WHITE & CASE

# Financial institutions M&A: Sector trends

Opportunities and challenges for M&A in the European financial services sector

**Progress 2017/Predictions 2018**

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We are often called upon to work on some of the most complex cross-border deals in the world, and in the past five years alone, we have advised on more than **280** M&A deals in the financial institutions sector worth **US$217 billion**.

With more than **100 partners** advising on financial services M&A across the Americas, EMEA and Asia-Pacific, we have a truly global offering. We were **ranked #1 by value for Global M&A by both *Mergermarket* and *Bloomberg*** in 2016, making us the most active M&A practice in the world.

**280**

Number of financial institution M&A deals we have worked on in the past five years

**US$217bn**

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**#1 by value for Global M&A**

*Mergermarket* and *Bloomberg* in 2016

# Financial institutions M&A: Sector trends

The road to recovery from the global financial crisis has been complex and challenging for financial institutions across Europe, with many still having some way yet to go

In 2017, the European financial services sector has weathered monumental political uncertainty as events in Spain challenge its constitution and financial ecosystem, Italy attempts to scale its €349 billion debt mountain and the UK's vote to leave the EU "becomes real". The uncertainty has been compounded by the shifting sands of financial regulation and the unprecedented eruption of new financial technology which promises to revolutionise, but also threatens to disrupt, the business models of even the most sophisticated and well-capitalised businesses.

Whilst the path ahead perhaps remains a daunting prospect for some, one thing is clear—successful implementation of inorganic business transformation strategies is a key solution for remaining competitive and winning market share.

With this in mind, in this report we analyse the key European M&A trends in 2017 spanning the main financial services subsectors, and offer insight into the 2018 outlook for M&A in each:

- **Banks**
- **State-aided banks**
- **Fintech**
- **Asset management**
- **Market infrastructure**
- **UK consumer credit**

## M&A forecast legend

- ▲△△△△ Flat
- ▲▲△△△ Limited growth
- ▲▲▲△△ Steady growth
- ▲▲▲▲△ Strong growth
- ▲▲▲▲▲ Very strong growth

**Patrick Sarch**
Partner, London
Co-head of Financial Institutions Global Industry Group

**Gavin Weir**
Partner, London
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Partner, Frankfurt
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# Bank appetite for dealmaking picks up

Banks, on the back foot following the financial crisis, are finally making a calculated comeback to M&A as they start to focus on core geographies and business lines. With balance sheets strengthened and capital reserves being rebuilt, global banks are now better placed to focus on markets and product offerings they believe will deliver the most growth in 2018.

## Our 2018 M&A forecast

**Banks**

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Steady growth in M&A driven by ongoing non-core disposals, re-emergence of strategic M&A, continued interest from PE, and in-bound US and Chinese investment.

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## With balance sheet repair largely behind them, global banks are now cautiously re-emerging in competitive auctions

**Patrick Sarch**
Partner, London
Co-head of Financial Institutions
Global Industry Group

## Disposal of non-core assets—one of the major drivers of deal activity in 2017—is likely to continue in 2018

A number of banks exited divisions they deemed non-core in 2017: Barclays has sold its French retail and wealth management businesses, disposed of a 22 per cent stake in its Africa Group and exited its UK trust business. Société Générale has offloaded a 49 per cent stake in Fortune and a 15.42 per cent stake in Eurazeo and spun-off TBC Bank. UBS, HSBC, BNP Paribas and Deutsche Bank are among the other banks to have made similar strategic disposals.

## Investing for growth gains momentum

Institutions are beginning to invest for growth and pursue strategically important deals. Goldman Sachs, J.P. Morgan, UBS and Citi have announced expansion plans in Saudi Arabia while BNP Paribas has acquired stakes in Italian credit insurer Cargeas Assicurazioni and Swedish consumer credit group SevenDay Finans.

## International buyer interest strengthens

Cross-border deals involving non-EU investors will continue in 2018. US investors—driven by stronger balance sheets—are likely to be active, taking advantage of the strengthening US$ and the loosening regulations.

# Banks (continued)

**2018 outlook**

**A steady growth in M&A activity driven by factors including ongoing non-core disposal programmes, re-emergence of strategic M&A (i.e., larger banks seeking to expand within newly selected core territories), in-bound US and Chinese investment, and continuing PE appetite.**

**Current market**

Upward

**We are seeing**

- Continuing non-core and financial asset disposals
- Sustained focus on restructurings, aimed at:
  - Streamlining within borders and movement towards leaner and simpler business models
  - Optimising regulatory capital and EU permission, governance, operational and tax efficiencies through centralisation
  - Leveraging existing third-party provider relationships across business lines and legal entities
  - Streamlining intra-group service arrangements (particularly in light of upcoming EU General Data Protection Regulation compliance requirements and rising cybersecurity threats)
  - "Hard" Brexit contingency planning
- Consolidation across Central and Eastern Europe, with support from political and regulatory authorities
- Early signs of re-emergence of strategic M&A
- JVs and other forms of collaboration focused on fintech development

**Key drivers**

- Banks are still shoring up their balance sheets, given mega-fines and increasing capital buffer requirements
- Stronger capitalised banks are ready to grow again, and regulators are being more supportive
- Competition from 'challenger' banks and fintech offerings
- US and Chinese buyers taking advantage of the strengthening US$

**Trends to watch**

- M&A strategies are very carefully managed:
  - Banks are acutely aware of internal resource restraints and seek to optimise use of management time
  - Many banks have limited P&L capacity for losses and prefer to attempt to improve businesses before selling
  - Wealth of experience of divestment activity means auction and bilateral processes are better managed
  - Some banks are holding out for improved market conditions and maximising positive impact on valuation multiples of retained businesses
- US in-bound investment, driven by repaired balance sheets (e.g., all US banks participating in the Federal Reserve's 2017 stress tests passed, loosening regulation (e.g., Volcker rule) and optimism for lighter post-Brexit UK regulation)
- Increasing focus by financial sponsors in FIG investment—including in banks
- Differing prerogatives between supranational and local prudential regulators
- Competition between local regulators across Europe attracts banks post-Brexit
- Squeeze-out of smaller banks following MiFID II coming into effect in January 2018

