**, with $340 million under management and administration. BOK, with significant exposure to the Southwest energy patch, cited the importance of the Dallas market, where Weaver is located. Weaver will be wrapped into BOK's Denver-based wealth manager, **Milestone Group**, with some $2 billion in AUM. BOK's assets under management or custody and fiduciary assets have climbed 60% since 2012 to $130 billion. **Midland States Bank** of Illinois acquired $400 million in wealth assets from **Sterling National Bank** of New York (part of **Hudson Valley Bank**), primarily in special needs and settlement trusts. Midland said the deal "allows us to expand our expertise in this specialized trust space." Midland, which did an initial public offering last year, has seen its assets under administration climb to $1.2 billion from $769 million since 2011.

million in AUM and 260 clients. Stanford said teaming with Aspiriant will provide its clients with enhanced services in areas such as taxes and estate planning, along with a larger investment infrastructure. In a second deal, Aspiriant acquired a Los Angeles competitor, **Glowacki Group**, which manages $360 million in assets for just 75 clients. "For as large a high net worth opportunity [as] there is in L.A., there aren't a lot of RIAs," Aspiriant CEO Rob Francais told *InvestmentNews*. "It's a market with many single family offices and business managers who take care of clients' financial affairs and hook them up with a wirehouse advisor for investing." With the two deals, the acquisitive Aspiriant boosts its assets under advice and management above $10 billion in accounts ranging as high as $60 million.

In the Midwest, Johnson Financial Group bought Cleary Gull Advisors to create one of Wisconsin's largest wealth managers, with $8.5 billion in assets under administration, including $2.1 billion from Cleary. Both firms are located in the Milwaukee area. "This move is part of our growth strategy for our wealth business and strongly demonstrates our commitment to the Milwaukee market," said JFG President and CEO Thomas Bolger. The two firms began discussions in 2015 after Cleary's then president and chief investment officer, Brian Andrew, left the firm to become CIO at JFG (part of consumer products group Johnson Family Enterprises). Cleary has a niche among airline pilots and employees in the health care industry. Cleary Gull also has an investment banking arm that remains independent. In Ohio, Akron's **Sequoia Financial Group** acquired **RAV Financial** of suburban Cleveland, adding about $400 million in assets to create a firm with more than $3 billion in assets under advice. Sequoia also acquired a small suburban Detroit firm, **GHD Wealth Management**, thereby establishing a Michigan presence; it also has an office in Florida. Sequoia is an affiliate of Cleveland-based accounting firm **Cohen & Company**.

Several wealth aggregators added to their portfolios last year, including Focus Financial Partners, both directly and through partner firms. A notable deal involving a Focus partner in Seattle saw Merriman Wealth Management acquire Summit Capital Management to create one of the largest wealth firms in the Northwest. With the addition of Summit's $500 million in assets, Merriman has more than $2 billion in assets. Merriman, which joined Focus in 2012, said the deal is part of an "overall regional growth strategy" and extends its presence to Spokane, where Summit has an office. Merriman also has a new office in Portland and plans further expansion. "We're also looking at the San Francisco Bay Area and the Scottsdale/Phoenix market, [where] many of our Pacific Northwest clients have relocated," Merriman CEO Colleen Lindstrom told the local *Journal of Business*.

Focus also cut deals with firms in Chicago, Denver and Memphis while expanding into Australia with the purchase of Melbourne-based **MW Lomax Group** *(see Cross Border)*. In August, the *Wall Street Journal* reported that New York-based Focus had "confidentially" filed for an initial public offering, a long-anticipated move (confidential filings involve firms with less than $1 billion in revenue). The filing could value Focus at around $1 billion. The company has some 40 partner firms in its portfolio and $400 million in annual revenue. Other aggregators that made acquisitions included **HighTower** and **United Capital**. Private equity firms that concluded deals directly or through wealth holdings included **Genstar Capital, Lightyear Capital** and **Lovell Minnick Partners**.

There were multiple deals involving either UK buyers or targets within the market's consolidating but still fragmented $1.7 trillion wealth business. New investor-friendly regulations that have added costs and complexity are driving many of the deals, but observers believe last year's Brexit vote could press even more small to mid-size firms into the arms of larger or similar-sized buyers. The dominant transaction in 2016 was an all-UK affair of similar-sized firms that saw Tilney Bestinvest buy one of the largest domestic independent wealth managers, **Towry**. Tilney Bestinvest, itself a product of a 2014 merger between Tilney and Bestinvest, paid £600 million ($860 million) for Towry, in the process nearly doubling its assets to £20 billion. The deal also involved two major European private equity players, with Tilney Bestinvest owner **Permira** acquiring **Palamon Capital Partners**' majority stake in Towry. Palamon acquired Towry in 2006 and then built scale through an ongoing series of acquisitions. Towry pursued a fee-based model rather than the more common commission-based one that regulatory changes eliminated in 2013. Palamon said it enjoyed a return of 13 times invested capital on the deal.

The combined firm has a national footprint with 30 offices, while 80% of assets are managed on a discretionary basis and 40% of clients have £1 million or more in assets. Permira said the new group "will have the scale to continue to invest to enhance its range of services for clients and will be well-positioned to take advantage of the increasing demand for advice." In a second deal executed prior to the one for Towry, Tilney Bestinvest acquired **Ingenious Asset Management**, a 13-year-old London firm with £1.8 billion in assets. Ingenious, part of the **Ingenious** financial services group, has a global, multi-asset orientation and seeks individual investments of at least £250,000. The firm gives Tilney Bestinvest additional scale in London.

A second deal of note saw Cazenove Capital Management acquire **C. Hoare & Co.**, a family-owned wealth manager with roots in the 17th century and headquarters in London. In a letter to clients, Partner and Director Alexander Hoare explained that "meeting the requirements of the regulators and new challenges of technology.... will require growing scale and investment" that he said would be best achieved as part of a larger firm. In C. Hoare's 2015-16 financial report, the firm noted that while it enjoyed record income, "costs also increased rapidly," driven by regulatory requirements and investment "in technologies that improve our services," including a mobile platform and app. Since 2014, C. Hoare's AUM has increased from £1.5 billion to £2.2 billion. Acquired by **Schroders** in 2013 for £424 billion, Cazenove acts as the wealth management arm for the British asset manager and has £34 billion in AUM. In an interview with *Citywealth* last year, Cazenove Deputy CEO Mary-Anne Daly noted the "increasing interest" among clients in passive products and acknowledged the role they could play "either to access those areas where active managers, however skilled, find it difficult to outperform consistently, or to gain quick access to a market."

In a transaction with a cross border angle — this one involving consolidation within the advisor platform business — Standard Life acquired **AXA Elevate**, the UK platform business of French insurer **AXA**. The deal creates one of the largest advisor platform businesses in the UK, with £36.4 billion in assets under administration and 350,000 customers, as well as pro forma net asset inflows of £5.7 billion in 2015. AXA Elevate adds £9.8 billion in AUA and 160,000 of those customers, while its platform supports more than 1,500 financial advice and wealth management firms and provides access to 5,000 funds. Standard Life said the deal "is a clear sign of our continued commitment to lead the UK adviser platform market. It demonstrates to advisers that, as the market consolidates, supporting their businesses and meeting the evolving needs of their clients is central to the long-term strategy of Standard Life." As part of its exit from life insurance and savings products in the UK, AXA also sold its UK investment, pension, life insurance and offshore investment bonds businesses.

Standard Life subsidiary **1825** made multiple acquisitions last year in the UK, in total adding some £1.4 billion in assets. One, for **Jones Sheridan**, was typical, involving an established small firm (£350 million in assets) that added a new geographic presence (North West England). Jones Sheridan said it cut the deal to take its business "to the next stage," noting: "The breadth of the 1825 proposition will enable us to offer our clients market-leading solutions for all their planning needs." Another target, Norwich-based **Almary Green** (assets: £400 million), attributed its sale to the "almost insurmountable" cost pressures facing small to mid-size firms, "due mostly to the increasing cost of regulation."

CROSS BORDER

From the U.S. to the UK to the eurozone, the reaction against free trade and globalization appeared to reach a crescendo last year. In the UK, voters stunned the chattering class in June by opting to leave the European Union — a decision that was in turn applauded by the populist chorus in Europe. This included Marine Le Pen, head of France's National Front party, who bluntly told *Time*: "This is the beginning of the end of the European Union." Le Pen has promised to hold a referendum on France's continuation in the EU if she is elected president this year.

In Belgium, regional politicians pushed back against the Comprehensive Economic and Trade Agreement that was signed between the EU and Canada in October, almost scuttling the deal in the process. "It is inevitable now that Europe will have to go through lighter and less ambitious trade agreements because of CETA," Hosuk Lee-Makiyama, director of European think-tank Ecipe, told the *Financial Times*. "First, we will receive less ambitious offers in return because our counterparts will not expect us to be able to ratify trade agreements. Second is that you will see a carve-out of several negotiation areas."

And in the U.S., Donald Trump drove his successful presidential campaign in part by railing against "unfair" trade deals going back to the 1994 North American Free Trade Agreement. That deal, which President Trump has vowed to renegotiate, had drawn the ire of another populist billionaire who ran for president in 1992, H. Ross Perot. As Trump's similarly fiery tirades gained resonance, American politicians of all stripes who had previously supported the free-trade Trans-Pacific Partnership raced for cover, including Democratic presidential nominee Hillary Clinton, who had championed the deal as secretary of state. The TPP was buried by Congress immediately after the election.

CROSS BORDER TRANSACTIONS: INVESTMENT MANAGEMENT

U.S. - INTERNATIONAL	2012	2013	2014	2015	2016
Number of Deals	22	27	21	26	**20**
Value ($B)	$3.0	$3.9	$5.2	$2.7	**$6.3**
INTERNATIONAL - INTERNATIONAL					
Number of Deals	26	23	20	27	**32**
Value ($B)	$1.7	$4.0	$6.5	$4.6	**$6.6**
TOTAL					
Number of Deals	48	50	41	53	**52**
Value ($B)	$4.7	$7.9	$11.7	$7.3	**$12.9**

Source: Berkshire Capital Securities LLC

Weighed down by the soft global economy, trade wasn't faring too well in any event. The World Trade Organization forecast last September that trade would rise just 1.7% in 2016 — the lowest increase since 2009 and well below an earlier forecast of 2.8% in April. WTO also downgraded its 2017 trade growth forecast from 3.6% to between 1.8% and 3.1%. WTO Director-General Roberto Azevedo called the negative trend "serious" and a "wake-up call," adding: "It is particularly concerning in the context of growing anti-globalization sentiment. We need to make sure this does not translate into misguided policies that could make the situation much worse."

