Growth in specialty finance, but payday lenders continue to experience pressure on profits

Dealmaking across the UK consumer credit landscape varies materially. While deal volume in the specialty finance and market place lending space continues to remain high, by contrast, M&A activity in the payday lending space is reserved for the few players who have weathered the Financial Conduct Authority's interest rate caps and enforcement actions.

Our 2018 M&A forecast

Credit cards

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M&A activity levels will remain steady as banks re-assess consumer credit risks.

Payday lenders

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M&A activity flat. Market is likely to continue to shrink as a result of regulator intervention. Only businesses with the healthiest consumer practices will survive and thrive.

Specialty finance and marketplace lending

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High levels of M&A activity. Specialty and marketplace lenders are likely to remain busy as Brexit creates a niche in consumer and SME markets.

“Brexit may create some unique growth opportunities for specialty finance businesses as large retail banks turn their focus to high-margin corporate lending

Hyder Jumabhoy
Senior Associate, London
Financial Institutions M&A Group

Credit cards: Activity flat with banks under pressure to move away from riskier business lines

A combination of banks seeking to limit PPI misselling liabilities, pressure to dispose of higher risk credit card businesses (and move to ‘white-labelling’ models), and financial sponsors being attracted by higher IRR of NPL deals have all weighed on deal activity in the credit card space. A handful of megadeals, like Lloyds’ purchase of MBNA, and interest in some credit card portfolios from trade consolidators and private equity, will provide some bright spots, but overall M&A activity is likely to remain steady.

Payday lenders: Only those with healthy customer practices will continue to win market share

The imposition of price caps on payday lenders by the Financial Conduct Authority have reduced revenues and pushed up compliance costs. Enhanced consumer protection rights under the Consumer Rights Act 2015 have added an extra layer of risk. This has knocked M&A activity in payday lending, but dealmaking could start recovering, as the herd thins and remaining market participants turn to M&A as a tool for building scale in order to reduce costs and diversify product offerings.

Specialty finance and marketplace lending: On the deal radars of banks and private equity firms

Specialty and marketplace lenders are expected to remain busy. Banks are actively seeking ways to build partnerships with specialty lenders in order to tap into new customer bases, while financial sponsors have been drawn by fast growth and buy-and-build consolidation opportunities. Compliance with new P2P lending rules and a focus on existing service lines may see some key players step back from dealmaking in the short term. Government support for responsible alternative finance, however, and the niche that specialty lenders are carving out as providers of finance to consumers and SMEs, should bolster deal flow.

UK consumer credit (continued)

	Credit cards	Payday lenders	Specialty finance/marketplace lending
2018 outlook	**M&A activity levels to remain relatively steady**	**Marginal uptick in M&A activity. Whilst the number of market participants is likely to continue to fall given the reduced profitability resulting from the UK FCA's financial caps, market players with healthy customer practices will continue to win market share and diversifying their product/ service offerings**	**Continuing high levels of M&A activity, driven by market participants seeking to capitalise on first-mover advantages.** **Brexit may present a unique opportunity for specialty finance businesses—while large retail banks focus more on high-margin corporate lending, specialty finance businesses may be able to carve a niche in consumer/SME lending**
Current market	Flat	Flat	Upward
We are seeing	Strategic M&A deals and financial sponsor interest	Strategic M&A	Strategic M&A and financial sponsor interest
Key drivers	□ Banks seeking to: – Dispose of non-core/ high-risk businesses—credit cards also have a higher risk profile under the Consumer Rights Act 2015 – Limit exposure to PPI misselling liabilities – Mitigate rising cybersecurity and fraud risks □ Move towards distribution/white-labelling models □ Increasing regulatory scrutiny and burden	□ Reduced profitability—UK FCA's intends to retain current financial cap levels until at least July 2020 □ Increased operating/ regulatory risks—UK FCA continues to crack down on 'unfair' consumer practices □ Increased litigation risks—following on from enhanced consumer protection rights under the Consumer Rights Act 2015	□ Marketplace lending securitisations remain a bright spot in the ABS market. Growth trajectory has increased capital availability for lender growth and peaked financial sponsor interest □ JVs and other business partnership to offer niche credit products □ 2017 fund raising successes means larger players have well-stocked M&A war chests
Trends to watch	□ Interest in consumer credit from trade consolidators and private equity—though private equity may continue to focus on more lucrative NPL investment returns □ Renewed disintermediation threats posed by PSD2	□ 'Survival of the fittest' □ Expansion/diversification by market players with healthier customer practices	□ Growth of new lenders, encouraged by UK government support for responsible consumer/ SME alternative finance □ Dampening of M&A activity by regulatory intervention—the UK FCA has banned peer-to-peer wholesale lending and is considering the imposition of stringent regulations for peer-to-peer lenders □ UK FCA's approach to policing of firms authorised to operate P2P platforms

