Podcast transcript

Future of Tax.

Podcast with David Dietz, Managing Director, Tax, KPMG in the US and Dino Mauricio, Managing Director and Financial Services Lead for Deal Advisory & Strategy KPMG in the US

Musical intro

Announcer:

Hello and welcome to another episode of the KPMG podcast series for tax leaders. In today's episode, we are looking at the consolidation of pension and sovereign wealth funds, a topic that more and more companies are focusing their attention on. To discuss the tax implications, potential risks and the challenges of this form of consolidation, I am joined by David Dietz and Dino Mauricio. David is Managing Director for Tax at KPMG in the US. David's primary focus is sovereign wealth funds and pensions. Dino is Managing Director and Financial Services Lead for Deal Advisory & Strategy at KPMG in the US. He specializes in providing enterprise-wide functional integration/separation services to Financial Services businesses.

David and Dino, thanks for joining me over the phone today.

Dino and David:

Thank you for having us. Pleased to be here.

Announcer:

As part of KPMG's Future of Tax program, we are exploring the themes of geopolitics, digitization and changing business models. For you both where does the topic of consolidation of pension and sovereign wealth funds fit in? David, perhaps you could lead off.

David:

Sure, tax departments find themselves under quite a bit of stress. Basically tax functions like many other support functions are required to do more with less. Chief tax officers are looking for opportunities to address the multitude of new tax requirements both in the specific jurisdictions in which they're operating such as aspects of US tax reform as well as regional or global challenges such as BEPS, anti-hybrid rules, and mandatory disclosure reporting. In light of these challenges, we're working with our clients to reimagine the tax function. This is basically a whiteboard exercise to evaluate in a controlled manner how best to address the tax requirements of the future. Recommendations could include greater use of technology as well as outsourcing and co-sourcing solutions. Fund consolidation presents specific tax issues that a tax function will be required to address including change of control provisions for tax attributes as well as possible structural issues for portfolio companies and of course, how the combined entities tax function will be designed going forward.

Announcer:

Great, thank you David. Dino, perhaps can help us understand why pension and sovereign wealth funds are being consolidated now?

Dino:

Good question. The consolidation of both pension and sovereign wealth funds is an important trend that we've seen over the past few years. We see several key factors behind this including regulatory encouragement, a desire to achieve greater economies of scale, the opportunity increased deal size and thereby gain access to better investment opportunities, and improved governance and internal resources. At the macro level all these investors whether pension fund's or sovereign wealth funds need to improve returns and address a number of key challenges in terms of meeting the needs of their investors. As sovereign wealth funds continue the trend of more active and direct investing we see fund consolidation as a reflection of their need to have greater internal capabilities to address the different asset classes and expanded geographical reach that may follow. In addition, many defined benefit funds are facing significant funding challenges, this is due to low interest rates and increased longevity of their beneficiaries. They see consolidation as a way to really address those challenges help them reduce costs by improving operations and investment efficiency as well as improved governance.

Announcer:

David, can you walk us through the opportunities associated with consolidation for both tax payers and tax authorities?

Dino:

So for taxpayers fund consolidation generally can have the benefit of economies of scale. This is true for the tax function as well as the broader organization. A possible result of consolidation is that the tax function will find itself with a greater talent pool or more sophisticated technology. The consolidation of the funds tax department also should have provided a tax function with greater negotiating power with service providers. From a tax authorities' perspective there are what I would call significant opportunities other than the tax authorities will be dealing with larger and more sophisticated taxpayers which should be a plus for tax authorities.

Announcer:

Dino, would you be able to elaborate for us on what you see as the potential risks and challenges of consolidation?