Within Europe's asset management industry, there is particular uncertainty regarding the post-Brexit relationship

CROSS BORDER TRANSACTIONS: INVESTMENT MANAGEMENT

2016	BUYER: SELLER:	U.S. INT'L	INT'L U.S.	INT'L INT'L	TOTAL
Wealth Management		2	2	10	**14**
Investment Management		3	8	14	**25**
Other		2	3	8	**13**
Total		**7**	**13**	**32**	**52**

2015	BUYER: SELLER:	U.S. INT'L	INT'L U.S.	INT'L INT'L	TOTAL
Wealth Management		2	1	12	**15**
Investment Management		6	9	11	**26**
Other		6	2	4	**12**
Total		**14**	**12**	**27**	**53**

Source: Berkshire Capital Securities LLC

between the UK and the continent. The UK manages £1.2 trillion ($1.5 trillion) in assets for continental Europeans, according to the UK Investment Association (IA), compared with €1.6 trillion ($1.8 trillion) in AUM for Germany's asset management industry as a whole. But in its latest survey of the domestic asset management industry, IA questions whether Europeans will begin to repatriate those funds. "To what extent will it remain straightforward to serve European funds and clients from the UK? What, if any, elements will need to relocate within the EU?" Notably, the UK could lose the EU's MiFID (Market in Financial Instruments Directive) "passport" that allows it to provide investment services across the continent.

The tide of slowing trade, public opinion and political activity didn't dent the global ambitions of asset managers last year, including three cross border megadeals. The largest showed the enduring legacy of the financial crisis, as **UniCredit** sold **Pioneer Investments** to **Amundi** for €3.6 billion ($3.8 billion) as part of a capital-raising and restructuring effort. A second megadeal, **Henderson Group**'s "merger of equals" with **Janus Capital Group**, underlined the pressures passive investments and increased costs are posing for active managers on both sides of the Atlantic *(see sidebar this section)*.

Zurich-based **EFG International** joined Amundi and Henderson Group in cutting a megadeal by paying CHF 1.1 billion ($1.1 billion) for Swiss wealth manager **BSI**, in a distress sale by Brazilian parent **BTG Pactual**. In general, wealth managers grappling with higher regulatory costs or simply seeking expansion via acquisition were active in Europe and Asia, led by a couple of Singaporean banks cutting cross border deals. U.S. firms, which have been making some high-profile deals in the restructuring European asset management industry, were notable for their absence.

Overall, cross border deals accounted for $922 billion of global M&A activity in the first nine months, according to Thomson Reuters. The dollar number, while significant, was down 12% from the same period in 2015, but as a percentage of all deals the number rose by five points to 39%.

The Amundi-Pioneer transaction — the largest asset management deal since **TIAA-CREF**'s $6.3 billion acquisition of Nuveen Investments in 2014 — occurred in December and followed the unraveling of a multiparty deal announced in 2015 to merge Pioneer with **Santander Asset Management**. The sale was part of the larger plan by UniCredit to strengthen its balance sheet, including the issuance of €13 billion ($13.6 billion) in new equity and the selloff of nearly €18 billion in nonperforming loans. Pioneer reportedly drew interest from a broad range of firms such as **Aberdeen Asset Management, Allianz, Ameriprise, Axa** and **Natixis**. The all-cash transaction was priced at 16.6 times 2016 earnings excluding synergies and 10.5 times including pre-tax run-rate synergies of €180 million. The French asset manager — which will pay for Pioneer with excess capital, equity and debt — estimates the deal will be 30% accretive to earnings per share.

In acquiring Pioneer, Amundi adds €222 billion in AUM to become the eighth-largest asset manager in the world, with €1.3 trillion in AUM, as well as pro forma net revenues of €2.5 billion (Pioneer: €875 million) and EBITDA (earnings before interest, taxes, depreciation and amortization) of €1.1 billion (Pioneer: €327 million). Pioneer also adds a stronger retail franchise, with such clients accounting for 74% of AUM compared with just 27% at Amundi. Additionally, Pioneer lowers Amundi's dependence on the French market from 56% to 42% of AUM on a pro forma basis, not including assets managed for the insurance arms of **Credit Agricole Group** and **Societe Generale** (Credit Agricole will retain its majority ownership of Amundi). Ex-insurance, the combination raises Amundi's share of its European AUM outside France from 18% to 33%, with particular strength in Germany and Italy, and U.S. AUM from 1% to 6%. On the product side, Pioneer brings expertise in multi-asset management, accounting for 47% of its AUM vs. 12% at Amundi, which has 51% of assets in fixed income (Pioneer: 34%). Yves Perrier, CEO of Amundi, called the acquisition "a major step to anchor Amundi as the European leader in asset management" and a "reinforce[ment of] Amundi's industrial model." As part of the deal, UniCredit agreed to a 10-year distribution partnership in Austria, Germany and Italy that provides Amundi with access to potentially higher-margin retail clients in those markets.

EFG International acquired wealth manager BSI, with the original cash-and-share price of CHF 1.4 billion ($1.4 billion) settling by closing at CHF 1.1 billion owing to a decline in tangible book value. That was due in part to the loss of BSI assets related to the scandalized Malaysian state investment fund, **1Malaysia Development**. BSI, based in Lugano, Switzerland, adds CHF 69 billion in AUM to the CHF 80 billion EFG already managed to create a top-10 private bank in Switzerland. The two firms also sport complementary footprints, with the combined entity having 60% of its AUM in Europe and 31% split about evenly between Asia and the Americas.

Joachim Straehle, CEO of EFG, hailed the combination as "forming a leading pure-play private bank with Swiss roots, a broad international presence and an entrepreneurial spirit." EFG is targeting 3% to 6% annual growth in AUM while synergies are projected to deliver pre-tax savings of CHF 185 million by 2019, or 15% of the firms' combined cost base. Seller BTG Pactual acquired BSI in 2015 as part of its ambitious global expansion, but an alleged bribery scandal in its Brazilian base soon after involving former CEO Andre Esteves rocked the company. Subsequently, BTG was forced to shore up its balance sheet via numerous asset sales, although the company retains a 30% share in the enlarged EFG.

A second wealth deal of note involving domestic consolidation but a cross border element saw Societe Generale acquire the UK's **Kleinwort Benson** from French financial services firm **Oddo & Cie**. SocGen plans to merge KB with its existing British private bank, **SGPB Hambros**, to create a leading UK wealth manager with £14 billion ($20 billion) in AUM. "This acquisition will bring together two of the most recognized names in private banking," said the French bank. SocGen's private banking business as a whole had a record €119 billion ($130 billion) in AUM as of the third quarter of 2016, including the addition of KB's assets. Prior to the deal, Oddo & Cie acquired KB parent **BHF Kleinwort Benson Group** aiming to divest some of the asset manager's holdings in the UK.

HENDERSON, JANUS EXTEND A TRANSATLANTIC EMBRACE

Henderson Group's all-share "merger of equals" with **Janus Capital Group** creates a top-50 global asset manager with some $320 billion in AUM ($195 billion from Janus), strength on both sides of the Atlantic, and headquarters in London and Denver. But at heart the deal reflects a response by two active managers to the pressure from passive investments, fee compression and the cost of new regulations. "This is one of many transnational deals we're likely to witness with the relentless rise of passive management," Amin Rajan, CEO of London asset management consultant Create Research, told the *Financial Times*. "Active managers need serious cost efficiencies to ride out this turbulent phase. Business as usual is no longer an option."

Henderson figures synergies will drive double-digit accretion for both companies' annual earnings per share and ultimately shred annual costs by $110 million, or 16% of pro forma underlying EBITDA (earnings before interest, taxes, depreciation and amortization) of about $700 million. The two firms have complementary investment capabilities and footprints, with Janus managing $149 billion in assets in the U.S. and Henderson $91 billion in Europe (73% in the UK). In the U.S., Henderson has $52 billion in AUM, primarily institutional, while Janus has a small presence in Europe. Both firms also have operations in Australia, but Janus adds a presence in Japan through its relationship with **Dai-ichi Life Insurance**, the largest Janus shareholder with 20% equity. Dai-ichi will assume a 9% share of the combined firm and plans to boost that to 15% while investing another $500 million in the product portfolio. In total, Henderson shareholders will have a 57% stake in the combined **Janus Henderson Global Investors** while Janus shareholders hold 43%.

On a pro forma basis, Janus Henderson will have 54% of its AUM in the Americas, 31% in Europe and the rest in Asia-Pacific. The two firms also complement one another from the product side: 58% of Janus' AUM is in U.S. equities and just 10% global while Henderson has nearly half its equity AUM in European and global equities. Both firms have significant fixed income businesses, including a marquee presence in Bill Gross, who left a storied career at **Pimco** in 2014 to join Janus, where he runs a $1.5 billion unconstrained fund. With those complementary footprints and products, the combined firm is aiming to deliver 2% to 3% net inflows each year. The deal occurred as a *Pension & Investments*/Willis Towers Watson survey showed that assets among the world's 500 largest fund managers declined in 2015 for the first time since 2011, by 1.7% to $76.7 trillion. Willis cited lower assets at defined benefit plans, more in-house asset management by institutions, and the impact of the stronger dollar on currency translations.

In discussing the deal, Henderson Chief Executive Andrew Formica emphasized that the "rationale for this transaction is not about cost synergies. It's about what we can do to grow in the future. Together we can grow faster than we could on our own." For clients, he said, the combined firm can deliver "broader investment expertise ... greater choice and ... improved client service." The new firm will also "build stronger relationships with our largest distributors with an enhanced and truly global service model. Our clients have ambitions to be more global and we need to move with them." At the time the deal was announced last October, the firms had a combined market capitalization of about $6 billion.

