Four key trends to watch in financial services M&A

AUTHORS

(Ricco) A.S. Bhasin

Andrew Gray

Dealmaking in the financial services industry had been booming prior to COVID-19.

M&A activity into early 2020 was notably strong, including in asset management, payments fintech, insurance, banks and related loyalty partnerships, and international bancassurance. For example, in Q4 2019 alone, Canada saw almost $11B of deals in this space[1]. With the past 7 months of M&A activity having shown a levelling-off, we are now seeing dealmaking return, and there is good reason to believe it will continue.

The financial services industry faces notable complexities: margin compression, expense pressures, IFRS 9 angst, acceleration of digitization, capital sensitivities, anticipation of the implementation of IFRS 17, and volatile performance of AUM are just some examples. These complexities often, however, come with corollary opportunities, including M&A opportunities: as an example, in late summer *Bloomberg* reported: “a majority of Banks are planning *major* divestments (of certain divisions and operations), with 87 per cent saying they will do so within two years and 60 per cent within 12 months”[2].

In this article, we look at four trending drivers and issues for financial services M&A.

1. Look to liquidity as the need to deploy capital grows

“Dry powder” is traditionally associated with private equity capital sitting on the sidelines waiting for deployment. Likewise, banks and insurance companies need to decide what to do with their excess capital. Thanks to strong regulation and management since the 2008 financial crisis, Canadian and U.S. banks and insurance companies are very well capitalized. While there are stresses on earnings and capital such as low interest rates and loan losses, excess capital can build up quickly. Industry players will have important choices to make about capital deployment, weighing up organic growth and investment, increased dividend payments, buy-backs (as permitted), and, in the face of market opportunity and the right valuations, M&A.

2. Scaling and consolidating

Financial services can be scaled quickly and very extensively in certain sub-sectors, a move that can mean cost savings. As such, consolidation in many areas of financial services is probable. Certain international banks with lighter capital and regulatory requirements may face capital and loan loss headwinds, accelerating sales processes to divest non-core assets. Further, if we see a sustained period of market volatility, this may encourage wealth and similar asset managers and founders to explore sales (minority or majority partnerships) more quickly than planned, while certain lenders and alternative asset managers—credit and debt funds and lending institutions, for instance—could

face asset valuation and quality pressures, as certain underlying borrowers experience difficulty and do the same. Fintech and payment transactions have also been busy. With the need for strategic platform consolidation, there is good reason to believe this trend will continue in the race for digitization and customer acquisition and expansion.

3. Many more buyers and deals are tricky

In addition to banks and insurance companies, we have seen many other buyers enter the financial services industry in recent years. That trend is continuing with asset managers, pension plans, private equity groups and even retail companies (like grocers) and media companies interested in seeking financial services businesses where fees and income streams can produce strong long-term returns, valuation multiples and an increased customer base over time.

Notably, auction processes involving the sale of insurance, fintech and asset management businesses are witnessing many more financial investors than in the past, intensifying the competition for good assets. Understanding how to deal with virtual diligence reviews and negotiations, and seizing on opportunities presented by market volatility and uncertainty are key. Recent deals in the space are requiring novel structuring of pricing (including earn-outs, carry and incentive equity), MAE and interim operating conditions, shareholder rights, exits, and, at times, patience. Doing financial services M&A throughout the course of the pandemic can be challenging, but may reward those willing to play at the right times.

4. Governance in the spotlight

Canadian corporate law mandates that directors consider all stakeholder interests, and not just those of shareholders, including in the context of a prospective M&A deal. For financial services buyers or sellers, especially federally-regulated entities, the interests of creditors, depositors and policyholders are always prominent in board deliberations. In the midst of a pandemic, and the associated economic uncertainty, board decision-making may have to balance urgency with care, ensuring that directors have the information and advice necessary to make reasonable business judgments. Where a financial services entity is considering M&A in a pandemic context, tailored care when deliberating in respect of an M&A opportunity—or M&A pressures—may be appropriate.

Conclusion

Although M&A may seem an even more complex undertaking for financial services during the ongoing circumstances of the COVID-19 pandemic, the timing may be right for a number of reasons to seek benefits gained from strategic dealmaking. It will be interesting to see if M&A activity continues to recover amid this still-uncertain economic environment.

---

[1] S&P Global Market Intelligence.

[2] Bloomberg News, June 23, 2020.