Pensions&Investments

Private equity firms seeing a lot to like with DC provider investments

By: Robert Steyer
Published: May 14, 2018

Morgan Lewis & Bockius' Robert Goldbaum

There's a lot to like about the retirement services industry, which helps explain why private equity investors are taking a shine to the sector.

Guaranteed growth is at the top of the list.

"They are looking for growth sectors with stable cash flows where they can create efficiencies and economies of scale," said Robert Goldbaum, a New York-based partner at Morgan Lewis & Bockius LLP, who specializes in mergers and acquisitions. "Ten thousand people are retiring every day. This is a growth sector with reliable trends."

Among the deals:

- Last month, Hellman & Friedman launched a bid for Financial Engines Inc., the leading provider of managed accounts as well as a provider of investment advice and investment education for retirement plan participants and individual retirees. The $3 billion deal is expected to close in the third quarter, pending approval by Financial Engines shareholders and regulators.
- Last year, Blackstone Group LP bought the record-keeping and other benefits businesses from Aon PLC. The record keeper, now known as Alight Solutions, is the fifth largest in terms of assets and sixth in terms of participants, according to Pensions & Investments' annual survey. Blackstone paid $4.3 billion and could pay another $500 million based on performance.
- And in the not-too-distant past, two private equity firms — Aquiline Capital Partners LLC and Genstar Capital LLC — acquired the record keeper and 529 plan administrator Ascensus LLC. Although it is 20th in assets in the Pensions & Investments' survey, Ascensus ranks fifth in the number of sponsor clients. It emphasizes small and midsize DC plans, whereas Alight focuses on larger DC plans. Terms weren't disclosed.

The reasons are varied for these large deals as well as for other private equity transactions involving the retirement, financial services and investment fields, but some common themes have emerged in addition to the pursuit of stable cash flows and reliable revenue.

Technology's big role

Technology plays a big role in what private equity firms can add to acquisitions, said Allen Waldrop, a Sacramento, Calif.-based managing director for Pavilion Alternatives Group, part of Pavilion Financial Corp.

"There's a lot of new technology that has the potential to reduce costs, improve synergies and increase scalability," said Mr. Waldrop, citing robo-advice as a prime example. "Private equity likes financial technology because they see a lot of growth."

Private equity firms also allow acquirees to maintain independence as pure-play businesses or to gain independence from former parents whose strategies had changed. In the case of Alight Solutions, for example, Aon officials said record keeping didn't fit long-term goals; but Blackstone officials said they would invest in technology to enhance innovation in retirement, health care and human resources."Private equity takes a strategic view with a willingness to invest," said Mr. Goldbaum, noting that his comments reflect industry trends rather than specific actions. "It's the very definition of patient capital."

Financial Engines' model counts on DC sponsors' confidence that the firm offers unconflicted advice not tied to selling proprietary investment products, and Hellman & Friedman wants to retain that approach.

"It's very important for the mission and philosophy for Financial Engines to be independent," said Allen Thorpe, a New York based Hellman & Friedman partner. "I think plan sponsors value this. It's a baseline need for the business."

Hellman & Friedman's ownership will enable Financial Engines to "bolster" its education and advice efforts, Mr. Thorpe said. "We have pretty big growth aspirations."

His firm will merge Financial Engines with Edelman Financial Services, a private investment advisory and wealth management firm. "It's a natural combination," Mr. Thorpe said.

Hellman & Friedman owns a majority stake in Edelman, and it will own a majority stake in the combined companies, Mr. Thorpe said. Financial Engines has $169 billion in assets under management; Edelman has $21.7 billion.

"We think this is an attractive industry bringing advice to millions of participants with a breadth of coverage," said Mr. Thorpe. Financial Engines "has looked attractive to us for many years," said Mr. Thorpe, adding that executives at his firm and Financial Engines periodically held discussions for several years.

He didn't discuss the intricacies of the negotiations. Aside from the April 30 news release describing the transaction, Financial Engines executives haven't commented.

Securities analysts also used the word "independence" in praising the deal."Independence is important for Financial Engines," said Robert Napoli of William Blair & Co., Chicago. Its appeal — through managed accounts, robo-advice and other services — could have been hampered if were acquired by a parent that offered proprietary mutual funds or other investment products, he said.

"Financial Engines generates a lot of cash and it has a sticky customer base," said Mr. Napoli, referring to sponsor client loyalty.

Combining Financial Engines with Edelman Financial Services "made perfect sense with Edelman's brand structure and personnel," said Peter Heckmann, the Overland Park, Kan.-based senior vice president and senior research analyst for D.A. Davidson & Co. "Edelman helps them with their personal adviser strategy."

He said the combination will help Financial Engines expand its efforts in the retail and individual retirement account markets. This strategy was accelerated in 2016 when Financial Engines bought the Mutual Fund Store, which provides advice to individuals with IRAs and taxable accounts. The deal enabled Financial Engines to provide more human-adviser contacts for participants who can visit at multiple locations, Mr. Heckmann said.

'Ripe' for efficiencies

Retirement-oriented financial services companies lure private equity firms because they are "ripe" for efficiencies due to the need for technological improvements, said Stephen Lee, a Los Angeles-based partner for the law firm Goodwin Procter LLP, who specializes in private equity transactions.

Defined contribution record keeping, for example, is an attractive target because "until recently, record keeping was very labor intensive and paper intensive," he said.

Many of the early record-keeping companies "didn't have the money or the desire to spend the money" on upgrading technology, thus leaving them vulnerable to peers that were better positioned to deal with the changing nature of the business, he said.

"This is a great opportunity for private equity to improve the business and improve costs," he said.

Because private equity appetites have expanded, Mr. Lee said, specialty firms have become "first movers" in specific asset categories. Once these firms have identified opportunities, "the generalist firms move in," said Mr. Lee, noting his comments reflect industry trends but not specific transactions.

One specialty firm is New York-based Aquiline Capital Partners, which focuses on financial services primarily among middle-market companies. In late 2015, it teamed with Genstar Capital to acquire the DC plan record keeper and 529 plan administrator Ascensus. Each owns 50%; they acquired Ascensus from private equity firm J.C. Flowers & Co.

"We saw multiple opportunities for growth both organic and through acquisition," said Richard Rosenbaum, an Aquiline partner. "It serves a very large market that is only getting larger." Jeff Greenberg, chairman and CEO of Aquiline, said the investment management-retirement sector has accounted for about one-third of its investments in the past 12 years. "We think the big themes about saving for retirement and saving for other life events offer us an opportunity," he said.

Aquiline's skill in technology services "was an opportunity to bring some of our strengths to this business," Mr. Greenberg added.

Original Story Link: http://www.pionline.com/article/20180514/PRINT/180519938/private-equity-firms-seeing-a-lot-to-like-with-dc-provider-investments