**Banks – Key deals and situations**

| | |
|---|---|
| Disposal of non-core assets | □ Barclays' disposal of its French retail and wealth management businesses *(September 2017)*, Barclays Bank of Zimbabwe *(June 2017)*, 22% of Barclays Africa Group *(May 2017)* and its UK trust business *(April 2017)*<br>□ Crédit Agricole's disposal of 16.2% of Banque Saudi Fransi *(September 2017)*<br>□ Société Générale's disposal of 49% of Fortune *(September 2017)*, TBC Bank *(June 2017)* and its 15.42% stake in Eurazeo *(June 2017)*<br>□ UBS's disposal of Dutch wealth management business *(August 2017)*<br>□ Credit Suisse's disposal of Next Investors *(August 2017)*<br>□ Deutsche Bank's disposal of Deutsche Bank Polska *(August 2017)* and Deutsche Bank Argentina *(June 2017)*<br>□ Banco de Sabadell's disposal of Sabadell United Bank *(July 2017)*<br>□ HSBC's disposal of HSBC Bank Middle East *(June 2017)*<br>□ BNP Paribas's disposal of UkrSib Capital Management *(June 2017)*<br>□ UniCredit's disposal of Bank Pekao *(June 2017)* |
| Disposal of financial assets | □ UniCredit's disposal of €300 million infrastructure PE portfolio *(July 2017)* and €310 million consumer NPLs *(June 2017)*<br>□ Santander's disposal of €300 million consumer/SME NPLs *(June 2017)*<br>□ Barclays' disposal of €190 million consumer NPLs *(May 2017)* |
| Restructurings | □ Idea Bank's merger of Idea Leasing and GETIN leasing *(November 2017)*<br>□ Bank BGŻ BNP Paribas's disposal of BGŻ BNP Paribas Faktoring to BNP Paribas *(November 2017)*<br>□ Saudi British Bank's acquisition of SABB Takaful *(August 2017)*<br>□ The Co-operative Bank's £700 million liability management exercise *(August 2017)*<br>□ Deutsche Bank's ongoing integration of Postbank *(March 2017)* |
| Strategic M&A "green shoots" | □ Goldman Sachs, J.P. Morgan, UBS and Citi announced expansion plans in Saudi Arabia *(October 2017)*<br>□ BNP Paribas's acquisition of a majority stake in Gambit *(September 2017)*, Cargeas Assicurazioni *(July 2017)* and Sevenday Finans *(June 2017)*<br>□ Morgan Stanley's acquisition of 5% of Permanent TSB *(August 2017)*<br>□ BAWAG's acquisition of Südwestbank *(July 2017)*<br>□ Santander's acquisition of Banco Popular Español *(July 2017)* |
| CEE consolidation | □ DNB's and Nordea's JV to consolidate Estonian, Latvian and Lithuanian banking activities *(October 2017)*<br>□ OTP's acquisition of Banca Românească *(July 2017)* and plans to acquire "at least 5 banks" in the next 2 years *(September 2017)*<br>□ KBC's acquisitions of United Bulgarian Bank and Interlease *(June 2017)*<br>□ AIK's acquisitions of Alpha Bank Serbia *(April 2017)* and Gorenjska Banka *(February 2017)* |
| JVs | □ Fintech collaboration:<br>– Commerzbank's, Bank of Montreal's, CaixaBank's, Erste's and UBS's joint development of blockchain-based trade finance platform *(October 2017)*<br>– Deutsche Bank's, KBC's, HSBC's, Natixis's, Rabobank's, Société Générale's and UniCredit's joint development and launch of blockchain-based trade finance platform *(June 2017)*<br>□ New markets:<br>– HSBC's securities JV, Bank of East Asia, in Southern China *(June 2017)* |
| Foreign buyers investment | □ Cerberus's acquisition of 3% of Deutsche Bank *(November 2017)*<br>□ Sampo Group's acquisition of 20% of Saxo Bank *(October 2017)*<br>□ CEFC China Energy's increased holding to 50% in J&T Finance Group *(September 2017)*<br>□ Legend Holdings' acquisition of 90% of Banque Internationale a Luxembourg *(September 2017)*<br>□ China Shuangwei Investment's acquisition of 60% of Altyn Bank *(June 2017)* |
| Competition from 'challenger' banks and fintech businesses | □ OakNorth made its first sizeable loan to UK-listed company, RM Secured Direct Lending *(November 2017)*<br>□ Orange's launch of Orange Bank *(November 2017)*<br>□ Redwood secured its banking licence and commenced trading *(August 2017)*<br>□ Tandem's acquisition of Harrods Bank *(August 2017)*<br>□ Clear Bank's approval to access the Bank of England's clearing platform *(January 2017)* |
| Diverging regulator prerogatives | □ Differing prerogatives between supranational vs. local regulators:<br>– European Commission's proposal to propose stricter controls for non-EU financial firms, including UK firms post-Brexit *(September 2017)*<br>– ESMA's rejection of 'letterbox' bank relocations following Brexit *(July 2017)* and proposal to increase its oversight of London's euro-clearing business post-Brexit *(July 2017)*<br>– ECB's involvement in enabling the EU to force the trade of clearing euro-denominated derivatives out of London *(June 2017)*<br>□ Competition between local regulators:<br>– UK's proposal to utilise new temporary authorisations to retain overseas financial services post-Brexit *(September 2017)*<br>– France's proposed tax reform set to boost bank relocations to Paris post-Brexit *(June 2017)*<br>– Delegates from Poland's, Denmark's, France's, Amsterdam's, Luxembourg's and Germany's respective regulatory authorities have encouraged relocation of mega banks post-Brexit *(January – November 2017)* |

# Damage control tops the agenda for state-aided banks

While rating agencies are beginning to show first signs of positive sentiment towards European banks, the shifting regulatory landscape continues to complicate M&A processes, making it challenging to find committed buyers. Against this backdrop, high levels of financial sponsor interest in stressed and distressed assets are a welcome source of new capital. Recovery is certainly possible, but not without significant uncertainty.

## Our 2018 M&A forecast

### State-aided banks

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High levels of M&A as stability funds across Europe seek to offload 'good banks'. Pressure from ECB on Southern and Central European market players boosts NPL disposals and dealmaking.

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# As pressure from local and supranational regulators mounts, state-aided banks seek to repair their balance sheets. Failure to act could result in a tailspin into financial distress

**Richard Pogrel**
Partner, London
EMEA Capital Markets

## Four key questions highlight the challenges and opportunities for M&A involving state-aided banks.

### Q There appears to be a steady flow of M&A involving state-aided banks. Why are these deals coming to market now?

A Governments are eager to offload stakes in banks bailed out during and following the financial crisis, which have since recovered. Local prudential regulators appear supportive of this policy and are facilitating opportunities to ready assets for sale and address potential buyer concerns. The EC, for example, has approved Portugal's restructuring plan for Novo Banco and a €5.4 billion state bailout of Monte dei Paschi.
By offering this kind of support, regulators seek to provide certainty over various long-running issues that have dogged state-backed banks until now. This should facilitate exits.

### Q Given the fact that regulators are displaying more support, are M&A processes likely to be relatively straightforward from here on in?

A Not quite. Some government exit strategies are coming under pressure, despite tacit regulatory backing. Government stability funds that have supported troubled banks have been stretched themselves and are focused on achieving a “clean break” from such assets.

### Q Why are auction processes being dragged out in the first place?

A An uncertain regulatory environment is one reason. For example, the UK government is consulting on tougher measures related to bank mergers, while the EC has issued a new discussion paper stating that 19 foreign banks will need to improve regulatory oversight. Some buyers are reluctant to take the plunge until there is more certainty around these key regulatory issues. Other buyers, financial sponsors in particular, are demanding seller protections that governments are reluctant to offer.

