Principal-Wells Fargo retirement deal hints at fee compression

Principal paid less than other firms that have acquired large retirement businesses in the past decade and a half, according to an InvestmentNews analysis

Apr 11, 2019 @ 2:13 pm
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https://www.investmentnews.com/article/20190411/FREE/190419988/principal-wells-fargo-retirement-deal-hints-at-fee-compression

The blockbuster deal inked by Principal Financial Group and Wells Fargo & Co. earlier this week provides a glimpse into the economics prevailing in the defined-contribution-plan record-keeping business.

Specifically, the deal's $1.2 billion price tag hints at the fee compression that's plagued the industry for the last several years.

Publicly disclosed details of other large retirement-focused deals over the past decade and a half indicate that Principal paid Wells Fargo less money per dollar of acquired assets under administration than other big deals, such as ING Groep's acquisition of CitiStreet (2008), Massachusetts Mutual Life Insurance Co.'s purchase of The Hartford's retirement plan business (2008), and Prudential Financial Inc.'s deal for Cigna Corp.'s retirement business (2003).

Principal, for example, paid 15 basis points per dollar of Wells' retirement assets. However, the others paid more handsomely for the assets — ING paid 34 bps, MassMutual 73 bps and Prudential 420 bps, according to an InvestmentNews analysis.

The cost of big retirement deals

Buyer	Seller	Deal cost	Assets under administration	Index [cost/assets]	Year
Principal	Wells Fargo	$1.2 billion	$827 billion	0.0015	2019
ING	CitiStreet	$900 million	$262 billion	0.0034	2008
MassMutual	The Hartford	$400 million	$54.9 billion	0.0073	2008
Prudential	Cigna	$2.1 billion	$50 billion	0.042	2003

Source: *InvestmentNews* analysis of publicly available data

While there have been other large mergers that aren't part of this analysis, the purchase prices involved weren't publicly disclosed, making a similar analysis impossible.

While each of these deals is different, fee compression likely played a role in the downward trend in deal cost, experts said. Fee compression causes $1 of assets to be worth less on a relative basis, they said, hence a reduction in cost per dollar acquired.

"It's a significant factor," said Philip Chao, principal and chief investment officer at Chao & Co. "If revenue is lower [due to fee compression], why should they pay more for it?"

Jane Slusark, a spokeswoman for Principal, declined to comment on the price the company paid relative to other industry deals, but said that Principal is paying a "fair price for a good business."

"We gain immediate scale that will make us a top three record keeper at closing in addition to growth opportunities that will be realized over time," she said.

A spokeswoman for Wells Fargo declined to comment.

According to consulting firm NEPC, median record-keeping fees fell by half over the past decade — to $59 per participant in 2017 from $118 in 2006. That trend las led firms to consolidate in order to gain economies of scale.

"If your fee is cut in half, you need to double the number of people you sell to in order to bring it back to 100%," Mr. Chao said.

Of course, not all deals are created equal, and many factors may have influenced Principal's lower purchase price relative to others.

The Principal-Wells Fargo deal, for example, included assets held in pensions, executive deferred compensation (nonqualified) plans, and the institutional trust, custody and asset advisory businesses. Of the $827 billion in acquired assets under administration, DC plans held $239 billion, or 29%, at the end of 2018.

The remaining $588 billion includes assets with services that would "command a very low price multiple," said Peter Demmer, CEO of consulting firm Sterling Resources Inc.

In addition, plan size and "fit" also influence purchase price, Mr. Demmer said. For example, The Hartford deal had a higher multiple because the transfer included large numbers of higher-revenue small plans, and the business was an "exact fit" with MassMutual's current book of business, he said.

It's also unclear whether any behind-the-scenes concessions were made between the parties that could have reduced the price. For example, Wells could have negotiated that Principal not sell its investment products to the retirement plans (and therefore not compete with Wells' products) for a certain period, or that Principal make its platform available to Wells Fargo advisers at a reduced cost, Mr. Chao speculated.

But experts said, fee compression is an undeniable calculation in any M&A deal between record keepers.

"Any price anybody pays today will take into account the fact of fee compression," Mr. Demmer said. "It would be foolish not to."