An additional wealth deal with a British target saw **LGT** acquire a majority stake in **Vestra Wealth**, an 8-year-old London firm with £5.6 billion in AUM. Owned by the Princely House of Liechtenstein, LGT said the deal gives it "a significant foothold in the important British market." In a second deal secured toward year-end, LGT acquired **ABN Amro**'s private banking business in Dubai, Hong Kong and Singapore (AUM: $20 billion). LGT called the deal a "major step" in its international growth strategy, saying the business will "enhance its already strong footprint in Asia and the Middle East." Prior to the two deals, LGT's AUM had climbed 50% over five years to CHF 132 billion.

A little over a month after it was acquired by European private equity firm **Cinven**, insurer **Ergo Italia** paid €278 million for **Old Mutual Wealth**'s Italian wealth business, which manages €7 billion for 53,000 affluent and high net worth clients. **Old Mutual Wealth Italy**'s AUM has grown by an annual average rate of 16% over the last four years while pretax adjusted operating profit in 2015 was €22 million. Old Mutual Wealth has been divesting its continental European portfolio as parent **Old Mutual** prepares to split the company into four parts, including a UK-focused wealth business and an emerging markets unit.

Asia-Pacific also played host to numerous cross border wealth deals. Although profitability in the region has been a challenge — for example, Switzerland's **Union Bancaire Privee** says it needs to double its Asian AUM to $20 billion to generate a reasonable profit — the lure remains powerful: Asia-Pacific passed North America in 2015 as the leading area for high net worth wealth, according to the latest World Wealth Report from Capgemini. That year, Japan and China alone accounted for close to 60% of the growth in the global HNWI population. In the 10 years through 2015, the region's HNWI population and wealth doubled, and Capgemini projects there could be another doubling by 2025.

Singapore's **Oversea-Chinese Banking Corp.** has been among the more aggressive local wealth players. Last year, OCBC made its second opportunistic deal at the hands of a retrenching European firm, paying $228 million for **Barclays**' wealth and asset management business in Singapore and Hong Kong. In 2009, OCBC acquired the large Asian wealth business of **ING Groep**. Barclays adds $13 billion assets to the $62 billion OCBC already managed while "deepening its presence in four core markets": Greater China, Indonesia, Malaysia and Singapore. OCBC also operates elsewhere in Southeast Asia and the Middle East. Even without the addition of Barclays' business, OCBC's AUM rose by 20% between the third quarter of 2015 and 2016. Wealth management accounts for more than one-quarter of OCBC's income and is the largest single contributor to fee income.

Another of Singapore's major banks, **DBS Bank**, acquired the Asian wealth management and retail banking businesses of Sydney-based **ANZ**, as the Australian bank continued to retreat from the "super regional strategy" it hatched in 2007, citing a lack of scale. ANZ will maintain an institutional banking presence in Asia. On the wealth side, the deal gives DBS $4.7 billion in AUM and 100,000 affluent and private wealth clients in such markets as Singapore and Hong Kong. The additional assets enhance DBS' position as a top-five private bank in Asia, with $83 billion in HNWI AUM. DBS said the acquisition will be earnings accretive one year after completion. In 2014, DBS acquired what remained of Societe Generale's Asian private banking operations.

Singapore figured in a third deal involving Old Mutual Wealth acquiring **AAM Advisory** (AUM: $300 million), which focuses on expatriate clients in the island republic. Singapore is one of OMW's two core markets in Asia, with the other being Hong Kong. AAM said it was "looking for a partner to help us grow." A second transaction involving a UK buyer and a major Asian wealth center saw London's **LJ Partnership** acquire **Guggenheim Investment Advisors** of Hong Kong, thereby adding a new location to its global footprint and bumping its assets to $13 billion. Founded in 2009, LJP is a private wealth partnership that includes members of the Guggenheim family, while GIA was an advisory group of investment firm **Guggenheim Partners**. LJP, which said the deal is "illustrative of our aspirations as we strive for further growth," also acquired a minority stake in European real estate advisor **Pradera** *(see Real Estate)*.

Australia hosted multiple cross border deals featuring North American players. New York wealth aggregator **Focus Financial Partners** made its first investment Down Under and third outside the U.S by acquiring **MW Lomax Group**, a Melbourne firm with $270 million in assets. Focus indicated it will seek more deals in Australia. In an interview with the *Australian*, MW Lomax Managing Director Jon White noted the chasm between the major Australian wealth managers and the smaller firms, saying, "Clients are desperate to leave these top-tier companies, but they've got nowhere to go — only this small cottage industry at the bottom. The independent adviser market needs to consolidate and come into the middle." Focus also made several deals in the U.S. *(see Wealth)*.

In a second deal involving a U.S. firm, asset management private equity investor **TA Associates** backed the management buyout of **Goldman Sachs Asset Management**'s Melbourne-based asset manager. The Australian unit manages a mix of long-only equity and fixed income products for institutions and retail investors and has more than $6 billion in AUM. The Australian pension market has assets of $1.5 trillion and has been growing at 9% annually over the past 10 years. Referring to the market's size and potential, TA noted that increased regulatory costs "have created barriers to entry and have highlighted the benefit and need for scale among asset management firms." GSAM will continue to offers its global products to Australian institutions.

Canadian fund giant **CI Financial** also tapped the market, acquiring 80% of **Grant Samuel Funds Management** (AUM: $4.6 billion), with management retaining the rest. CI said the acquisition aligns it "with a proven competitor in one of the world's fastest-growing pension markets." Founded in 2007, GSFM has relationships with several asset managers, including New York's **Epoch Investment Partners**, which runs the $1.5 billion Grant Samuels Epoch Global Equity Shareholder Yield fund. That fund focuses on firms with a track record for delivering dividends and share buybacks while reducing debt.

Aggressive Montreal asset manager **Fiera Capital** cut three diverse cross border acquisitions, bringing the number of deals it has concluded since 2012 to 10, including five in the U.S. The first involved Ohio's **Apex Capital Management**, a growth equity manager with $7.1 billion in AUM in a mix of branded funds, subadvisory roles and separate accounts. Fiera, which paid about $145 million for the 29-year-old firm, said the deal will double its presence in the U.S. institutional and subadvisory retail markets. In his annual shareholder letter, Chairman and CEO Jean-Guy Desjardins said the addition of Apex gives Fiera "a full-fledged U.S. presence, and a growing offering of proprietary strategies for institutional, private wealth and retail clients." As of 2015, Fiera had $26 billion in AUM in the U.S., or around one-third of total AUM.

In a second deal, Fiera paid $53 million for another independent firm, **Charlemagne Capital**, an emerging and frontier markets specialist. Founded in 2000 and based in London, Charlemagne has more than $2.2 billion in AUM. Fiera said Charlemagne will provide a European distribution platform for the Fiera portfolio as well as an emerging and frontier markets capability that will "benefit our clients who are consistently looking for diversification opportunities." Fiera said both transactions will be accretive in the first year. Fiera also acquired New York hedge fund **Larch Lane Advisors**, among other alternative deals *(see Hedge Funds/Private Equity)*.

REAL ESTATE

After a multiyear expansion in real estate driven by historically low interest rates, strong commercial demand in major cities, and institutional clamor for the asset class, the market began to show a few cracks last year. In the U.S., mortgage defaults and vacancy rates inched higher while sales volume dropped. Additionally, as Donald Trump prepared to assume the presidency and his proposals for stimulative infrastructure spending and tax cuts came closer to reality, the specter of inflation and higher interest rates added a new wrinkle to the real estate picture.

The global picture was equally uncertain. In the year through June 2016, global property investment rose 0.5% to $1.35 trillion from the year-earlier period, with the top 25 "gateway cities" accounting for 53%, according to Cushman & Wakefield. But if development land is factored out, investment actually declined by 6%, marking the first such drop in seven years. "Falls were broadly spread in all regions and sectors as investors have reacted to tight supply and high pricing on the one hand but also greater volatility and a seemingly unending flow of uncertainty on the other," Cushman wrote in an October report.

Still, institutional investors appear prepared to stay the course and then some. In a 2016 survey of institutions worldwide by Cornell University's real estate program and Hodes Weill & Associates, respondents said they plan to hike their real estate allocations once more this year to 10.3%, up from 9.9% in 2016 and 8.9% in 2013. At the same time, the "conviction index" dropped year-over-year from 5.6 to 5.4 on a scale of 10. "Investors continue to cite too much capital pushing valuations ahead of fundamentals, the risk of rising interest rates, global capital markets volatility and geopolitical risks as causes of concern," the report said. Still, in a reflection of the uncertainties facing other assets, the report noted that chief investment officers continue to view real estate as offering "a favorable risk/adjusted return."

REAL ESTATE TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	10	13	13	15	**18**
Combined Value ($M)	$230	$875	$1,458	$1,526	**$2,892**
Total Seller AUM ($B)	$39	$78	$93	$90	**$151**
Average Deal Size ($M)	$23	$67	$112	$102	**$161**
Average Seller AUM ($B)	$3.9	$6.0	$7.1	$6.0	**$8.4**

Source: Berkshire Capital Securities LLC

The ongoing demand for real estate was evident in the private equity industry last year, as funds drew $74 billion in new capital through the first three quarters. While that was down from $87 billion during the same period in 2015, 61% of funds achieved or exceeded their target compared with 54% the previous year, according to Preqin. **Blackstone Group** was one of the beneficiaries, having raised €5.5 billion ($6.1 billion) and counting by May in its Real Estate Partners Europe V fund. The private equity firm is targeting a 20% gross internal rate of return and 15% net of fees. In November, Blackstone also acquired the €3.3 billion portfolio of Germany's **IVG** in what was Europe's largest property deal of 2016 up to that point. Blackstone made the purchase through its opportunistic $8.2 billion Real Estate Partners Europe IV fund, which closed in 2014.

The real estate advisory sector continued its steady consolidation last year, registering 18 transactions valued at $2.9 billion. The 2016 INREV Fund Manager survey showed the top 10 property fund managers accounted for 41% of AUM in 2015, up sharply from 36.5% the prior year. In 2016, a diversified asset manager, **Legg Mason**, accounted for the largest real estate advisory deal, spending $585 million for an

83% stake in **Clarion Partners**, with management retaining the rest. In business for 33 years, Clarion is based in New York and manages $40 billion in core, core-plus, and opportunistic portfolios across a range of property sectors. The firm has 300 clients (20% outside the U.S.) and AUM has climbed from $24 billion since 2011. Legg said the deal would be "modestly accretive" in the first year.