### Q Where is the most deal activity taking place?

A A number of state-backed banks, including ABN AMRO, UniCredit and Intesa Sanpaolo, are among many that have been able to strengthen their balance sheets by selling off large portfolios of NPLs. Others, like National Bank of Greece, which has made no fewer than six disposals this year, have exited non-core operations. There have also been several state-backed bank mergers, such as the tie-ups between Bankia and Banco Mare Nostrum in Spain.

# State-aided banks (continued)

**2018 outlook**

**A constant high level of M&A activity as stability funds seek to offload 'good banks', and the European Central Bank exerts pressure on market participants, especially across Italy, Greece, Spain, Portugal and Austria.**

**Current market**

Upward, significant

**We are seeing**

- NPL management and disposals
- Continuing non-core disposals
- Market consolidation, especially across the retail banking sector
- M&A activity involving government stability funds
- Continuing high level of financial sponsor interest in stressed and distressed assets

**Challenges**

- Government stability funds' exit strategies are under pressure. Temporary financing measures are necessary to allow breathing space as auction processes are becoming increasingly challenging
- Rising borrowing costs for struggling banks
- Few committed buyers and tough deal-financing market conditions
- 'Shifting sands' of regulatory landscapes making it tricky to find committed buyers
- Stringent and complex auction process rules
- Private equity buyers seeking to extract buyer-friendly deal protection from sellers/governments/stability funds
- Heightened litigation risk: 'private' litigation from market participants' reaction to government action, as well as 'public' litigation from inconsistency from application of new Member State regulatory reforms
- Damage to buyer sentiment by inconsistent implementation of supranational legislation across the EU

**Trends to watch**

- There is a perception that local prudential regulators are being lenient on sellers. But it is still unclear whether direct supervision of Significant Institutions by the European Central Bank will result in strict compliance with resolution ability
- Rating agencies showing early signs of positive sentiment towards European banks
- Inconsistency between antitrust and prudential regulatory imperatives continues to complicate processes

**State-aided banks – Key deals and situations**

| | |
|---|---|
| NPL management and disposals | □ Banca Mediocredito del Friuli Venezia Giulia's disposal of €385 million of NPLs (*August 2017*)<br>□ Liberbank's disposal of €169 million of NPLs (*July 2017*)<br>□ Banco Ibercaja's disposal of €489 million of NPLs (*July 2017*)<br>□ Caixa Geral de Depósitos' disposal of €476 million of NPLs (*July 2017*)<br>□ UniCredit's disposal of €450 million of NPLs (*June 2017*)<br>□ Intesa Sanpaolo's disposal of €2.1 billion of NPLs (*June 2017*)<br>□ ABN AMRO's disposal of €200 million of real estate NPLs (*July 2017*)<br>□ Banca Carige's disposal of €940 million of NPLs (*May 2017*)<br>□ Banca Sella's disposal of €125.5 million of NPLs (*May 2017*) |
| Non-core disposals | □ RBS's disposal of 4% of Euroclear *(October 2017)* and 33.3% of Hua Ying Securities (*July 2017*)<br>□ NL Financial's disposal of 7% of ABN AMRO (*September 2017*)<br>□ Novo Banco's disposal of 90% of Banco Internacional de Cabo Verde *(August 2017)* and 75% of its Macau-based operation (*May 2017*)<br>□ NBG's disposal of 99.8% of South African Bank of Athens Ltd. *(August 2017)*, Vojvodanska banka a.d. Novi Sad (*August 2017*), NBG Leasing (*August 2017*), United Bulgarian Bank (*June 2017*), Interlease (*June 2017*) and 75% of Calamos-Exin (*June 2017*)<br>□ NordLB's disposal of Deutsche Hypothekenbank (*July 2017*)<br>□ BES Venetie's disposal of Benfica (*June 2017*)<br>□ Alpha Bank's disposal of Alpha Bank Srbija (*April 2017*) |
| Consolidations | □ Santander's acquisition of Banco Popular Español (*July 2017*)<br>□ Intesa Sanpaolo's acquisition of good assets of Banca Popolare di Vicenza and Veneto Banca (*June 2017*)<br>□ Bankia–Banco Mare Nostrum merger (*June 2017*) |
| Exit strategies under pressure | □ Eurogroup Chairman, Jeroen Dijsselbloem, stated Greece must wrap-up an upcoming bailout review quickly to effect a 'clean' bailout exit in mid-2018 (*September 2017*)<br>□ Single Resolution Board Chairman, Elke König, called on the EU to implement tighter restrictions on winding down lenders (*August 2017*)<br>□ Taxpayer bail-out of Veneto Banca and Banca Popolare di Vicenza amidst controversial Single Resolution Board support on grounds that formal resolution under the EU Bank Recovery and Resolution Directive was 'not warranted in the public interest' (*June 2017*) |
| 'Shifting sands' of regulatory landscapes | □ UK Financial Reporting Council will require banks to disclose expected effects of IFRS 9 loss accounting rules (*October 2017*)<br>□ UK government has begun its consultation on proposed amendment of policies related to UK bank mergers (*October 2017*)<br>□ European Commission could have power to block Chinese and other foreign takeovers under a new EU screening framework (*September 2017*)<br>□ EU discussion paper stated that 19 foreign banks in the EU (including BAML, J.P. Morgan, Morgan Stanley and Mitsubishi UFJ) will need to set up new holding companies to improve regulatory oversight (*September 2017*) |
| Stringent/complicated auction processes | □ Auction sale of Novo Banco took nearly 3 years to complete (*October 2017*)<br>□ Banco Popular's shares plummeted 17% to record lows over concerns that no buyers would be found (*June 2017*)<br>□ NBG struggled to find buyers for Ethniki Hellenic General Insurance, finally selling to Exin Partners (*June 2017*)<br>□ RBS's proposed sale of its stake in Alawwal Bank (previously Saudi Hollandi) was abandoned (*April 2017*) |
| PE seeking to extract buyer-friendly deal terms | □ Lone Star secured back-stop guarantees from Fundo de Resolução (for a Tier 2 capital raise and capital shortfalls resulting from legacy portfolios) in connection with its acquisition of 75% of Novo Banco (*October 2017*)<br>□ Blackstone reportedly secured favourable terms for its 49% stake in real estate management JV with Banco Popular (*August 2017*) |
| Heightened risk of 'private' and 'public' litigation | □ Private:<br>– Northern Rock's shareholders renewed their legal campaign for compensation (*September 2017*)<br>– Santander has provisioned €7 billion for potential Banco Popular lawsuits (*September 2017*)<br>– Banco Popular's investors are seeking annulments of Single Resolution Board and European Commission decisions which led to Santander's acquisition (*August 2017*)<br>□ Public:<br>– US Federal Deposit Insurance Corp launched a UK High Court claim against 9 banks for alleged LIBOR-rigging (*August 2017*) |
| Perception of lenient regulators | □ European Commission approved Portuguese restructuring plan of Novo Banco (*October 2017*),<br>□ European Commission approved RBS's abandonment of Williams & Glyn disposal (*September 2017*)<br>□ European Commission approved €5.4 billion state bailout of Monte dei Paschi (*July 2017*)<br>□ European Commission approved aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law (*June 2017*) |

# Stars align for fintech M&A as the bull run continues

Established financial institutions are engaging with fintech as never before and are now active participants in fintech M&A. Private equity and venture capital appetite for transactions remains strong. Fintech dealmaking is booming as a consequence, and there is every indication that this will continue for some time yet.

