

Asset Management M&A In The COVID-19 Era: Part 3

By **Joe Castelluccio, Reb Wheeler and Jenna Miller** (June 11, 2020, 5:50 PM EDT)

In the final installment of this three-part article, we focus on closing asset management industry M&A transactions in the COVID-19 era. **Part one** looked at factors that may drive deal activity, and **part two** examined regulatory compliance and key personnel retention.

Even in the best of circumstances, the time period between signing a transaction and closing can be tense.

The target must continue to manage its business and respond to unexpected issues while ensuring it complies with preclosing operating covenants under the acquisition agreement. At the same time, the parties will be working together to plan for the often complex task of integrating the acquired business after closing.

With the added uncertainty of the impact of COVID-19 on the economy, public health, and the target business, this tension is likely to be elevated. Even smaller acquisitions of asset management businesses typically require a delay between signing and closing in order to allow the target to obtain client or other consents and, in some cases, regulatory approvals.

In the current environment, when negotiating deal terms, sellers are likely to be focused even more keenly on their ability to respond to the ongoing crisis during the preclosing period, and on certainty of closing, while buyers are likely to be concerned about guarding against any deterioration in the value of the target business after signing.

The fallout from, and uncertainties created by, the COVID-19 crisis are likely to lead buyers and sellers pursuing asset management deals in the near term to focus particular attention on the following areas: (1) interim covenants regarding the operations on the business, (2) closing conditions, and (3) planning for integration of the target business.

Considerations in these areas include:

Operating the Target Business and Responding to Unexpected Events

In general, M&A agreements typically require the buyer's consent in order for the seller to take actions outside of the ordinary course of business between signing and closing or to take a variety of specified actions during the preclosing period. As the vast impacts of COVID-19 unfold, it is clear that asset managers are operating in an environment that is anything but ordinary.

Asset managers, like many other businesses, will likely continue to face new and evolving challenges in the coming months. These may relate to issues ranging from compliance challenges and personnel difficulties to client management issues and novel investment decisions.

Although most M&A agreements provide that buyer's consent to an otherwise prohibited



Joe Castelluccio



Reb Wheeler



Jenna Miller

action cannot be unreasonably withheld, given the widespread uncertainty and disagreement as to the most appropriate responses to the outbreak at all levels, it is quite possible that buyers and sellers will disagree as to appropriate steps for the seller to take in response to a particular issue, with little clarity as to whether a buyer's refusal to consent is reasonable.

Parties should consider trying to anticipate and address these uncertainties where possible, particularly given that asset management M&A transactions in the near term may require a longer-than-usual period between signing and closing due to likely delays in obtaining client and other consents and regulatory approvals.

For example, sellers may want to include exceptions to interim restrictions that allow them to take reasonable and prudent measures to respond quickly to issues related to COVID-19 without the buyer's consent. Buyers may be sympathetic to such exceptions but will likely be resistant to broad exceptions and seek to limit a seller's leeway to specific situations.

Parties may also want to prescribe specific communication pathways in the acquisition agreement so there is a clearly defined process to respond to unexpected events that may require company action. To avoid delays and confusion in the consent process, parties may consider streamlining the process for obtaining the buyer's consent by, for example:

- Designating a specific individual at the buyer to whom requests for consent should be directed and specifying the appropriate method of contact (e.g., by email);
- Placing a specific time limit on the period for the buyer to consider and respond to the request for consent, such as two to three business days;
- Providing for deemed consent by the buyer if it does not respond within the prescribed time period; and
- Providing that the buyer cannot unreasonably withhold, delay, or condition its consent.

At the same time, buyers will want to ensure that the process allows them enough time to internally review requests, particularly for buyers with internal bureaucracies and/or with respect to requests that may impact the future value of the business.

Outside of the consent process, the parties may also consider establishing concrete communication plans for the interim period, such as weekly calls, to allow an opportunity to get ahead of emerging issues.

Crafting Closing Conditions in the Current Environment

In a typical M&A deal, closing conditions linked to the target business are generally focused on materiality, including with respect to the accuracy of representations and warranties, compliance with covenants, and whether a material adverse effect, or MAE, has occurred.

Using these standards in closing conditions for an asset management acquisition, however, often will not capture issues signaling a decline in the value of the target business, especially in the era of COVID-19. In particular, MAE definitions typically establish a very high bar for a buyer seeking to not close.

Applicable U.S. law may not deem a short-term deterioration in the business, even if it is very substantial, to be a material adverse effect. Further, MAE definitions often specifically exclude effects related to matters such as pandemics, general financial or economic conditions, or fluctuations in capital markets.

In other words, if COVID-19 fallout causes material deterioration in a target's business prior to closing, it is very possible such deterioration will not be considered an MAE, such that the buyer would not be able to rely on a no-MAE closing condition to get out of the deal.

Accordingly, buyers will likely be better off focusing on specific closing conditions which are tied to the metrics driving the valuation of the target business, such as those discussed above.

For example, parties may want to focus on client retention through a condition that requires the seller to deliver consents from a certain percentage of clients or clients representing a certain percentage of assets under management, as compared to a baseline. Such a metric would be more resistant to market fluctuations than, for example, a condition requiring retention of a specified absolute amount of AUM.

Preparing for a Business Combination in a Work-From-Home Environment

Many business combinations experience unexpected difficulties after closing, during the integration process. Remote working and other restrictions on normal operations resulting from the COVID-19 crisis are likely to make the integration process even more difficult in the near term.

In an effort to ease this additional integration burden, parties should be more thoughtful and prescriptive than usual regarding the integration of the target business both in the preclosing planning period and following the closing. Issues to be mindful of include:

- Due to remote working issues or facility closures or restrictions, there may be instances where a buyer will need the seller to provide certain post-closing transaction services it might not have otherwise required.
- Where post-closing transition services are contemplated, longer service periods may be warranted.
- Onboarding personnel may be more complicated with new hires and human resources personnel alike not able to come into the office and with background checks and other necessary steps likely taking longer. Parties should work together to identify these issues and agree on an approach that will avoid potential delays.
- Parties will need to be careful about transferring client records in accordance with compliance policies while personnel are working remotely.

These and other considerations warrant proceeding even more carefully with integration planning than usual. Buyers should focus on the preclosing access provisions of the acquisition agreement to ensure that they have the ability to conduct integration-focused due diligence prior to closing and to access key personnel to assist with integration planning.

Such rights will help the buyer to troubleshoot problems in the integration process and

achieve transaction efficiencies more quickly after closing.

As with so much of what's going on in the world today, the trajectory for M&A transactions in the asset management industry is not clear. There are, however, reasons to think that we may see deal flow recover in the sector sooner than in other areas.

As market participants begin to consider how to get deals done in the face of the challenges posed by COVID-19, being thoughtful about the issues discussed in this article should serve them well.

Joe Castelluccio and Reb Wheeler are partners, and Jenna Miller is a senior associate, at Mayer Brown LLP.

Mayer Brown partners Adam Kanter and Stephanie Vasconcellos, and associate Sam Stender, contributed to this article.

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