In Legg's first earnings call after the Clarion transaction, Chairman and CEO Joe Sullivan emphasized that the fundamentals of commercial real estate remained solid, saying "the supply-demand curve, increasing institutional allocations to real estate, and the burgeoning retail and foreign demand" pointed to "the real potential for continued upside." Accordingly, Legg plans to provide Clarion with co-investment capital of $100 million in the future. Legg cut the deal with New York private equity firm **Lightyear Capital**, a financial services specialist that held the Clarion investment for five years. Legg concluded two other deals last year *(see Investment Management and Hedge Funds/Private Equity)*.

In a second U.S.-based deal, **Neuberger Berman** acquired a minority stake in **Starwood Capital Group** via its **Dyal Capital Partners** alternative investments unit. Dyal made two other investments last year *(see Hedge Funds/Private Equity)*. Founded in 1991 to invest in non-performing loans and real estate assets resulting from the savings and loan crisis, Starwood has $53 billion in AUM, primarily in global real estate and energy-related investments. The company also owns Starwood Hotels & Resorts and **Starwood Property Trust**, a commercial mortgage finance company. Starwood Capital said it will use Dyal's investment to "fund strategic growth initiatives worldwide."

A third all-U.S. deal merged real estate investment trust and advisory businesses and involved three parties: **Colony Capital, NorthStar Asset Management Group** and its former parent, **NorthStar Realty Finance**. The companies, which split equity about evenly, said the merger will "create a world-class, internally managed, diversified real estate and investment management platform." The combined firm, **Colony NorthStar**, has $58 billion in AUM in private funds, traded and non-traded REITs, and mutual funds. Combined, the firms will generate $115 million in annual cost synergies and facilitate a "stronger balance sheet, ongoing deleveraging and improved liquidity," with a debt-to-capitalization ratio below 50%. NorthStar Realty, a commercial property REIT, spun off its asset management arm, NSAM, in 2014, but NSAM continued to manage its former parent's business — a structure that some investors found objectionable. Colony Capital is a global real estate firm that invests in equity and debt and manages private equity funds.

In a domestic French deal, **Amundi** and **Credit Agricole** merged their real estate advisory units to create a top-five European business with €20 billion ($22 billion) in AUM and designed to drive "ambitious business development with large institutional clients in France and abroad." Publicly traded Amundi, which was formed from the merger of the asset management businesses of Credit Agricole and **Societe Generale**, said the deal is in keeping with its "determination to strengthen its position in real assets" *(see Cross Border for more on Amundi).*

The largest number of real estate advisory deals crossed borders in Europe and Asia, including a transatlantic deal in which real estate services firm **JLL** of Chicago bought **Acrest**, a leading Germany retail real estate advisory firm (AUM: €5 billion). JLL said the deal is a "further example of [its] disciplined strategy of supporting organic growth with carefully selected strategic business acquisitions." JLL already has exposure to the German retail sector via its services arm, but Acrest provides expansion into asset management. The German property market in general has drawn greater interest since the UK's Brexit vote, though strict commercial regulations and limited space, particularly in Frankfurt's financial center, may hinder investment.

Within Europe, **Swiss Life Asset Managers** acquired a UK-based firm, **Mayfair Capital Investment Management**, which has £1 billion ($1.2 billion) in AUM. Swiss Life Asset Managers, part of **Swiss Life Group**, said the "acquisition of a highly regarded UK property fund management business has been a key business objective." The addition of Mayfair adds to Swiss Life's presence in France, Germany and Switzerland to create a larger pan-European business with £55 billion of real estate assets under management and administration. Mayfair said the deal will allow it to "develop its business" by "entering new markets and launching new products."

In the UK, multi-family office **LJ Partnership** acquired a "significant" minority interest in pan-European retail property specialist **Pradera** (AUM: €2.3 billion). Pradera Chairman Colin Campbell, who cut his own deal in 2015 to buy back the 60% of the firm he did not own, said the investment "brings a long-term strategic partner with a commitment to helping us grow the business." Just prior to the Pradera deal, Hong Kong-based investment firm **Peterson Group** bought a 20% shareholding in LJP with plans to invest £200 million alongside its new partner in European and Asian property *(see Cross Border for more on LJP)*. Pradera engaged in one more transaction, creating a joint venture with **Macquarie**'s retail real estate unit to provide asset management services in Asia. Pradera said the deal "reflects our long-held ambition to take our tried and trusted approach in the retail property market into new geographies."

Man Group reached outside its core hedge fund business to add a London-based real estate advisory business, **Aalto Invest Holding** (AUM: $1.7 billion). Founded in 2010, Aalto mixes equity and debt strategies that include direct investment in single-family homes in the U.S. and commercial and residential lending in Europe and the U.S.

In 2015, for example, the firm teamed up with **Ilmarinen Mutual Pension Insurance** to create a partnership focused on building a geographically diversified portfolio of relatively new "high-quality" rental homes in "family-oriented neighborhoods." In making the acquisition, Man also launched a private markets unit, saying Aalto will be "instrumental in the development" of the new business and noting that it will provide clients "with access to longer-term investments with a complementary risk-reward profile to our current product suite."

There were several other deals in Asia-Pacific, including the establishment by **BNP Paribas** of a partnership with Hong Kong-based real estate advisory and private equity firm **Orion Partners** (AUM: $1 billion). BNP cut the deal via its asset management unit, **BNP Paribas Investment Partners**. BNP, which will develop and launch Asia-focused alternative funds with its new partner, said the deal extends its exposure to "fast-growing alternative investment opportunities in Asia." Founded in 2000, Orion manages assets for institutions and family offices, including many newly wealthy Chinese families. Following the BNP deal, Orion cut a strategic partnership with Hong Kong's Hemei Group to provide expertise and capital in the development of fashion-oriented industrial parks aimed at capitalizing on China's emerging consumer culture.

French insurer **AXA** acquired Australia's **Eureka Funds Management** (AUM: $3.7 billion), securing the deal through its **AXA Investment Managers** real assets unit. The two firms had worked on property deals in the past. AXA IM, which already has a presence in Japan, said the deal "significantly" enhances its footprint in Asia-Pacific and in particular in Australia's large pension market. AXA IM has €66 billion in assets, 95% of which are in Europe. In an interview with the *Australian*, Frank Khoo, global head of Asia for AXA IM, said the company wanted to establish a base in Australia before expanding into China and India. "This acquisition opens opportunities for European clients here and for Australian clients to access [AXA] investments in Europe and Japan and the U.S.," he said.

Tokyo-based **Mitsui & Co.** took a 22.5% stake in Australia's **New Forests**, a timberland manager with $2.1 billion in AUM and more than 600,000 hectares of timber plantations, rural land and conservation investments globally. New Forests is the largest manager focused on the growing timber market and plantations in Asia-Pacific and a top-10 timberland manager worldwide. In discussing the deal rationale, Mitsui, which has other timberland investments, cited the ongoing demand among institutions for real assets such as timberland and praised New Forests' "sustainable forestry investment model."

HEDGE FUNDS/PRIVATE EQUITY

The hedge fund industry, grappling in the last few years with a growing and previously unfamiliar chorus of criticism regarding both fees and performance, delivered a mixed bag of news in the third quarter of 2016. Assets reached a record of nearly $3 trillion, by Hedge Fund Research's reckoning, or an increase of $74 billion from the previous quarter. The other positive news for the industry was performance: The HFRI Fund Weighted Composite Index gained 2.9% in the quarter, bringing the nine-month performance to a positive 4.2%.

On the flip side, the industry suffered $28 billion in net outflows in the July through September quarter, or nearly 1% of total assets, representing the largest quarterly outflow since the second quarter of 2009. In the first nine months, total outflows were $52 billion, with investor outflows and liquidations concentrated "in several of the industry's largest and most well-established firms," notes HFR.

HEDGE FUND/HEDGE FUND OF FUNDS TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	23	19	7	10	**11**
Combined Value ($M)	$892	$755	$76	$986	**$1,874**
Total Seller AUM ($B)	$61	$71	$7	$98	**$89**
Average Deal Size ($M)	$39	$40	$11	$99	**$170**
Average Seller AUM ($M)	$2,632	$3,743	$1,000	$9,818	**$8,108**

Source: Berkshire Capital Securities LLC

Among the prominent hedge funds enduring negative returns was **Brevan Howard Asset Management**'s flagship macro fund — one of Europe's largest though half its peak size at some $14 billion. In the U.S., **Paulson & Co.** continued to hemorrhage assets with losing bets on drug companies as its AUM fell to $12 billion, or less than one-third or what it managed just five years ago. Meanwhile, a roll call of significant institutions continued to either quit the investments or pare their exposure, with taxpayer-funded U.S. public pension funds particularly sensitive to the fees vs. returns equation. New Jersey's $72 billion pension fund said it will halve its hedge fund allocation to 6% and was joined in a similar move by Rhode Island's $7.6 billion fund. New York City's $55 billion Employees' Retirement System, one of multiple city pension funds, said it will cash in all its hedge fund chips, noting that it had seen "little evidence" of better returns or decreased risk, although some of those assets were acquired by the city's fund for police and firefighters.

In a survey of institutions by Preqin last year, 49% of respondents cited both fees and performance as the "key issues" facing the industry, with transparency a distant third at 29%. Another 79% reported that returns had fallen short of expectations in the previous 12 months while 58% said investor and manager interests are not properly aligned. In a *Pensions & Investment* survey of hedge funds for the year through June 30, 2016, 58% reported a decline in AUM while only one-quarter reported increased-to-flat assets. In the year-earlier survey, 70% had reported an increase from the prior year.

The ongoing negative news did not deter dealmakers from expanding their exposure to the industry in the expectation that institutions and wealthy individuals will continue to seek out hedge funds, with the hope they can bet on the right horse. **Legg Mason** made one of the largest deals last year, for fund of hedge funds manager **EnTrust Capital**. Legg will wrap the established New York firm into its **Permal** hedge fund affiliate (renamed **EnTrustPermal**), adding $12 billion in assets to the $14 billion Permal already managed to create one of the largest fund of funds companies in the world. EnTrust has generated 18% average annual growth in assets since 2007, with only one slightly down year in 2008. Institutional accounts have jumped nearly sixfold during that time to 476. Legg paid $400 million in cash plus 35% equity in the combined firm for Gregg Hymowitz, EnTrust co-founder and managing partner. Legg, which retains 65%, expects to generate as much as $40 million in annual cost savings from the combination *(see Investment Management and Real Estate for other Legg transactions)*.