## Our 2018 M&A forecast

**Fintech**

Fintech is the 'darling' of financial sector M&A and will enjoy the spotlight for some time to come as market participants embrace enablers in their quest for competitive advantage.

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**Fintechs are offering consumers a richer and smoother experience and are removing friction and cost from market infrastructure. Believe the hype! But proceed with caution...**

**Guy Potel**
Partner, London
Financial Institutions M&A Group

## Technology is fundamentally changing the way we deal with money and capital.

Fintech has moved from “disruptor” to “enabler” for many financial institutions and continues to shape the future of the financial sector. Here’s how:

### Strategics’ hunger for more fintech M&A

Strategic buyers have seen tangible examples of fintech success, such as Calastone’s purchase and sale of mutual funds using blockchain and Natixis making its first blockchain-powered fund distribution. Case studies like these mean other traditional institutions cannot afford to sit on the sidelines and wait to see how fintech develops. They have had to act and this has prompted a flurry of joint ventures and acquisitions, such as RBS’s partnership with blockchain-based mortgage reporting developer R3 CEV, Santander’s acquisition of transaction processor Elavon and BNP Paribas’s investment in robo-adviser Gambit Financial. Established banks, insurers and asset managers recognise that fintech can accelerate the re-architecture of back-end infrastructure with new efficient and cost-effective models.

**293**

Number of global fintech M&A deals in Q2 2017 alone

**Source:**
KPMG

**US$8.4 billion**

Value of global fintech M&A deals in Q2 2017 alone

**Source:**
KPMG

### PE and venture capital: Fintech high on the deal radar

Private equity and venture capital investors have continued to invest heavily in the fintech sector, attracted by growth prospects and the willingness of financial services companies to do deals, which increases exit options for sponsors. Payment processors Klarna and iZettle have both received financial sponsor backing this year, while Monzo, OakNorth Bank, Nubank, Neyber, Revolut, Tide, Yoyo, Zopa and Neos all reported successful funding rounds in H2 2017.

### Fintech’s transformation of financial services sector grows apace

EU finance ministers have emphasised the need to introduce fintech regulations to protect consumers, and the ECB has begun drawing up new licensing regulation for fintech businesses. While increasing regulatory scrutiny remains a concern, on the whole, local governments are supportive of the industry and are competing to attract fintech businesses to their shores. Fintech transformation of the financial services sector continues apace.

# Fintech (continued)

**2018 outlook**

**Fintech remains an M&A focus for financial sponsors and an investment omphalos for many established financial institutions. Global banks and insurers are increasingly looking to 'market infrastructure' fintech as a cure for internal cost management.**

**By contrast, 'customer-facing' fintech is having an increasingly disruptive impact on traditional retail banking models. Such solutions offer the intuitive end-user experiences which High Street lenders struggle to provide. But penetration of such solutions has not been consistent across all financial subsectors—for instance, penetration within the asset management industry has been more gradual.**

**Current market**

Upward, significant

**We are seeing**

- Expansion of fintech business, through successful fundraisings as well as inorganic growth strategies
- High, and growing, financial sponsor appetite for fintech
- Steady upward trajectory of strategic M&A. Established financial institutions are engaging with fintech in a variety of ways:
  - JVs with existing fintech businesses
  - JVs with competitors to develop fintech
  - Acquiring the whole/strategic stakes in fintech businesses
  - Funding fintech start-ups in exchange for 'early bird' stakes
  - Establishing accelerator programmes to foster ground-up development
- Early signs of profit generation for established financial institutions from M&A

**Key drivers**

- Fintech is being embraced as an 'enabler' of financial service provision—perception that fintech could be the solution to:
  - Realising cost efficiencies across existing service provision models
  - Maximising existing customer bases, through enhanced data analytics and processing
  - Attracting new consumers, especially millennials, who respond well to just-in-time personalised services
  - Accessing new markets, including unbanked and under-banked communities in China, Africa, India and SE Asia
  - Rapidly growing cybersecurity threats
- Top-down support for fintech businesses, including from national governments across Europe and local EU regulators. However, growing scepticism from supranational regulators could impact M&A levels
- Progressive regulatory and supervisory approach. Both UK prudential regulators are acutely aware of their national imperatives of ensuring the UK financial services market remains 'open for business' as Brexit looms—but they face stiff competition from other regulators across the bloc
- Regulatory intervention (e.g., the European Commission, through PSD2, and the UK Capital Markets Authority, through its February 2017 final banking order, are encouraging 'open banking')

**Trends to watch**

- Fintech continuing to disrupt traditional retail banking models—how will the High Street banks react?
- Tangible fintech successes boosting M&A activity. We are seeing the first signs of blockchain technology deployment across fund distribution, cross-border FX transfers and securities settlement
- Profit generation for established financial institutions from M&A activity
- Financial sponsors seeking to realise investments through IPOs, disposals and other exit strategies
- Will the UK be toppled as the epicentre of fintech development post-Brexit?
- Regulatory intervention in certain fintech subsectors (e.g., P2P, coin offerings and bitcoin CFD trading)

