The forces at work in the Trust & Corporate Services sector and their impact on M&A activity

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Historically, the Trust & Corporate Services sector (T&CS) has been somewhat fragmented. However, in recent years, the sector has undergone a wave of consolidation, first at the local level and subsequently at the regional or global level. The purpose of this article is to outline the reasons underpinning these developments, and to provide some insight into what the future might hold for the sector.

From a highly fragmented market to the rise of local champions

The T&CS space has historically been populated by small and local operators. With barriers to entry relatively low and demand for services offered high, the opportunity for individuals with the right skill set and entrepreneurial flair to launch a thriving business was significant.

Throughout the 1990s and 2000s, Luxembourg saw several success stories based almost exclusively on a local presence.

Over the years, some M&A activity has appeared to be driven in part by: (i) the desire for a number of the earlier entrepreneurs to exit their business and monetise their life's work, (ii) the opportunity to reap synergies and economies of scale on the operating side, and (iii) the opportunity to gain size and be recognised as a credible operator by large institutional clients.

The result has been the creation of a small number of local champions, followed by a long tail of small and medium-sized operators.

As these local champions become increasingly important, smaller operators have been faced with increasing pressure to either turn consolidator or sell to a competitor.

2008: a game changer for the industry

The 2008 crisis has had a significant impact on the industry, both from the demand side and from a regulatory standpoint.

A new regulatory paradigm

The public deficits that followed the crisis have led many governments to seek new ways to balance budgets and collect additional revenues. Several media articles have increased calls from the public for governments to clamp down on tax optimisation by multinationals, and for a fair allocation of the tax burden between private and corporate citizens, including: 'The Great Corporate Tax Dodge' (Bloomberg), 'But Nobody Pays That' (The New York Times), 'Secrets of Tax Avoiders' (The Times) and 'Tax Gap' (The Guardian). These are just a few examples of the increased media attention on the tax affairs of corporations.

It was against this backdrop that in July 2013 the OECD launched an action plan on base erosion and profit shifting (BEPS) in order to equip governments with a multilateral instrument to amend bilateral tax treaties and prevent double non-taxation. While the consequences of this move are not yet fully known, it could have a significant impact on some of the structures implemented by T&CS service providers. It may be necessary to operate in a more integrated fashion at an international level as well as increase reporting requirements.

In parallel to this situation, the number of new regulations affecting the financial sector has significantly increased in recent years, thereby adding several layers of complexity to the sector.

Regulatory pipeline
Alternative Investment Fund Managers Directive (AIFMD)
UCITS V
EU Savings Directive
FATCA
Limitations of Benefits Provisions in tax treaties
Dodd-Frank
HIRE Act
Bipartisan Tax Fairness and Simplification Act
Stop Tax Haven Abuse Act
Controlled Foreign Companies & Excluded Territories exemption
The Offshore Funds (Tax amendment) regulations 2011
Proposed FSA ban on unregulated collective Investment schemes

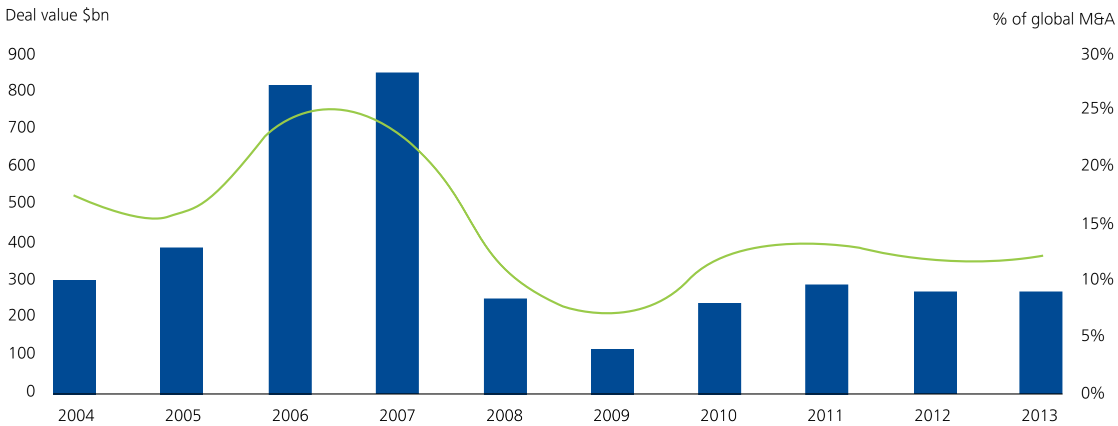
Regulatory change	Opportunity/risk factor
Increase in transparency requirements	Increased information sharing on account information between jurisdictions
Change to substantiation requirements	Modification to substantiation requirements to prove 'Ultimate beneficiary' resides domestically
Transfer pricing assessment	Enhanced assessment of transfer pricing practices across legal entities
Fund compliance	Increased compliance, disclosure and reporting requirements
Revision of bilateral tax treaties	Changes to key terms affecting economic incentive and/or operational requirement
Revision to participation exemption	Changes to key terms affecting economic incentive and/or operational requirement
Tax harmonisation	Harmonisation of tax code across jurisdictions, reducing incentive for cross-border solutions