PRIVATE EQUITY TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	9	9	7	6	**10**
Combined Value ($M)	$575	$834	$354	$910	**$638**
Total Seller AUM ($B)	$32	$55	$39	$36	**$78**
Average Deal Size ($M)	$64	$93	$51	$152	**$64**
Average Seller AUM ($M)	$3,511	$6,158	$5,533	$5,973	**$7,825**

Source: Berkshire Capital Securities LLC

Both **Goldman Sachs** and **Neuberger Berman** cut deals for alternative managers through funds or affiliates. Goldman's **Petershill II** acquired minority stakes in two U.S. firms: middle-market private equity manager **Littlejohn & Co.** (AUM: $4 billion) and systematic investment hedge fund **Fort LP** (AUM: $1.5 billion). Fort was founded in 1993 by two former World Bank fund managers and is a global multi-asset investor, including a flagship long/short Contrarian fund that has exhibited "a low correlation to other systematic peers." Neuberger Berman's **Dyal Capital Partners** made minority investments in three alternative managers, including a Connecticut-based macro-oriented hedge fund, **Graham Capital Management**, and Miami-based middle-market private equity company **HIG Capital**. Dyal, with a portfolio of 19 alternative managers, also took a minority stake in a U.S. real estate advisory and energy investment firm, **Starwood Capital Group**.

As Goldman was making investments via its Petershill II vehicle, it sold five hedge fund managers in Petershill I to **Affiliated Managers Group**. AMG, which has been an aggressive buyer of alternative managers in recent years, paid $800 million for 100% of the minority equity interests held by the 9-year-old fund. The five managers have $55 billion in AUM, but London-based systematic manager **Winton Capital Group** accounts for the lion's share with $35 billion. According to the *Wall Street Journal*, Petershill I, which wrapped up after the sale, delivered a 100%-plus return after fees. "The transaction demonstrates the potential to exit positions to strategic asset management buyers, such as AMG, at attractive valuations," Peterson said in a client letter quoted by Bloomberg.

In a second deal, AMG bought a minority interest in the largest dedicated Asian private equity firm, **Baring Private Equity Asia** (AUM: $8 billion). Founded in 1997, BPEA is a value-oriented investor in companies based in Asia or doing business in the region. The company has more than 30 portfolio holdings with an aggregate $30 billion in revenue as of 2014. In AMG's second-quarter earnings call, Chairman and CEO Sean Healey noted that alternative strategies account for 40% of the firm's $700 billion in AUM and said alternative affiliates had delivered consistent net inflows over the past five years. "We have strategically and deliberately assembled a very large and diverse set of alternative strategies, which taken as a whole not only generate strong organic growth but also have low correlation with equity markets and low correlation with each other," he said.

Two other traditional North American managers joined AMG and Legg Mason in enhancing their alternatives lineup with acquisitions. **AllianceBernstein** acquired **Ramius Alternative Solutions** (AUM: $3 billion), which offers hedge fund replication strategies and fund of funds investments for institutions "that can complement an investor's existing alternative strategy." The deal provides AB with new capabilities in factor-based and alternative risk premia. Montreal's **Fiera Capital Corp.** rounded out an active year buying traditional managers *(see Cross Border)* by cutting several deals for alternative firms, including 23-year-old New York hedge fund **Larch Lane Advisors** (AUM: $500 million). Larch Lane creates customized and commingled portfolios, emphasizing early-stage investing via its fund of funds portfolios and hedge fund seeding platform. In an interview with MFWire, Benjamin Thompson, president and CEO of Fiera's U.S. division, called Larch Lane "one of the pioneers of hedge fund seeding" with a "very strong and long track record in the hedge fund of funds world." In a second deal, Fiera paid C$33 million ($25 million) for Quebec's **Centria Commerce**, a private debt manager operating in the property and short-term lending markets with C$325 million of net AUM.

Two more deals involved the creation of alternative joint ventures, the first with Toronto's **Aquila Infrastructure Management** and dubbed **Fiera Infrastructure**, with C$1.2 billion in invested and committed capital and infrastructure debt. Fiera Chairman and CEO Jean-Guy Desjardins said the "infrastructure sector's importance to the global investment community cannot be overstated." In the second, **Fiera Comox Partners**, Fiera will team up with three partners to invest in agriculture and ultimately private equity. Fiera's alternatives portfolio represents 4% of AUM but 12% of revenues, numbers the firm expects to rise to 10% and 25% to 30%, respectively, within four years.

In Europe, Switzerland's **GAM** paid $217 million upfront plus a future earnout of around $75 million for **Cantab Capital Partners** (AUM: $4 billion), a multi-strategy, systematic firm that is based in Cambridge, England. Cantab partners retained a 40% interest in the company. Subsequently, GAM launched a new platform driven by the acquisition, GAM Systematic, focused on both long and alternative quantitative strategies across multiple asset classes. Systematic asset managers have been enjoying strong growth, with leading firms generating double-digit AUM growth on average over the past five years. GAM also acquired the UK's **Taube Hodson Stonex**, a global and European equity manager with £1.8 billion ($2.6 billion) in AUM. Taube has been a longtime subadvisor of one of GAM's global equity strategies.

Private equity firms continued to grapple last year with the challenge of finding appropriate investments for their abundant capital. In a June 2016 survey by Preqin, nearly half of industry respondents cited deal pricing as the "biggest challenge" over the next year, with North American and European managers expressing the most concern. Blackstone Group, for one, was sitting on $102 billion in "dry powder" as of the 2016 third quarter, up 20% from the year-earlier period, while the industry total had climbed $73 billion in the first six months to $818 billion, according to Preqin. As the industry searched for opportunities, capital raising for secondary funds hit a record $19 billion in the first nine months. Goldman Sachs raised $4 billion for a secondaries fund en route to a goal of $5 billion to $6 billion.

The dry powder notwithstanding, institutions remain fixated on private equity as an asset class. According to a 2016 second-quarter survey from Preqin, close to half of institutions plan to commit less than $50 million to private equity funds, but one in six expect to invest at least $300 million, with half of those planning on $600 million. Those mouth-watering numbers ensured that dealmakers remained active. In addition to the previously noted transactions from Affiliated Managers Group, Goldman Sachs and Neuberger Berman, buyers included a range of alternative and traditional managers.

In one of the larger deals, North America's **Pavilion Financial Corp.** acquired **Altius Holdings**, a global private equity firm with $30 billion in AUM and offices in Singapore, the UK and the U.S. Subsequently, Pavilion established **Pavilion Alternatives Group** to combine the operations of its alternatives subsidiary, **LP Capital Advisors**, and Altius. The new firm will have more than $60 billion in assets, $130 billion of committed capital, and expertise across the range of alternative asset classes. The two firms have complementary client bases, with LPCA serving North American institutions and Altius having clients in Asia-Pacific and Europe. Pavilion Financial said the acquisition, its fifth since 2010, "is consistent with our strategy of assembling various expert and specialized teams."

The post-crisis restructuring of American banks continued to play out in an all-U.S. private equity transaction in which Boston's **HarbourVest Partners** acquired **Bank of America**'s **BAML Capital Access Funds**. BAML is a private equity fund of funds manager with a specialization in "emerging and diverse" managers. The firm, which has advised on $1.9 billion in capital commitments over its 14-year history, also touts itself as the first fund of funds manager to "measure, capture and report on the social impact of its investments." In a more significant transatlantic deal, HarvourVest (AUM: $40 billion) agreed to pay £807 million ($1 billion) for the private equity portfolio of London's **SVG Capital**, beating out several other suitors in the process. SVG's fund of funds portfolio, with exposure to eight private equity mangers in Europe and the U.S., was valued at £802 million. The shares of publicly traded SVG had significantly trailed the value of its portfolio prior to the bidding war that erupted, making the firm an attractive takeover target.

In a second deal with a transatlantic element, **OM Asset Management** paid $240 million for 60% of **Landmark Partners**, an established U.S. firm with a focus on the secondary markets in private equity and real estate funds. OMAM, the U.S. asset manager of London's **Old Mutual**, could make an additional payment of up to $225 million based on the growth of the business over two years *(see Cross Border for more on Old Mutual)*. Founded in 1989, Landmark has nearly $9 billion in AUM. The previous majority owner of Landmark, **Religare Enterprises** of India, sold the majority stake it had acquired in 2010 in another U.S. alternatives manager, **Northgate Capital**. Northgate is a San Francisco-based private equity and venture capital firm with $4.8 billion in AUM. The buyer, London-based private equity and venture capital firm **Capital Partnership**, had a longstanding relationship with Northgate. Capital Partnership said the deal "will help our investors capitalize on the growth opportunities" in Silicon Valley.

CREDIT

In the U.S., Dodd-Frank Act regulations that kicked in at the end of 2016 mandate that firms creating structured products have some skin the game in the form of a minimum 5% stake. The regulation is designed to check the excesses of the pre-crisis era, under the assumption that product manufacturers will pay closer attention to credit risk when they actually own the securities. But companies are already limiting their exposure by employing a provision of the law that allows them to hold the securities via affiliates in which they have a "controlling financial interest." While some firms may simply opt to sell off their investments altogether, other transactions could occur as a variety of players assume financial interests in newly formed affiliates. At the same time, the election of President Donald Trump, with his decidedly anti-regulatory rhetoric, raises the prospect for the rollback of some aspects of Dodd-Frank *(see Regulation)*.

As firms prepared for the new rules last year, they engaged in multiple transactions for U.S. structured credit firms. The deals, primarily cross border in nature, continued the consolidation in the sector that started after the financial crisis. At the same time, the market for such products showed weakness in the first half of the year. In the U.S., commercial mortgage-backed security issuance dropped more than 40% from the year-earlier period while collateralized loan obligation issues were off more than 50%, with the full-year market for CLOs expected to lag significantly behind 2015. In Europe, the securitization market remains well below its 2008 peak.