**Fintech – Key deals and situations**

| | |
|---|---|
| Scaling up of fintech businesses | ☐ Successful fundraisings:<br>– Monzo, OakNorth, Nubank, Neyber, Revolut, Tide, Yoyo, Zopa and Neos all reported successful funding rounds in H2 2017 (*June – November 2017*)<br>☐ Deployment of inorganic growth strategies:<br>– Deposit Solutions' acquisition of Savedo (*August 2017*)<br>– Payconiq's acquisition of Digicash Payments (*August 2017*)<br>– My Buck's acquisition of 50% of New Finance Bank (*July 2017*) |
| Fintech – an "enabler" of financial services | ☐ JVs with existing fintech businesses:<br>– Blockchain-based mortgage reporting JV between, amongst others, RBS and R3 CEV (*September 2017*)<br>– E-commerce JVs between CaixaBank and Alibaba (*August 2017*) and Yandex and Sberbank (*August 2017*)<br>☐ JVs with competitors to develop new technologies:<br>– Commerzbank's, Bank of Montreal's, CaixaBank's, Erste's, UBS's and IBM's joint development of a blockchain-based trade finance platform (*October 2017*)<br>– Barclays', Credit Suisse's, UBS's and HSBC's joint development of a new digital currency (*August 2017*)<br>☐ Acquisitions of fintech businesses:<br>– Santander's acquisition of Elavon (*July 2017*)<br>– Arkea's acquisition of Pumpkin (*July 2017*)<br>☐ Acquisitions of strategic interests in fintech businesses:<br>– BNP Paribas's acquisition of a majority stake in Gambit Financial (*September 2017*)<br>– Julius Bar's acquisition of a minority stake in Nectar Financial (*July 2017*)<br>☐ Funding fintech start-ups in exchange for 'early bird' stakes:<br>– Intesa Sanpaolo's 'Neva Finventures': established in 2016<br>– Aviva's 'Aviva Ventures': established in 2015<br>☐ Establishing accelerators:<br>– RBS's partnership with Entrepreneurial Spark to create the Business Accelerator Hub (*August 2017*)<br>– UBS's partnership with Credit Suisse to create the KickStart Accelerator programme (*March 2016*) |
| Fintech – a 'disruptor' of financial services | ☐ Revolut applied for a European banking licence *(November 2017)*, commenced offering insurance products (*September 2017*), mortgage services (*April 2017*) and consumer loans (*March 2017*)<br>☐ Klarna's successful Swedish banking licence application (*June 2017*)<br>☐ Adyen's successful pan-European banking licence application (*June 2017*) |
| Tangible fintech success whetting appetites | ☐ Calastone's successful buying and selling of mutual funds using blockchain technology (*July 2017*)<br>☐ Natixis's first blockchain transaction completed in fund distribution (*July 2017*)<br>☐ Banco Bilbao Vizcaya Argentaria's use of blockchain to effect cross-border money transfers (*April 2017*)<br>☐ Deutsche Bundesbank and Deutsche Börse commenced testing of a functional prototype for blockchain-based securities settlement (*January 2017*) |
| Profit generation for established banks | ☐ Credit Suisse's disposal of Next Investors (*August 2017*)<br>☐ Goldman Sachs's proposed disposal of Simon (*July 2017*) |
| Top-down support for fintech. But dark clouds may be gathering… | ☐ Government support:<br>– Spain's research, development and innovation tax credits for fintech businesses (*May 2017*)<br>– Sweden's National Innovation Counsel established to support fintech (*May 2017*)<br>☐ Regulator support:<br>– European Commission raided banking associations in Poland and the Netherlands as part of a crackdown on lenders which block fintech from legitimate access to customer data (*October 2017*)<br>– European Commission's resolution to support expansion of fintech (*May 2017*)<br>☐ Direct regulator involvement:<br>– UK FCA's continued support of fintech start-ups (e.g., AssetVault, Experian and Sabstone) through its 'regulatory sandbox' (*June 2017*)<br>– Bank of England's launch of its Fintech Forum (*March 2017*)<br>☐ Regulatory scepticism:<br>– EU finance ministers have emphasised the need to introduce regulation to protect consumers (*September 2017*)<br>– ECB commenced drawing up of new licensing regulation for fintech businesses (*September 2017*) |
| Financial sponsor interest in fintech | ☐ Bain's investments in Acorn, Digital Currency Group, iPay Technologies and Receivables Exchange and TxVia (*2014 – 2017*)<br>☐ Rocket Internet's and Finstar Financial's investment in Spotcap (*October 2017*)<br>☐ Zouk Capital's investment in iZettle (*September 2017*)<br>☐ Permira's acquisition of 10% in Klarna (*July 2017*)<br>☐ BlackRock's investment in Scalable Capital (*June 2017*)<br>☐ Northzone's investment in Zopa (*June 2017*)<br>☐ Pollen Street/BC Partners' acquisition of Shawbrook (*June 2017*)<br>☐ Passion Capital's investment in Tide (*June 2017*) |

# Acquire or be acquired: Three reasons why asset managers are consolidating

Megadeals in the asset management industry have been coming thick and fast: Standard Life's £3.8 billion tie-up with Aberdeen Asset Management, Amundi's €3.55 billion acquisition of Pioneer and Henderson and Janus Capital joining forces, to name but a few. Activity is likely to continue as MiFID II comes into force.

## Our 2018 M&A forecast

**Asset management**

Exponential growth in consolidation at all levels underpinned by regulatory change.

“

# Consolidation is likely to continue apace, but there is no M&A “magic wand”: The right business pairing, efficient execution and post-deal integration are key

**Gavin Weir**
Partner, London
Co-leader of Financial Institutions M&A Group

## Three key drivers for consolidation in the asset management sector in 2018:

1

### Keeping up with compliance

Asset managers have faced a wave of regulatory change since the financial crisis. MiFID II and GDPR are arriving imminently and will materially increase the volume of regulation asset managers need to manage. Firms that fail to do so run the risk of huge fines.

The Financial Conduct Authority, meanwhile, following a review of the industry, has clamped down on commission-based fee structures and the charging of dealing commissions for research. This has squeezed fee revenue further.

Ultimately, what this means is that more resources are needed to ensure and demonstrate compliance. M&A has been an obvious strategy for achieving synergies and attempting to benefit from economies of scope and scale.

2

### Expanding strategy, geography and appetite in alternative assets

Customers are becoming more demanding and are no longer satisfied with single-strategy products restricted to a handful of geographies.

They want access to developed and emerging markets and there is appetite for exposure to alternative assets like real estate, infrastructure and private equity in addition to traditional bonds and equities. Schroders has backed alternatives specialist Adveq, and M&G has expanded in Europe.

More deal activity is anticipated as asset managers actively seek to build themselves into “one-stop shops”, offering investors exposure to a variety of strategies across a wider range of geographies.

3

### Rise of the robots

‘Robo-advisers’ have disrupted the asset management model, providing cheap, diversified portfolios based on client risk profiles that can be managed online. They have been especially popular with younger investors. Traditional managers are having to move fast to keep up.

# Asset management (continued)

**2018 outlook**

**Steep upward trajectory in M&A activity at all market levels, in line with growing international buyer interest. A significant number of notable market players have already started to implement their consolidation strategies.**

**Current market**

Upward, significant

**We are seeing**

- Consolidation at all market levels, in multiple forms: mergers of equals, bolt-on acquisitions and intra-group reorganisations
- Growing polarisation between global players with diversified offerings and local niche players
- Some banks stepping back from asset management, while others step up

**Key drivers**

- Profitability squeeze from passive strategies, movement away from traditional fund management models (i.e., commission-based to fee-based)
- Cost escalation from increasing regulatory burden:
  - MiFID II, which will lead to higher overhead costs due to restrictions on commission-based arrangements with brokers, stringent fee transparency requirements and payment for equity research
  - GDPR, which will necessitate significant upfront investment and lead to higher ongoing compliance costs from direct obligations on both customer data controllers and processors
  - AIFMD, which has brought conduct of business, safekeeping of investments and delegation of certain functions within the regulatory perimeter
- Operational synergies, economies of scale, expertise, enhanced product offerings and new distribution channels
- Global players moving to and/or upscaling in key growth markets
- Response to increasing competition from fintech and 'alternative' service providers
- Growing international, private equity and 'non-traditional' buyer interest
- Deployment of existing M&A war-chests