While some of these new regulations represent an opportunity for T&CS operators to offer their clients additional services, this will mainly benefit operators that have reached a sufficient scale to have the in-house capabilities to provide these services.

In summary, while historically the T&CS sector was characterised by relatively low barriers to entry, the recent changes in the regulatory environment have contributed to raising these barriers. They have also led to increasing differentiation between operators in terms of their size; while larger operators will be able to leverage the opportunities offered by the new environment, the smaller ones might struggle to keep up.

A market which has yet to fully recover

The second major impact of the recession was on T&CS clients.
Transaction volumes for private equity funds, which represent a significant portion of T&CS business, have yet to rebound to pre-crisis levels, as shown in the chart below.



Source: Mergermarket and Bain

However, according to private equity data provider Preqin[1], private equity fundraising for 2013 totalled US$431 billion, up 13% from 2012. Preqin also reported that the previous high point for private equity funds raised was in 2008, with a total of US$688 billion.

1 Source: Preqin press release, 6 January 2014

From local to regional and global

In this context, a second wave of corporate activity has taken place in the T&CS sector whereby local champions have begun to enter new geographies. While in some cases this has occurred via greenfield operations, acquisitions have proven to be a widely used approach to achieve immediate critical mass in a new market.

In addition, some of the local champions have acquired private equity shareholders, drawn to the sector by attractive margins and historically good visibility on revenues. The arrival of these professional investors has added financial and managerial capabilities to the local champions in their endeavour to expand their footprint through acquisitions.

This wave of international consolidation is underpinned by three major factors:

1. The need to diversify event risk related to a single jurisdiction
2. The need for large clients to be served by professionals across all jurisdictions in which they operate
3. The ability for multi-jurisdiction operators to spread central corporate functions across a wider base, as well as develop centres of excellence for dedicated services within the network

This context has provided an opportunity for local operators to participate in the ongoing consolidation phase in a different way, which combines the need to join a larger platform with the willingness to monetise part of their assets, while retaining some degree of relative autonomy within a larger group.

As a result, the M&A market has remained active, as demonstrated by the large number of transactions that have occurred in recent months.

Date	Buyer/Bidder	Target
Mar-14	Hawksford	Janus Corporate Solutions Pte
Feb-14	Electra Partners	Ogier Fiduciary
Dec-13	Sanne	State Street Bank & Trust Company
Nov-13	JTC Group	Ardel Trust Company
Jul-13	First Names Group	Temmes
Jun-13	Intertrust	ATC
Apr-13	First Names Group	Basel International Limited
Apr-13	Silverfleet Capital Partners	IPES
Dec-12	Blackstone	Intertrust
Nov-12	Maitland & Co	Admiral Administration Ltd.
Oct-12	Inflexion Private Equity	Sanne Group
Sep-12	SGG	FAcTS
Jun-12	Orangefield Trust	ICS Trust (Asia) Limited
May-12	Vistra	HTGroup
Mar-12	CBPE Capital LLp	JTC Group
Mar-12	Intertrust	Walkers Global
Mar-12	AnaCap	IFG

Source: MergerMarket and press releases

Conclusion

The factors that have driven the industry to consolidate in recent years are still very much present today. At a local level, the increased complexity and rising cost of doing business, as well as the desire of some entrepreneurs to monetise what is usually their main asset, continues to drive deal flow.

At regional and global levels, the need to diversify risk away from overexposure to any particular geography and the increasing requirement of clients to be served on a global basis is adding fuel to the consolidation fire.

Against this backdrop, the limited rebound in corporate activity since the highs of 2005-2007 and increased scrutiny of international tax structuring have impacted on the speed and multiples at which deals get done.

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