In the one pure-credit all-U.S. transaction last year, **Fortress Investment Group** acquired $1.4 billion in management contracts from four CLOs run by **Hildene Leveraged Credit**. Fortress cut the deal with the New York firm through one of its affiliates, adding to an existing portfolio of more than $18 billion in credit funds. Fortress' credit AUM has more than doubled since 2008. For parent **Hildene Capital Management**, founded in 2008, the transaction marks an exit from a CLO market it tapped opportunistically, along with other areas of structured finance, following the financial crisis. In particular, HCM made an early and successful bet on trust preferred securities (Trups) issued by financial firms. "When we started Hildene the world was in chaos and we took advantage of that with our first fund," President Brett Jefferson told *Hedge Funds Review* in 2013. A period of "elevated volatility" was then followed by a recovery, he explained, with the third phase involving a "long span of boredom."

A second headline U.S. transaction that mixed credit with a private equity element saw **Ares Capital Corp.** pay $3.4 billion in stock and cash for **American Capital**, excluding the firm's mortgage management business. Ares' slice of American Capital includes several private equity funds, but primarily comprises American Capital's middle-market credit business engaged in leveraged finance, real estate and structured products. Ares, the leading U.S. development company, said demand from middle-market firms "has created the need for flexible capital providers like us to fill the financing gap as banks continue to retrench from the market." With the addition of American Capital's business, Ares Capital has more than $13 billion in investments at fair value.

The company said the combination, with financial support from parent **Ares Management**, will be immediately accretive to core earnings per share and expand its "ability to originate larger transactions with increased final hold positions, enhancing its market presence and value proposition with financial sponsors and borrowers." Activist hedge fund **Elliott Management** had been pressing American Capital to take action to boost performance. In January of this year, **Marble Point Credit Management** acquired American Capital's **American Capital CLO Management**, which has $3.4 billion in eight CLOs. Marble Point gains a majority holding in seven of those CLOs. Marble Point is a credit boutique founded in 2016 in partnership with **Eagle Point Credit Management**.

The other three deals with U.S. targets crossed borders, with the largest involving Jersey-based startup **FAB Partners** cutting its first deal by paying $333 million for New York's publicly traded **CIFC**, a U.S. corporate debt specialist with $14 billion in AUM. In 2015, Moody's ranked CIFC as the leading CLO manager in the U.S. by number of deals, with 30 CLOs under management. The firm was established in 2005 and has a clientele of more than 200 institutional investors. CIFC, majority-owned by a U.S. unit of Russian conglomerate **Renova Group**, said that after "building a robust and scalable U.S. private debt business" it was ready to embark "on a new chapter of growth and product line expansion." FAB is an alternative investment platform created by former executives of **Deutsche Bank** and **Goldman Sachs** and backed by multiple investors, including the royal family of Qatari.

In a second deal with a New York target, **Allianz Global Investors** acquired **Sound Harbor Partners** (AUM: $1.1 billion), a middle market investor that focuses on funding balance sheet restructurings and strategic growth initiatives. The firm makes investments of between $10 million and $50 million in companies with annual EBITDA (earnings before interest, taxes, depreciation and amortization) of $15 million to $100 million, wrapping those investments into CLOs and separately managed accounts. In 2014, for example, the firm closed a $457 million CLO fund investing primarily in U.S. dollar-denominated senior secured corporate loans. Sound Harbor will join AGI's private debt platform. AGI, which also acquired global bond specialist **Rogge Global Partners** last year, said the deal gives it access to U.S. private credit funds managed by a team with a "robust investment approach and track record of outperformance." Sound Harbor said the association adds "scale, brand recognition and long-term capital." AGI has 3% of its AUM, or €17 billion ($18 billion), in alternatives.

Alberta Investment Management of Canada bought a minority stake "on behalf of certain of its clients" in a third New York-based credit firm, **DFG Investment Advisers**. AIM said the two companies, which have collaborated on alternative credit strategies since 2009, have a "shared investment philosophy centered on fundamental analysis, risk management and active portfolio monitoring." DFG has $2.5 billion in structured and leveraged credit assets via commingled funds, separate accounts and CLOs. Last June, the 10-year-old company closed its fourth CLO, totaling $406 million, as well as a separate $100 million fund designed to "pursue strategic initiatives." Owned by the Government of Alberta, AIM manages investments for 26 pension, endowment and government funds in that province. AIM had C$882 million ($670 million) in its private debt and loan pool generating a 7.2% average annual net return in the five years through 2015, compared with a 4.5% return for the overall C$32 billion fixed income portfolio.

The fourth cross border transaction saw **Schroders** acquire **Brookfield Asset Management**'s asset- and mortgage-backed securities team. Schroders adds $4 billion in AUM from Toronto-based Brookfield to a similarly sized ABS business it already runs in New York. The deal occurred shortly after Schroders veteran Peter Harrison took over as CEO. Harrison was reportedly on the lookout for a fixed income shop as part of the effort to diversify the company's portfolio. Fixed income represents 19% of Schroders' £325 billion ($470 billion) in AUM, but in 2015 accounted for 70% of net inflows of £13 billion. The Brookfield team, based in New York, manages U.S. products and an Irish Qualifying Investor Alternative Investment Fund.

In a cross border deal spanning the Middle East and Europe, Bahrain-based alternative firm **Investcorp** paid £222 million ($270 million) for the debt management business of London's **3i Group**, doubling its AUM in the process to $23 billion. Unlike 3i, which made the sale as part of a shift away from debt management in favor of infrastructure and private equity, Investcorp said its credit business has more than doubled in the past five years and is "one of the central pillars of [our] product platform going forward." The acquired portfolio consists primarily of senior secured debt from mid-size to large corporations in the U.S. and Europe. As part of a medium-term growth strategy announced in 2015, Investcorp also acquired a fund of hedge funds that year. The firm counts institutions and wealthy families from the oil-rich Gulf states among its shareholders.

SECURITIES INDUSTRY & MARKET STRUCTURE

What a difference an election can make. As U.S. securities firms spent 2016 preparing to adapt to the U.S. Department of Labor's new fiduciary rule, Donald Trump completed his long-shot run for the White House, throwing support for the rule — and its implementation — up in the air *(see Regulatory Developments)*. One of President Trump's fundraisers and closest advisors during the campaign, Anthony Scaramucci, has been crystal clear about his view of the rule. "We're going to repeal it," the managing partner of fund of hedge funds firm **Skybridge Capital** was quoted as saying last October by *InvestmentNews*. "It could be the dumbest decision to come out of the U.S. government in the last 50 to 60 years." In March of this year the Department of Labor proposed a 60-day extension to the April implementation date so it could review the rule.

In an illustration of the new reality, the largest U.S. independent broker-dealer, **LPL Financial Holdings**, did an about-face late last year on a potential sale it had mulled partly, perhaps, in response to the expectation of the fiduciary rule. LPL terminated that strategic review in favor of continued independence, or at minimum a wait-and-see approach, as the Trump administration clarifies its regulatory posture regarding the rule and related market structure issues.

SECURITIES INDUSTRY & MARKET STRUCTURE TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	84	87	116	88	**74**
Combined Value ($B)	$29	$7	$14	$15	**$30**
Average Deal Size ($M)	$344	$77	$124	$170	**$404**

Source: Berkshire Capital Securities LLC

Against the backdrop of that impending regulation, the North American securities industry and broader capital markets structure sector continued its multi-year wave of consolidation. Merger activity in 2016 was broadly driven by secular change more than cyclical factors and centered on several key strategic themes:

- Implications of a fiduciary rule world;
- The continued quest for scale economies, in particular by mid-size institutional investment banks;
- The continued rise of independent advisory specialists and their strategic assessment of growth via diversification;
- The rationalization of excess capacity in all tiers of the securities industry supply chain, from the market centers (exchanges) to the wholesalers (institutional investment banks) through to the ultimate distributors (including retail broker-dealers and online brokerages).

Many of these themes reflect the real-world impact of globalization and technology-driven innovation on financial services' business processes since the adoption of electronic trading and decimalization in the late 1990s. On top of that is the pervasive regulatory regime that has followed in the wake of various financial scandals and the crisis of 2007-2008. Indeed, in the last 15 years, the three big catalysts of technological innovation, regulatory change and globalization have eclipsed all other M&A drivers and deal-making catalysts.

Online Brokerage Consolidation: Overcapacity & Efficiency-Driven High-Profile Mergers

Based on announced value, the two largest securities industry mergers occurred in the U.S. online brokerage sector with industry bellwethers **TD Ameritrade** and **E*Trade Financial Corp.** participating as the consolidators. These transactions underscore both the growth and operating margin pressures on these brokers caused principally by a "double-whammy" convergence of protracted low interest rates and subdued daily trading volume, with additional unrelenting pressure caused by investor embrace of passive products. Having battled one another for clients by playing "how low can you go" on already-low trade commissions, online brokers are also gearing up to contest the newest low-cost competitors: robo advisors. Late last year, TD Ameritrade launched its Essential Portfolios robo advisor, for example.

BROKERAGE TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	52	49	75	58	**28**
Combined Value ($B)	$13	$5	$12	$10	**$6**
Average Deal Size ($M)	$255	$107	$157	$176	**$214**

Source: Berkshire Capital Securities LLC

Accordingly, consolidation provides brokers with cost savings that can be invested in the sort of state-of-the-art technology required to keep customers in the fold. But there's an additional element in these deals: the interest income brokers earn on customers' cash balances. As is the case with banks, brokers can't make much when rates are near zero — a particular stress when daily average revenue trades (DARTs) are in cyclical troughs and commission fees are under pressure. But in a rising rate environment, buyers can capitalize on a new crop of acquired customers along with wider spreads on account (credit) balances and margin (debit) balances to generate additional income.

Joined by minority shareholder **TD Bank Group**, TD Ameritrade announced the largest transaction in the brokerage sector when it entered into a definitive agreement to acquire closely held online competitor **Scottrade Financial Services**. In a creatively structured transaction, TD Ameritrade agreed to pay $2.7 billion in cash and shares for Scottrade's brokerage business while affiliate TD Bank Group agreed to concurrently pay $1.3 billion for Scottrade's wholly owned U.S. bank subsidiary, **Scottrade Bank**.

The transaction creates a formidable online brokerage and technology solutions retail provider, with $944 billion of client assets ($170 billion from Scottrade) and approximately 600,000 DARTs (137,000 from Scottrade). Scottrade will also boost the size of TD Ameritrade's branch network from 100 to 600, although integration is expected to trim that number by around 25%. TD Ameritrade, which cited a net purchase multiple of 3.8 times pro forma revenue of $713 million, said it expects to generate annual synergies of $450 million, or 60% of addressable operating expenses (excluding depreciation, amortization and corporate debt interest expense), once the businesses are fully integrated. These synergies are forecasted to drive GAAP earnings per share accretion of 12% to 15% in years two and three. Scottrade founder and CEO Rodger Riney said combining with his new partner "will enable us to offer clients an expanded array of trading tools, enhanced education resources and advanced option capabilities with broader geographic reach."

