Deloitte.


# 2022 banking and capital markets M&A outlook

**Firing on all cylinders**

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# Contents

# Introduction

Banking and Capital Markets (B&CM) mergers and acquisitions (M&A) activity is firing on all cylinders. Each of the industry's major sectors—banking, investment management (IM) and wealth management (WM), and financial technology (fintech, payments, and exchanges)—rebounded from a very tough 2020 to post impressive increases in deal volume and value in 2021—a trend that we expect to continue.

The COVID-19 pandemic accelerated the B&CM sector's transition from in-person, brick-and-mortar customer interactions to online platforms. It also stalled 2020 dealmaking, creating pent-up demand among strategic and financial buyers with strong balance sheets and abundant cash reserves. Throughout 2021, B&CM organizations demonstrated that they are eager to buy, sell, invest, and/or partner to rightsize their portfolios; add scale and digital capabilities; expand markets; and increase their competitive positioning—all of which presage a robust 2022:

- Banks are reassessing their portfolios—which geographies they want to be in, which capabilities they need to acquire, and which assets they want to carve out.
- Numerous banks in the $10 billion to $100 billion sweet spot are looking for a partner to add scale, products, and services.
- Longtime, one-stop-shop financial services firms are divesting to focus on core capabilities and markets.
- Players in the crowded financial technology space—both fintechs and traditional financial institutions—are pursuing "tech and talent" deals to expand their customer base, enter new markets, or shore up their business and operating models.
- Payments, retail, and B&CM are converging as the transition from in-person to digital customer engagement accelerates.
- The consolidation wave is still gaining steam as new players emerge to challenge industry stalwarts and new markets offer unprecedented growth opportunities.

This is not to say that 2022 will be without headwinds: B&CM respondents to our recent M&A survey cite a number of traditional challenges to future dealmaking. Among these are access to capital (40%), asset valuations (38%), translating strategic needs to M&A strategy (34%), a competitive deal market (22%), and lack of available acquisition targets (20%).[1] Adding to the mix is late-2021 regulatory activity that may complicate and/or stall midsize and large bank mergers. Also, the current deal deluge is pushing in-house staff, financial advisers, law firms, and regulators to keep pace, potentially extending transaction approval timelines.

Nevertheless, there are compelling reasons for B&CM organizations that have been sitting on the sidelines to reengage in M&A in 2022. These include positive macroeconomic conditions, an abundance of investment capital, continuing consolidation in fintech and at the community and midsize bank levels, and accelerating digital transformation across the financial services industry. These factors should keep the B&CM M&A growth engine humming.

**62%** of B&CM respondents to Deloitte's 2022 M&A Survey state their M&A strategy is focused on increasing their competitive positioning.