UK Consumer credit – Key deals and situations

Credit cards/consumer credit	
Banks seeking to dispose of non-core/ high-risk businesses	□ Commerzbank and BNP Paribas agreed to dissolve their consumer credit JV *(August 2017)* □ Banco Popular Español's disposal of Popular Servicios Financieros *(May 2017)* □ GE's disposal of GE Money Bank *(March 2017)*
Increasing litigation risk	□ Filing of an appeal against the UK CAT's denial of class action status to a £14 billion lawsuit filed against Mastercard for alleged EU competition law infringement on behalf of 46 million customers *(August 2017)* □ US Consumer Financial Protection Bureau published proposals to curb the use of contractual clauses that require customers to resolve disputes in out-of-court arbitration *(July 2017)*
Banks seeking to limit PPI misselling exposures	□ Lloyds Banking Group reportedly considered terminating its bid for MBNA over concerns of a £4 billion fine for PPI misselling *(October 2016)*
Increasing regulatory scrutiny and burden	□ Bank of England ordered British lenders to prove by September 2017 they are adequately protected against consumer credit risk *(July 2017)* □ Bank of England raised UK lenders' counter-cyclical capital buffer from 0% to 0.5% of UK risk-weighted assets, with a further rise to 1% by end-2017 *(June 2017)*
Appetite of trade consolidators and PE	□ HSBC's announced plans to acquire US credit card businesses *(November 2017)* □ Lloyds Banking Group's acquisition of MBNA *(May 2017)* □ MasterCard's acquisition of VocaLink Holdings *(April 2017)* □ Cerberus's acquisition of GE Money Bank *(March 2017)* □ DSO's acquisition of Effico *(February 2017)*
Acquisition of new technologies	□ MasterCard's acquisition of Nudata (fraud mitigation technology) *(March 2017)* □ AmEx's acquisition of inAuth (online authentication technology) *(January 2017)* □ Visa's acquisition of Cardinal Commerce (fraud detection technology) *(January 2017)*
Payday lenders/high-cost credit	
Reduced profitability of payday lenders	□ Wonga's £65 million of losses in 2016 *(September 2017)* □ Provident Financial's expected losses of £80 million – £120 million in 2017 *(August 2017)*
Continuing profit squeeze	□ UK FCA determined current financial cap levels applicable to high-cost-short-term credit products (i.e., 0.8% cap on daily interest and fees, £15 on default fees and aggregate cap of 100% of borrowed amount) will be maintained *(Feedback Statement FS17/2 published in July 2017)*
Increased operating / regulatory risks	□ UK FCA ordered BrightHouse to pay £14.8 million compensation to customers *(October 2017)* □ UK FCA launched an enquiry into alleged repayment option plan misselling by Provident Financial *(August 2017)*
'Survival of the fittest'	□ Shrinkage: – Car Finance Company's collapse into wind down *(August 2017)* – DFC Global's disposal of The Money Shop *(April 2017)* – CFO Lending's collapse into administration *(April 2017)* – Wonga's disposal of BillPay *(February 2017)* □ Expansion: – Everest Finanse's acquisition of Tempo Finanse *(November 2017)* – 4finance's acquisition of 80% of Friendly Finance *(June 2016)*, 9.9% of Spotcap *(June 2016)*, TBI Bank *(August 2016)* and 24.4% of Billfront *(December 2016)*
Specialty finance/marketplace lending	
Success of marketplace lending securitisation	□ Total issuance topped US$2.6 billion in Q3 2017, up by 7.6% from Q3 2016. Cumulative issuances in 2017 totalled US$23.8 billlion across 96 deals *(October 2017)*
Market consolidation activity	□ Non-Standard Finance's acquisition of George Banco *(August 2017)* □ Ekspres Bank's acquisition of Sevenday Finans *(June 2017)* □ 1pm's acquisition of Tracx Finance *(May 2017)* □ Creamfinance's acquisition of Moneyveo *(April 2017)*
More partnerships	□ AEGON's partnership with Funding Circle to offer SME loans *(August 2017)* □ Funding Circle's partnership with Just Eat to offer F&B loans *(July 2017)* □ Goldmoney's partnership with Lend & Borrow Trust to offer loans collateralised by precious metals *(May 2017)* □ Revolut's partnership with Lending Works to offer mobile credit *(March 2017)* □ British Business Bank's partnership with Funding Circle to offer SME loans *(January 2017)*
Growth of new lenders	□ Morses Club's expansion of its debt facilities to fund growth *(September 2017)* □ Prodigy Finance's US$240 million equity and debt raisings to fund its US growth plans *(August 2017)* □ Zopa's £32 million successful funding round *(June 2017)* □ RateSetter's £13 million successful funding round *(May 2017)*