E*Trade Financial agreed to pay $725 million in cash for **Aperture New Holdings**, the parent company of **OptionsHouse**, a leading online derivatives brokerage firm with $3.6 billion in client assets and 154,000 funded client accounts. E*Trade called options "an important component of an investor's arsenal, and this deal will intensify our derivatives firepower." E*Trade structured and negotiated the transaction with private equity firm **General Atlantic**, which in 2014 acquired OptionsHouse and another retail options broker, TradeMonster, merging the two and wrapping the new entity inside the holding company Aperture. E*Trade expects the transaction to be accretive in year two. Subsequently, E*Trade shook up its executive ranks "to better align the company for growth," citing "core brokerage growth [that] has come under pressure." Daily trading at E*Trade continues to lag the numbers generated prior to the financial crisis.

In a third notable transaction within the online retail brokerage sector, **Ally Financial** said it would pay $275 million for **TradeKing Group**, which has $4.5 billion of client assets and a proprietary robo advisor platform. TradeKing provides Ally with the opportunity to expand beyond its core consumer lending businesses and savings account products, and to capitalize on a rarely available cross-selling opportunity to an existing base of 1.1 million depositors and another 4.4 million auto loan customers. In announcing the transaction, Ally said that the fully integrated firm will "create a powerful combination of segment-leading direct banking and innovative investment services in a single integrated customer experience." The former financing unit of General Motors, Ally received a government bailout during the financial crisis before going public in 2014. Ally CEO Jeffrey Brown told the *Wall Street Journal* the deal follows years of restructuring at the firm and allows it to "actually ... think about growth."

Exchanges: Continuation of Efficiency-Driven Mergers Among Leading Market Centers

The exchange segment — dominated by a relatively small number of major institutions following a decade and a half of demutualization, initial public offerings and mergers — played host to what was arguably the highest-profile transaction in the financial services industry last year: the "merger of equals" agreement between the **London Stock Exchange** and **Deutsche Borse**. The proposed combination represents a marriage between the national exchanges of Europe's two largest economies and two of the region's leading financial centers — and the potential creation of a powerful competitor to leading exchange operators in the U.S. and Asia. Shareholders of Deutsche Borse would hold 54% ownership in the combined company to LSE shareholders' 46%, with London designated as corporate headquarters.

If completed, the combined business will be the most profitable global exchange operator with €4.7 billion ($5.3 billion) of operating income (based on fiscal 2015 results) and the listing venue for more than 3,200 public companies with an aggregate market capitalization of some €7.1 trillion. It will offer market participants multi-asset class capabilities (equities, fixed income, currencies and commodities); multiple-product types (cash, derivatives and futures); and a vertically integrated platform, including settlement, processing and clearing. The derivatives trading and clearing business will account for 37% of pro forma revenues, highlighting the importance of diversification to augment a slowing cash equities asset class. The two exchanges expect to achieve approximately €450 million of expense savings, equivalent to some 20% of combined adjusted operating expenses, underlining the compelling strategic logic of the combination.

Nonetheless, the proposal, which was announced on March 16 and approved by shareholders of both companies last July, faces intense regulatory scrutiny, particularly in light of the UK's June decision via referendum to leave the European Union. The selection of London as headquarters is proving nettlesome for German and European regulators, as is the issue of clearing euro-denominated derivatives trades in London. The specter of competing regulatory authorities in the UK and EU overseeing the combined exchange adds another complication. In September, the European Commission opened an investigation into the merger, reviewing the potential impact on competition in a number of areas, such as equities trading, clearing, derivatives and repurchasing agreements. Ultimately, the EC zeroed in on the antitrust implications for derivatives and fixed income clearing. In an effort to address those concerns, LSE reached agreement the first week of 2017 to sell its French clearing unit, **LCH.Clearnet**, to Paris-based **Euronext** for €510 million. This transaction is contingent upon LSE closing the merger with Deutsche Borse.

In a second major exchange merger, **CBOE Holdings** announced it had entered into a definitive merger agreement to acquire **Bats Global Markets** for $3.2 billion. A leading electronic venue and relative upstart with origins as an affiliate of Kansas City-based high-frequency market-maker **Tradebot**, Bats will offer CBOE asset class and product type diversification along with complementary businesses and significant expense synergy potential. CBOE is the largest options exchange operator in the U.S., handling contracts on the Standard & Poors 500 index and the VIX volatility index, which it created. Bats' major business involves stock trading — it is the No. 2 exchange operator in U.S. cash equities and No. 1 in pan-European equities — but the firm has also launched its own volatility product. Additionally, Bats enjoys a strong position in exchange traded funds and foreign exchange trading and operates two equity options markets.

CBOE, whose options-focused business generates far higher operating margins than the equity trades handled by Bats, said the combination will expand its product line across asset classes and its reach into pan-European equities and global foreign exchange. Edward Tilly, CEO of CBOE, said the deal "strengthen[s] our position as a global leader in innovative tradable products and services, and is a transformative next step in our growth strategy." CBOE said the transaction will be accretive to adjusted earnings per share in year one and expects to generate $50 million to $65 million of expense savings annually (approximately 34% to 44% of Bats' annual operating expenses on a stand-alone basis), primarily by migrating to a single proprietary trading platform managed by Bats.

EXCHANGE TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	4	4	2	1	**7**
Combined Value ($M)	$8,357	$158	$26	-	**$20,085**
Average Deal Size ($M)	$2,089	$39	$13	-	**$2,869**

Source: Berkshire Capital Securities LLC

A second exchange sector transaction of note involved **Nasdaq**'s agreement to pay $1.1 billion for **International Securities Exchange**, an operator of three exchanges that account for approximately 15% of U.S. options trading. ISE parent Deutsche Borse cut the deal just prior to the announcement of its merger with the London Stock Exchange. Nasdaq said the addition will improve "efficiencies" for clients, expand technology offerings, and facilitate innovation in the equity options market. "The equities options business has been core to our long-term strategy, and we believe an essential component to the strength of the Nasdaq franchise," said Bob Greifeld, CEO of Nasdaq. Nasdaq also doubles its stake in **Options Clearing Corp.**, the largest equity derivatives clearing corporation in the world, by gaining ISE's 20% shareholding. In a third, smaller transaction, the **New York Stock Exchange** (a wholly-owned subsidiary of **Intercontinental Exchange**) acquired the **National Stock Exchange**, a minor exchange with thin trading volume that was on the brink of closing. Founded in 1885 as the Cincinnati Stock Exchange, NSE provides NYSE with a fourth exchange license.

Retail & Wealth Management: A Year of Strategic Tuck-ins

In 2016, there were several mergers involving the acquisition by larger regional and mid-size securities firms and investment banks of small/boutique traditional retail and wealth management broker-dealers. While the retail-oriented deals were not necessarily financially transformative, they were strategically significant in terms of asset gathering, distribution and geographic coverage. For example, **D.A. Davidson**'s acquisition of **Smith Hayes Companies** enhances its existing retail brokerage presence in Nebraska, where Smith Hayes is based and operates in three cities. Established in 1985, employee-owned Smith Hayes had approximately $4 billion of assets under management and administration. Prior to announcing the transaction, Davidson, one of the largest employee-owned securities firms in the Western U.S., had some $36 billion of AUM and AUA in its individual investors group. "We like the Nebraska market — it fits our culture," D.A. Davidson CEO Jim Kerr told *Financial Advisor*. "We know how to do business in smaller and medium-sized communities across the country." The deal continued a string of three other targeted acquisitions by closely held D.A. Davidson since 2009.

In another example of consolidation motivated by product line extension, this time involving two fixed income and credit market specialists, **FTN Financial** of Memphis announced it would pay approximately $160 million for closely held **Coastal Securities** of Houston. For FTN, the addition strengthens an existing but subscale Small Business Administration loan origination, syndication and securitization business. Established in 1991, Coastal is a leader in the trading, securitization and analysis of SBA loans, as well as other government guaranteed loans. GGLs account for two-thirds of its income, primarily derived from SBA loans. Coastal stands to benefit from its new parent's scale, including distribution and liquidity. Pool issuance for SBA 7(a) loans — the most common SBA loan program — has been on a steady incline since the financial crisis, reaching around $6.5 billion in 2015, or twice the level in 2010. FTN, which said the deal will be immediately accretive to earnings per share, is a division of **First Tennessee Bank**.

A strategically impactful cross border transaction saw Cairo-based **Beltone Financial Holding** enter into a definitive agreement to acquire a 51% interest in New York-based **Auerbach Grayson Inc.**, a specialist in trading emerging and frontier market equities via a unique network of broker-dealer partners in some 125 global markets. (The initial 51% interest increased to 60% when the deal closed last September.) In addition to that global expertise and network, Auerbach Grayson provides Beltone with access to the U.S. institutional investment community. For its part, Auerbach Grayson gains exposure to the Gulf states and the opportunity to expand into asset management and investment banking. Beltone is a publicly traded, diversified financial services company that is principally backed by Egyptian billionaire entrepreneur Nagib Sawiris. Sawiris acquired Beltone in 2015 through his Orascom Telecom Media and Technology holding company, in conjunction with Egyptian investment bank **Act Financial**.

In a unique business combination and rare transaction structure involving two Nasdaq-listed companies, **Fortress Biotech** reached beyond its biotechnology venture investing business to acquire, via cash tender offer, approximately 54% of the issued and outstanding common shares of **National Holdings Corp.** National provides retail brokerage, wealth management, insurance and tax preparation advisory solutions, along with a range of specialty investment banking, securities trading and market-making capabilities. In an unusual and relatively complex structure, Fortress Biotech made a tender offer for all of National's common shares, but fell short of its goal of a complete takeover. For New York-based Fortress Biotech, the transaction was borne of a strategic relationship enjoyed by the two parties that included National's role as its investment banker on biotechnology company equity offerings.