Yes, it's important for us to help clients understand the risk and challenges that come with consolidation. For us pre and post-merger challenges are very similar. At a high level these include cultural, political, technological, financial, tax, accounting, and operational considerations. So a lot of these need to be addressed before any consolidation opportunities are pursued. Culture for example, is a very important issue that needs to be addressed early in the merger. Culture clashes weather it is between investment funds or pension funds can provide a serious distraction and worse significantly reduce the perceived value of that consolidation. Human capital retention is also important as part of the cultural integration. Technologies as you can imagine would be another troublesome area in a consolidation. Systems handle everything from payroll to accounting, so a clear plan must be developed to really best integrate these disparate systems into something that works on the whole very efficiently. Technology has also enable more key processes and procedures and controls important to address that upfront. And as David, mentioned there's a number of tax challenges that are significant. This includes investment level tax accounting of capital gains and transfer taxes as well as local notification requirements. From an operational standpoint it's important to understand that two funds coming together aren't just aren't always compatible they have various approaches to strategy, source of funding liability, management governance, and investment styles that need to be aligned and integrated. That's the major risk of any consolidation, is viewing the individual culture, investment style, investment operations, and governance elements in place that need to be aligned in order for the combined consolidated entity to operate efficiently and achieve the cost savings that are anticipated.

Announcer:

So David, if a fund is looking to consolidate, what should they know and what should they do to get prepared?

David:

So a merger is a very complex exercise and as with most complex exercises the key to success is a good plan. As touched on by Dino with most significant changes, proper preparation allows funds to anticipate and plan for the multitude of challenges that are inherent in a fund consolidation. The range of issues that need to be considered in advance of a fund merger include looking at investment mandate, asset allocations, staffing, delegations of authority, governance. We've touched on tax and there are significant accounting and cultural aspects of the merger. All of these require a good thoughtful plan in advance to minimize, what's bound to be the uncertainty that's associated with a fund merger. Politics can be an important aspect because you're merging entities which have different histories and different cultures and can really be significant challenges in bringing together two separate influences. One significant rationale for merging funds and we've touched on this earlier is economies of scale. It's important to understand what the expectations are around achieving greater economies of scale, which would entail identifying where savings are expected and determining metrics so that the organizations can be sure that they're achieving what they set out to achieve to have a more efficient organization post-merger. The plan is really what makes or at least increases the chances of having a successful merger and helps to mitigate the many risks that are associated with a merger. It's also important not only to think about the different components that need to be addressed in a plan but to also be clear about the timeframe in which funds expect to complete the plan.

Announcer:

And so how do you see consolidation transforming tax and possibly other functions?

David:

Yeah tax is you know, like many functions is going to need to adapt to the newly merged entity. It's a challenge for tax. It'll be a challenge for other functions within the emerging funds. It's also an opportunity. The tax function as we mentioned earlier has the opportunity to combine resources which include the people as well as technology. And also it's a new start. So the merged entity can take a fresh look at people, processes, and technology to address the needs of a newly merged fund. It's important to address these, identify and address these issues early and to develop a plan to address the impact of consolidation on the tax function, as well as all other functions, and to establish clear metrics that are well-defined, and to be able to measure progress within the determined timeframe.

Announcer:

Finally Dino, what are your predictions for the future of consolidation?

Dino:

Based on what we're hearing the merger trend is likely to continue. We believe this reflects the challenges facing funding to improve returns, exploring new assets classes and investment, enhance governance, and also reduce costs. We also feel like consolidation reflects a set of broader related trends such as in-sourcing, co-investment, and increased emphasis on expense reduction. Also, partnerships in infrastructure and SMB financing as well as increased emerging market and foreign investments will contribute to consolidation trends as a favorable solution for funds facing these challenges. While the merger is a tempting solution to address the number of those challenges we feel it's important to consider a number of factors that need to be addressed in advance to help insurance successfully merged fund.

Announcer:

David and Dino on behalf of myself and our audience thanks for joining us today.

David and Dino:

Thank you, Thank you.

Announcer:

I'm sure we'll return to this topic again in future episodes. Stay tuned for our next podcast in the Future of Tax program where we will explore another trending topic within geopolitics, digitization or changing business models and please email us with any suggestions you have for future topics at tax@kpmg.com. Thanks for listening!

Musical exit