**Challenges**

- Uncertain regulatory environment, exacerbated by greater EU and local regulatory intervention
- Competition for attractive targets resulting in over-valuation of robo-advisors and other fintech businesses
- Few 'mid-size' assets remain available, which may mean M&A polarises at the top and bottom of the market, resulting in higher valuations
- Brexit

**Trends to watch**

- 'Winner takes all'—becoming the go-to provider of high-margin products/services
- US inbound investment into Europe—weaker £/€ creates more opportunities for US buyers
- Competing with international fund managers in EU markets
- Technological development (e.g., AI, machine learning, big data and analytics)
- Outsourcing to reduce costs, but MiFID II may disadvantage some European asset managers
- Use of passive investment strategies—is the movement away from active fund management models permanent?
- Investors are more demanding and have higher expectations
- EU fund managers are expanding into international markets to meet growing customer demand for global products

**Asset management – Key deals and situations**

| | | | |
|---|---|---|---|
| Market consolidation | Larger:<br>□ Lazard's, Lloyds Banking Group's, Vanguard's and HSBC's announcement of expansion plans for asset management *(February – November 2017)*<br>□ BNP Paribas Asset Management–THEAM–CamGestion merger *(November 2017)*<br>□ Prudential–M&G merger (*August 2017*)<br>□ Standard Life–Aberdeen Asset Management merger (*July 2017*)<br>□ Amundi's acquisition of Pioneer (*March 2017*) | Mid-sized:<br>□ Theodoor Gilissen–Insinger de Beaufort merger (*August 2017*)<br>□ ICU's acquisition of UkrSib Capital (*July 2017*)<br>□ Bank Pekao's acquisition of 51% of Pioneer Pekao Investment Management (*June 2017*)<br>□ Groupe Crystal's acquisition of Expert & Finance (*June 2017*)<br>□ Lombard International's JV with Akaan (*May 2017*)<br>□ Amaika's announced plans to acquire firms of equal and smaller sizes (*May 2017*) | Smaller:<br>□ Storebrand's acquisition of 90.95% of SKAGEN (*October 2017*)<br>□ Mirova's acquisition of 51% of Althelia Ecosphere (*October 2017*)<br>□ Lakefield–Edrofin merger (*October 2017*)<br>□ Impax's acquisition of Pax World (*September 2017*)<br>□ Bellpenny–Ascot Lloyd merger (*July 2017*)<br>□ Van Lanschot Kempen's acquisition of UBS' Dutch wealth management business (*June 2017*)<br>□ Aldermore's acquisition of 48% of AFS (*June 2017*) |
| Non-core disposals and focus on core markets | □ Banco BPM's disposal of Aletti Gesttielle (*November 2017*)<br>□ Danske Bank's disposal of part of its wealth management business to Davy Group (*July 2017*)<br>□ UBS's disposal of its Dutch wealth management business (*June 2017*)<br>□ BNP Paribas's disposal of UKrSib Capital (*June 2017*)<br>□ UniCredit's disposal of Pioneer Asset Management (*March 2017*) | | |
| Banks searching for stable returns | □ Deutsche Bank's and Julius Baer's announced UK expansion plans (*July – August 2017*)<br>□ Credit Suisse's announced plans to expand its onshore wealth management business (*January 2017*) | | |
| Growing buyer appetite | □ Financial sponsors:<br>– KKR-backed Avendus's acquisition of Ocean Dial (*August 2017*)<br>– FAB's acquisition of a majority stake in Halkin Asset Management (*May 2017*)<br>□ Non-traditional investors:<br>– Saudi Public Investment Fund's announced plans to invest US$65 billion with foreign asset managers (*May 2017*)<br>□ Foreign buyers:<br>– HNA's acquisition of a strategic stake in Old Mutual's US asset management unit (*March 2017*) | | |
| Regulatory intervention | □ EU Commission published its proposals on a framework for review of in-bound foreign direct investments (*September 2017*)<br>□ French Autorité des marchés financiers' powers under the Sapin II Law vis-à-vis conditions for implementing redemption gates on open-ended funds (*June 2017*)<br>□ UK FCA's reaction to the charging of dealing commissions for research (*March 2017*) | | |
| EU fund managers expanding into foreign markets | □ Impax Asset Management's acquisition of Pax World Management (*September 2017*)<br>□ AXA's announced Asia expansion plans (*August 2017*)<br>□ UBS Asset Management's successful application for Chinese fund management licence (*July 2017*)<br>□ Schroders' acquisition of Adveq (*July 2017*) | | |
| Competition with foreign fund managers | □ Hywin Financial Holding Group's acquisition of Azure Wealth (*April 2017*)<br>□ HNA's acquisition of C-Quadrat (*May 2017*)<br>□ GF International Asset Management UK's launch of new LSE-listed ETF products (*January 2017*) | | |
| Technological advancement | □ Allianz, AXA and Aviva announced continuing deliberations on financing of investment research (*August 2017*)<br>□ Julius Baer's investment in Nectar Financial (*July 2017*)<br>□ Natixis' deployment of blockchain through its FundsDLT mobile app (*July 2017*)<br>□ BlackRock's investment in Holtzbrinck and Tengelmann (*June 2017*)<br>□ Hellman & Friedman's and GIC's acquisition of Allfunds (*May 2017*)<br>□ BinckBank's acquisition of Pritle (*March 2017*)<br>□ RBS's replacement of 220 investment advisers with robo-advisers (*March 2017*) | | |
| Outsourcing vs. insourcing | □ Deutsche Asset Management's launch of its internal research institute (*July 2017*) | | |
| Use of passive investment strategies | □ Scale back:<br>– Deutsche Bank closed 16 ETFs in Hong Kong (*July 2017*)<br>– BlackRock Canada delists seven ETFs (*April 2017*)<br>□ Expansion:<br>– L&G's acquisition of Canvas *(November 2017)*<br>– WisdomTree's acquisition of ETF Securities' European commodities platform *(November 2017)*<br>– Invesco's acquisition of Source (*August 2017*) | | |

# Regulation and technology overhaul financial market infrastructure

Technology and tougher regulation are reshaping the infrastructure the financial services industry relies on to function. The four pillars of financial market infrastructure: payment systems; trading platforms; financial benchmarks; and custodians are all unique in the trends that are influencing their M&A activity.

## Our 2018 M&A forecast

### Payment systems/e-money providers

▲▲▲▲▲

Compounded by new regulation and innovators, the disruption will continue to drive M&A levels to new highs.

### Stock exchanges/clearing houses

▲▲▲△△

MiFID II expanding the types of regulated trading venues will result in an uptick in market consolidation.

### Financial benchmarks

▲△△△△

A lull in M&A as many benchmark administrators concentrate efforts on EU Benchmark Regulation compliance.