Fortress Biotech — which makes principal investments in innovative sectors of the health care and life sciences industry — was drawn by National's specialized capital raising and financing capabilities within the emerging biotech company sector, as well as its retail brokerage distribution capabilities. Fortress Biotech Vice Chairman Michael Weiss, a former chairman of National, said the company plans to "enhance National's biotech and life science investment banking franchise into a leader in the field, while also identifying important additional verticals to broaden their breadth of product offerings for their clientele." In its fiscal half-year prior to the Fortress deal, National generated two-thirds of its $82 million of total revenues from commissions and investment advisory fees and 15% from investment banking activities.

Investment Banks: Industry Specialists Continue To Be Attractive & Scarce; Advisors Continue Their March to Prominence, Pausing Occasionally to Consider the Merits of Growth Via Diversification

In the investment banking sector, industry specialists continue to be coveted while their dwindling numbers drive scarcity value. Similarly, the profile of independent M&A advisory specialists continues to rise in lockstep with their league table standings and M&A market share. While the jury appeared out for quite some time, the success of the October 2014 **Evercore**-ISI Group combination now appears certain, as evidenced in each of the Evercore business and financial results; its enhanced market positioning including that of the **Evercore ISI** operating segment; and Evercore's positive stock price performance over the last several quarters.

Piper Jaffray Companies announced in November 2015 and completed at the end of February 2016 the acquisition of 42-year-old iconic energy investment bank **Simmons & Company International**. A storied U.S. financial institution with a century of history, Piper Jaffray embarked on a strategically important and opportune initiative, with Simmons' energy expertise dovetailing neatly with Piper's existing industry coverage capabilities and the Simmons M&A advisory business furthering the five-year expansionary buildout of Piper's own advisory platform. As an indicator of the importance of the business to Piper Jaffray, Simmons Chairman, President and CEO Michael Frazier joined the board of directors upon the closing of the transaction. Structurally, the transaction included both a cash and stock component, the latter of which is proving to be rewarding for Simmons' shareholders given the 63% increase in Piper's stock price between the February closing and year-end 2016.

INVESTMENT BANK TRANSACTIONS

	2012	2013	2014	2015	2016
Number of Transactions	10	10	24	21	**28**
Combined Value ($M)	$4,121	$64	$1,433	$3,680	**$269**
Average Deal Size ($M)	$412	$6	$60	$175	**$10**

Source: Berkshire Capital Securities LLC

The marquee announcement of 2016 was perhaps the agreement by **Perella Weinberg Partners** to acquire **Tudor Pickering Holt & Co.**, the prestigious energy industry specialist formed by former **Goldman Sachs** partner Robert Tudor in 2008 through the combination of his new advisory firm, Tudor Capital Partners, with the energy research boutique Pickering Energy Partners. Notably, the PWP/TPH combination creates a powerful advisory investment bank with a diversified and global business, including a multi-strategy asset management subsidiary with approximately $12 billion of AUM spanning the range of private and public asset classes and including TPH's energy-related products. The combined firm will boast a specialized though compact and very efficient institutional securities sales and trading and capital markets business, and be positioned to expand the research, sales and trading, and capital-raising capabilities beyond TPH's energy sector specialization should the opportunities arise. The company's scale and footprint could also provide access to the IPO market, should the leadership team seek such opportunities.

Culturally, the combination unites two independent and complementary banks whose leadership teams share lineage: TPH Founder, Chairman and CEO Robert Tudor and PWP Co-Founder and Head of Advisory Peter Weinberg once worked together at Goldman Sachs. The firms also have complementary headquarters in New York and Houston. Since TPH's formation, the firm has emerged as one of the biggest success stories in North American investment banking. TPH has advised on some $175 billion of energy-related advisory engagements and participated in capital offerings raising in aggregate $75 billion for its corporate clients, with a focus on IPOs.

PWP CEO Robert Steel said the merged firm "will also be well-positioned to play a leading role in the evolution of the energy sector," including renewables. In addition to its position in the energy industry, TPH brings PWP entry to some of the largest equity institutions as part of its securities, underwriting and research businesses. "PWP doesn't really talk directly to the largest equity institutions in the world," said Peter Weinberg. For TPH, PWP delivers expertise in such areas as restructurings and shareholder activism advice. "We now can speak to a whole set of industrial clients for whom energy expertise is really important but that we haven't known," said Robert Tudor.

The collaborative and efficient manner in which the combination materialized has been evident in a number of ways, including the relatively short time period that elapsed between the signing of the definitive transaction agreements and closing. This was an important process-related point given the inherent volatility in energy markets and the uncertainties posed last year by an unusual and heated U.S. presidential election.

While Evercore's acquisition of Ed Hyman's prestigious research firm ISI was a transformative move into macro and fundamental research, as well as one of the most robust and systematic corporate access platforms in the industry, PWP's deal for TPH's boutique energy investment banking business is a more targeted entree into the securities and capital markets business. But the deal does raise larger strategic questions for other independent advisory firms. Will they choose to diversify, expand the range of service offerings, and augment the available fee pool via an acquisition of (or merger with) a capital markets-based firm? Secondly, which firms will remain (perhaps staunchly) focused on advice?

REGULATORY DEVELOPMENTS

After eight years of a sweeping, complex and often criticized full-court regulatory press on the financial services industry under President Barack Obama, does the election of Donald Trump mean Washington is about to go into reverse? Judging by the statements from President Trump and some of his advisors, it would appear so. In commenting on the U.S. Department of Labor's "fiduciary rule," Trump campaign fundraiser, advisor and hedge fund executive Anthony Scaramucci has promised a repeal, calling the rule perhaps the "dumbest decision" Washington has made in decades *(also see Securities Industry & Market Structure)*.

After the election, Steven Mnuchin, Trump's choice for Treasury Secretary, told CNBC his "number one priority on the regulatory side" will be "to strip back parts of Dodd-Frank." On the Democratic side, Senate Minority Leader Chuck Schumer vowed to hold the line, saying, "Forget about repealing or modifying Dodd-Frank." Although the Republicans have a 52-seat majority in the 100-member U.S. Senate, the Trump administration's expected effort to alter the law will be complicated by the need to accumulate 60 votes to bring any changes to a vote on the Senate floor. Among its many provisions, the 2,300-page Dodd-Frank Wall Street Reform and Consumer Protection Act placed tight restrictions on the activities of banks, including principal investment, securities trading and alternative investments, while adding capital requirements.

Unlike Dodd-Frank, the fiduciary rule has yet to take effect, and in March of this year the Department of Labor proposed a 60-day extension to the June implementation date so it could review and presumably alter parts of the rule. A number of financial firms have also filed lawsuits challenging the rule. In one, the U.S. Chamber of Commerce, joined by financial firms, alleges that the Department of Labor exceeded its authority and defined "the term 'fiduciary' in an impermissibly broad manner." In that case, a federal judge in Texas upheld the rule early this year, but the U.S. Chamber quickly filed an appeal.

The fiduciary rule introduces a tighter client-focused interest standard for broker-dealers and advisors handling individual retirement accounts, effectively threatening the ubiquitous commission model in favor of a fee-based one. The Obama administration argued that the rule would minimize or eliminate the potential conflict of interest advisors face in offering mutual funds from which they receive commissions. But the industry has decried the rule for hamstringing its ability to serve clients, threatening a wave of litigation, and adding significant costs. **Morningstar** projects the rule would affect approximately $3 trillion of client assets and some $19 billion of industry revenues.

Their assessment of the rule aside, by the second half of 2016 firms had already begun making changes in anticipation of implementation. Last August, **Edward Jones** became the highest-profile company to comply when it announced it will stop offering mutual funds as well as exchange traded funds in favor of stocks, bonds and variable annuities in its commission-based retirement accounts. **Bank of America Merrill Lynch** followed by saying it will drop commission-based IRAs this year and also remove mutual funds.

A third U.S. regulatory issue of importance involves the "living wills" section of Dodd-Frank impacting "systematically important financial institutions" (SIFIs). Separate from stress tests, this regulation requires banks to create "credible" bankruptcy plans that avoid government bailouts, adding another regulatory-related expense and further stretching internal resource constraints. The challenge for the SIFIs has involved meeting the definition of "credible." Last April, the Federal Reserve and Federal Deposit Insurance Corp. instructed five major U.S. institutions — **Bank of America**, **Bank of New York Mellon**, **JPMorgan Chase & Co.**, **State Street** and **Wells Fargo** — to return to the drawing board after determining they did not meet the standard. The banks were given until last October to draw up and present revisions. FDIC Chairman Martin Gruenberg underlined the government's determination to ensure that SIFIs "demonstrate a clear path to an orderly failure under bankruptcy at no cost to taxpayers." For their part, the banks expressed a commitment to meeting the credible standard, but Wells Fargo was alone among the five to come up short after the October review, leading the Fed and FDIC to impose sanctions and the bank to huddle again as it sought to meet objections.

Across the Atlantic, a key regulatory issue is the European Commission's MiFID II, or Markets in Financial Instruments Directive. The regulation was scheduled to take effect in January of this year, but the complicated nature of the rollout led the European Union to delay the date until January 2018. The EU cited the need to collect data from some 300 trading venues on 15 million financial instruments. Similar to regulatory changes in the U.S., the revisions to MiFID occurred after the financial crisis and cover areas such as trading, investor protections, transparency and governance. As one example, derivatives traders, largely ignored under MiFID I, will be pushed toward regulated exchanges and face greater transparency requirements.

But many industry participants expect one of the more far-reaching aspects of the rule to be the unbundling of research and trading, which will disrupt the traditional relationship between institutional investors (i.e., "buy-side" firms) and securities broker-dealers ("sell side"). Historically, the buy-side has paid for research, trading, corporate access, and access to new issue (offering) products via a bundled "all-in" model and typically through commissions generated via trade order execution. Under MiFID II as of 2018, investment managers must systematically dismantle and state the units costs of the services and products they purchase from the sell side, most notably research, as opposed to bundling those costs into execution charges. In turn, the sell side may no longer count on delivering a laundry list of bundled services (including research) to the buy side knowing they will be compensated on the back end with trading volume.

"The sell side is going to have to think about how it produces research and how it's getting distributed to the client," Brad Bailey, director of the securities and investments practice at consultant Celent told Finextra. "We will see firms picking the places they want to be in and which sectors they want to cover. You will see engagement with the buy side on what they are going to do around research product."

ABOUT BERKSHIRE CAPITAL

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