### Custodians

▲△△△△

Some consolidation M&A as Central Securities Depositories (CSDs) continue to encroach on custodians.

“

## The high tide of new regulation has passed, but a long implementation period is yet to come. M&A is on the horizon

**James Greig**
Partner, London
Financial Regulatory Group

## Competition among payment systems intensifies

Competition in the payment systems space is increasing as technology opens the door for new entrants to challenge established operators. Regulators have been paying more attention to the space too, encouraging competition and thereby adding pressure on profitability.

Businesses in the sub-sector have had little option other than to scale up to mitigate the risk of regulation and competition eroding margins further.

M&A has been an obvious strategy, prompting deals like Vantiv’s merger with Worldpay, Blackstone’s and CVC’s acquisition of Paysafe and Hellman & Friedman’s takeover bid for Nets.

## Consolidation in trading platforms continues

New regulations like MiFID II, which will expand the types of trading venues that are regulated, will ensure that consolidation remains a theme in the trading platform space, as will ongoing efforts to promote co-operation and harmonisation between exchanges through joint ventures and strategic alliances. Although the proposed merger between LSE and Deutsche Börse was aborted earlier in 2017, both LSE and Deutsche Börse have subsequently reported active inorganic strategies.

Some trading platforms, however, are now curbing their global ambitions in favour of building themselves up as “home grown” champions, as evidenced by Euronext’s acquisition of LSE’s French clearing business.

## Feeling cost pressures, financial benchmarks take cautious approach

Operating costs for the producers of financial benchmarks have increased substantially post-financial crisis, as new regulation bites and the risk of tougher enforcement action from EU and non-EU regulators intensifies. Regulators now expect benchmark administrators to police their data submitters and only a few have the infrastructure to fulfill this role.

Administration of financial benchmarks has consolidated in the hands of a few institutions, as the new EU Benchmark Regulation nears its effective date.

## Custodians with stronger balance sheets seek consolidation

Global custodians like BNY Mellon, State Street and J.P. Morgan continue to dominate, but there are signs of entrants like BNP Paribas making inroads.

Custodians with stronger balance sheets, such as Bank of N.T. Butterfield and Northern Trust, continue to grow inorganically.

# Market infrastructure (continued)

| | Payment systems/ E-money providers | Stock exchanges/Clearing houses | Financial benchmarks | Custodians |
|---|---|---|---|---|
| **2018 outlook** | **High M&A levels. Main motivation is likely to include competition with other established participants, compounded by disruption by new regulation and innovators** | **An uptick in market consolidation. Main motivation is likely to include regulatory change (e.g., expanding the types of trading venues which are regulated under MiFID II)** | **Many businesses have already up-scaled their operations. Strategic investments into fintech is likely to continue** | **Continued rise in outsourcing arrangements. Global custodians are likely to continue to remain dominant, though regional players may expand (possibly through sub-custodian arrangements)** |
| **Current market** | Upward, very high levels of activity | Upward | Flat | Flat, with a dip in the levels of M&A |
| **We are seeing** | Strategic M&A, financial sponsor-led M&A, established bank deals and successful fundraisings | □ Strategic M&A:<br>– Market consolidation globally and regionally, with some signs of platforms concentrating on 'home continent' markets<br>– JVs and other forms of strategic alliance<br>– Vertical integration, through fintech and financial information service acquisitions | Strategic M&A | □ Strategic M&A:<br>– Rise in outsourcings. While global players (namely BNY Mellon, State Street, J.P. Morgan and Citi) continue to dominate, there are early signs of inroads by smaller players<br>– Some custodians with robust balance sheets execute inorganic growth strategies |
| **Key drivers/ challenges** | □ Market participants being forced to scale up to meet reduced profitability resulting from:<br>– New EU regulations<br>– Increasing operating costs from additional regulatory burden and multilateral interchange fee litigation risk<br>– Competition from innovators and alternative services<br>□ Market participants expanding their offerings (e.g., banking services)<br>□ Upward demand trajectory for payments services | □ Increasing co-operation between exchanges<br>□ Mega-mergers are unlikely to secure regulatory and anti-trust clearances | □ Changing market requirements (e.g., LIBOR to be phased out by end-2021)<br>□ Increasing operating costs from:<br>– New regulation<br>– Increasing litigation risk (e.g. heightened enforcement action risk from EU and non-EU regulators and end-user lawsuits)<br>□ Investment in fintech | □ Competition from Central Securities Depositories (CSDs)—as CSDs face increasing competition under the EU Central Securities Depositories Regulation, they are seeking to cannibalise custodians<br>□ Increasing operating cost bases and heightened regulatory enforcement risk<br>□ Identifying new revenue streams given low net-interest income |
| **Trends to watch** | □ Interest in payment services from financial sponsors, market participants and established banks<br>□ Regulatory intervention in the payments sector<br>□ Regulator acceptance of fintech—if stability and security can be demonstrated | □ Impact of Brexit on London's euro-clearing business<br>□ Impact of efficiencies derived from Target2-Securities, the single pan-European platform for securities settlement in central bank money | □ A smaller number of market participants having sufficient infrastructure to support benchmark administration<br>□ Uncertain profit margins | □ Smaller custodians chipping away at global players' businesses |

## Market infrastructure – Key deals and situations

| | |
|---|---|
| **Payment systems/E-money providers** | |
| Market participants scaling up | □ Ingenico Group's acquisition of IECISA (*October 2017*) and Bambora (*July 2017*)<br>□ Vantiv's merger with Worldpay (*August 2017*)<br>□ B+S Card Service–PAYONE merger (*May 2017*) |
| Expansion into banking services | □ PayPal's deal with Visa to issue debit cards in Europe *(July 2017)*<br>□ Klarna *(June 2017)* and Adyen *(June 2017*) both successfully secured European banking licences |
| Established bank interest in payment service providers | □ CaixaBank's agreement with Alibaba to support Alipay (*August 2017*)<br>□ Swedbank's acquisition of PayEx (*May 2017*)<br>□ BNP Paribas Fortis's acquisition of PaySquare Belgium (*May 2017*) |
| Private equity interest in payment service providers | □ Hellman & Friedman's takeover bid for Nets (*September 2017*)<br>□ Blackstone's and CVC's acquisition of Paysafe (*August 2017*)<br>□ Neptune's acquisition of Transact Payment (*July 2017*) |
| Favourable market conditions | □ The World Bank projects 3-4% annual growth in the coming years (*August 2017*)<br>□ TransferWise's projected revenues of £100 million in 2017 (*August 2017*) |
| Competition from new entrants and innovators | □ Payconiq's acquisition of Digicash Payments (*August 2017*)<br>□ Stripe's tie-up with WeChat Pay and Alipay (*July 2017*) |
| Increasing litigation risk | □ Revival of class action against Mastercard alleging anti-competitive behaviour (*August 2017*)<br>□ US Consumer Financial Protection Bureau published proposals to restrict use of out-of-court arbitration clauses (*July 2017*) |
| Regulatory intervention | □ UK Payment Systems Regulator's plans to alter fee calculation and collation methodology (*August 2017*)<br>□ Bank of England's widening of access to UK payment systems to non-bank service providers (*July 2017*) |
| **Stock exchanges/Clearing houses** | |
| Market consolidation | □ Euronext's acquisition of Credit Suisse's forex platform (*August 2017*)<br>□ Deutsche Börse's acquisition of a stake in Trumid (*July 2017*) and aborted merger with LSE (*March 2017*) |
| Concentrating on 'home continent' | □ Deutsche Börse's sale of International Securities Exchange Holdings to Nasdaq (*June 2016*)<br>□ Euronext's acquisition of LSE's French clearing business (*January 2017*) |
| Co-operation between exchanges | □ MSE's collaboration with GMEX to develop high impact initiatives in Indian capital markets (*May 2017*)<br>□ Nasdaq and Shanghai Stock Exchange rumoured to be in talks over Kazakh bourse stake (*May 2017*) |
| Vertical integration | □ Fintech:<br>– Euronext's acquisition of 90% of FastMatch *(August 2017)* and 60% of iBabs (*July 2017*)<br>□ Financial information services:<br>– Deutsche Börse's announced interest in index data and analytics M&A opportunities (*June 2017*)<br>– LSE's acquisition The Yield Book and Citi Fixed Income Indices (*May 2017*) |
| Possible impact of Brexit | □ MEPs have sought tougher rules on London's euro-clearing business after Brexit (*August 2017*)<br>□ ESMA plans to increase its oversight of London's euro-clearing business after Brexit (*July 2017*) |
| **Financial benchmarks** | |
| Changing market requirements | □ SONIA to replace LIBOR by end-2021 (*August 2017*) |
| New regulation | □ EU Benchmark Regulations (*comes into force on 1 January 2018*) expands the regulatory perimeter and is likely to foreshadow a rise in regulatory and end-user litigation |
| Increased litigation risk | □ US Federal Deposit Insurance Corp launched US$400 billion LIBOR-rigging suit against 9 banks (*August 2017*)<br>□ Citi, Deutsche Bank and J.P. Morgan paid mega-fines to settle LIBOR-rigging investor lawsuits (*August 2017*) |
| Investment in technology | □ IHS Markit's acquisition of automotive Mastermind Inc. (*September 2017*)<br>□ ICE's acquisition of TMX Atrium (*May 2017*) |
| Vertical integration | □ ICE's acquisition of remaining 20% of ICE Endex from N.V. Nederlandse Gasunie (*July 2017*)<br>□ LSE's acquisition of The Yield Book and Citi Fixed Income Indices (*May 2017*) |
| **Custodians** | |
| Rise in outsourcing | □ BlackRock transitioning US$1 trillion of AuM from State Street to J.P. Morgan for custody (*January 2017*) |
| Dominance of global custodians | □ Citi selected by Iberclear to provide global custody services (*October 2017*)<br>□ State Street selected Deutsche Bank as its T2S partner (*October 2017*) |
| Smaller players making inroads | □ BNP Paribas selected by UK's Local Government Pension Schemes (*September 2017*), Mirae Assets Securities (*July 2017*) and MAPFRE Inversión (*February 2017*) to provide custody services |
| Inorganic growth by custodians with strong balance sheets | □ Bank of N.T. Butterfield's acquisition of Deutsche Bank's global trust solutions business (*October 2017*)<br>□ Northern Trust's acquisition of UBS's Swiss and Luxembourgian fund administration units (*October 2017*)<br>□ BNP Paribas's acquisition of Credit Suisse's fund administration business (*August 2017*)<br>□ JTC Group's acquisition of New Amsterdam Cititrust (*April 2017*) |

# 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

▲▲▲△△

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

### Payday lenders

▲▲▲△△

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.

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**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.**<br>**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:<br>– Dispose of non-core/ high-risk businesses—credit cards also have a higher risk profile under the Consumer Rights Act 2015<br>– Limit exposure to PPI misselling liabilities<br>– Mitigate rising cybersecurity and fraud risks<br>□ Move towards distribution/white-labelling models<br>□ Increasing regulatory scrutiny and burden | □ Reduced profitability—UK FCA's intends to retain current financial cap levels until at least July 2020<br>□ Increased operating/ regulatory risks—UK FCA continues to crack down on 'unfair' consumer practices<br>□ 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<br>□ JVs and other business partnership to offer niche credit products<br>□ 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<br>□ Renewed disintermediation threats posed by PSD2 | □ 'Survival of the fittest'<br>□ Expansion/diversification by market players with healthier customer practices | □ Growth of new lenders, encouraged by UK government support for responsible consumer/ SME alternative finance<br>□ 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<br>□ 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)*<br>□ Banco Popular Español's disposal of Popular Servicios Financieros *(May 2017)*<br>□ 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)*<br>□ 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)*<br>□ 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)*<br>□ Lloyds Banking Group's acquisition of MBNA *(May 2017)*<br>□ MasterCard's acquisition of VocaLink Holdings *(April 2017)*<br>□ Cerberus's acquisition of GE Money Bank *(March 2017)*<br>□ DSO's acquisition of Effico *(February 2017)* |
| Acquisition of new technologies | □ MasterCard's acquisition of Nudata (fraud mitigation technology) *(March 2017)*<br>□ AmEx's acquisition of inAuth (online authentication technology) *(January 2017)*<br>□ 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)*<br>□ 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)*<br>□ UK FCA launched an enquiry into alleged repayment option plan misselling by Provident Financial *(August 2017)* |
| 'Survival of the fittest' | □ Shrinkage:<br>– Car Finance Company's collapse into wind down *(August 2017)*<br>– DFC Global's disposal of The Money Shop *(April 2017)*<br>– CFO Lending's collapse into administration *(April 2017)*<br>– Wonga's disposal of BillPay *(February 2017)*<br>□ Expansion:<br>– Everest Finanse's acquisition of Tempo Finanse *(November 2017)*<br>– 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)*<br>□ Ekspres Bank's acquisition of Sevenday Finans *(June 2017)*<br>□ 1pm's acquisition of Tracx Finance *(May 2017)*<br>□ Creamfinance's acquisition of Moneyveo *(April 2017)* |
| More partnerships | □ AEGON's partnership with Funding Circle to offer SME loans *(August 2017)*<br>□ Funding Circle's partnership with Just Eat to offer F&B loans *(July 2017)*<br>□ Goldmoney's partnership with Lend & Borrow Trust to offer loans collateralised by precious metals *(May 2017)*<br>□ Revolut's partnership with Lending Works to offer mobile credit *(March 2017)*<br>□ 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)*<br>□ Prodigy Finance's US$240 million equity and debt raisings to fund its US growth plans *(August 2017)*<br>□ Zopa's £32 million successful funding round *(June 2017)*<br>□ RateSetter's £13 million successful funding round *(May 2017)* |

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