# 2021 review; 2022 outlook

## Banking

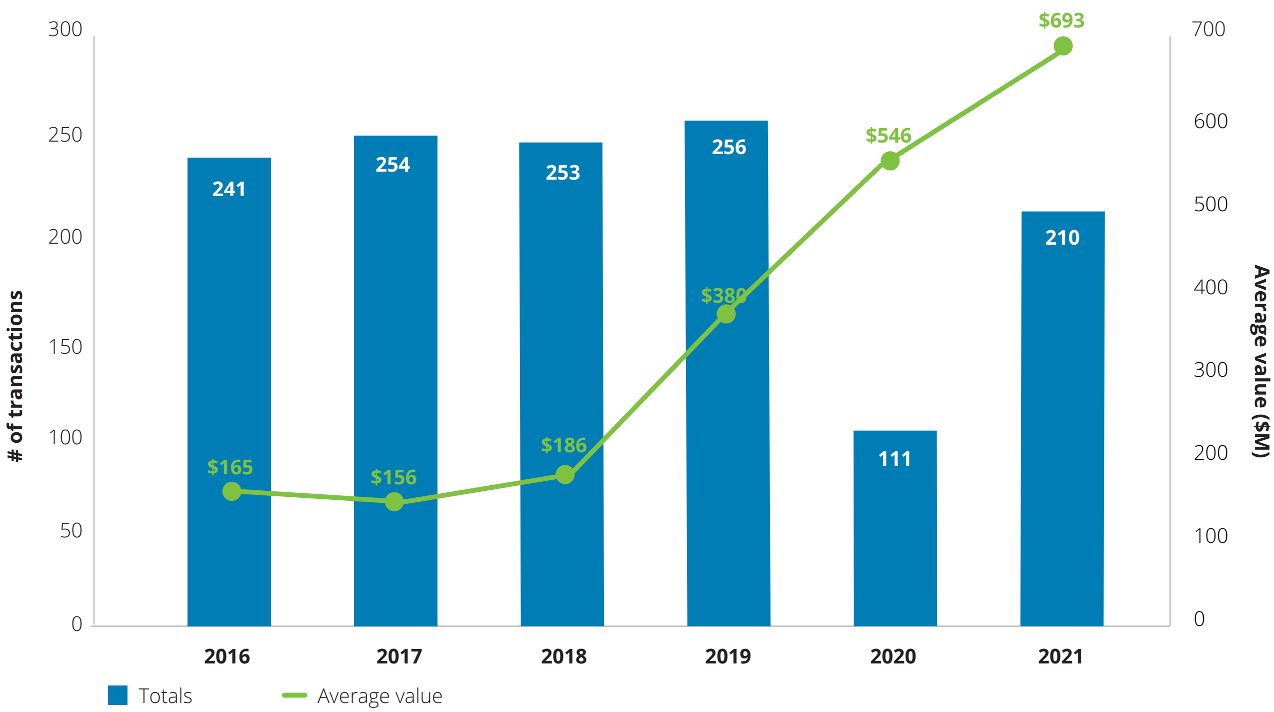
### 2021 review

After a tough 2020, banking M&A rebounded with 210 announced transactions as of December 31, an 89% increase from the prior year's 111 deals—and an average deal value of $693 million, a healthy rise from 2020's average $546 million (figure 1). 2021 also had the largest number of transactions over $500 million in enterprise value (23) since the financial crisis, going back to 1998 (24). The total 2021 disclosed deal value of $77.6 billion (figure 1) exceeded 2019's next-highest total deal value of $54.8 billion, which included the BB&T and SunTrust Banks merger[2] that created Truist Financial Corporation.

2021 was a banner year for megadeals as banks sought scale, capabilities, business lines, and markets to compete against larger rivals. The five largest announced deals all topped the $5 billion mark: Bank of Montreal's (BMO) acquisition of Bank of the West for $16.3 billion;[3] US Bancorp's acquisition of Union Bank from MUFG for nearly $8 billion; the M&T acquisition of People's United for $7.6 billion[4] (M&T's first bank acquisition in six years[5]); Webster Financial's $5.2 billion acquisition of Sterling Bancorp; and Umpqua Holdings' $5.1 billion purchase of Columbia Banking System in a reverse merger transaction.[6]

While 2021 deal activity spiked across the country, M&A for banking largely has remained a regional story. The West demonstrated its highest level of regional activity in several years, accounting for more than 11% of activity and, when considering banks over $1 billion in

**Figure 1. Banking M&A metrics**




| Top five 2020 banking transactions by deal value | | | | | |
|---|---|---|---|---|---|
| **Target** | **Buyer** | **Announcement date** | **Value ($M)** | **Price/TBV** | **Region** |
| Bank of the West | Bank of Montreal | December 20, 2021 | $16,300 | 172% | West |
| MUFG Union Bank, National Association | US Bancorp | September 21, 2021 | $7,971 | 128% | West |
| People's United Financial, Inc. | M&T Bank Corporation | February 22, 2021 | $7,599 | 168% | Northeast |
| Sterling Bancorp | Webster Financial Corporation | April 19, 2021 | $5,225 | 193% | Mid-Atlantic |
| Columbia Banking System, Inc. | Umpqua Holdings Corporation | October 12, 2021 | $5,147 | NA | West |

Note: Average deal size is based on disclosed deal value: 33%, 33%, 37%, 43%, 54%, and 47% of reported deals did not disclose deal values for FY16, FY17, FY18, FY19, FY20, and FY2, respectively.
Source: SNL Financial and S&P Global Market Intelligence

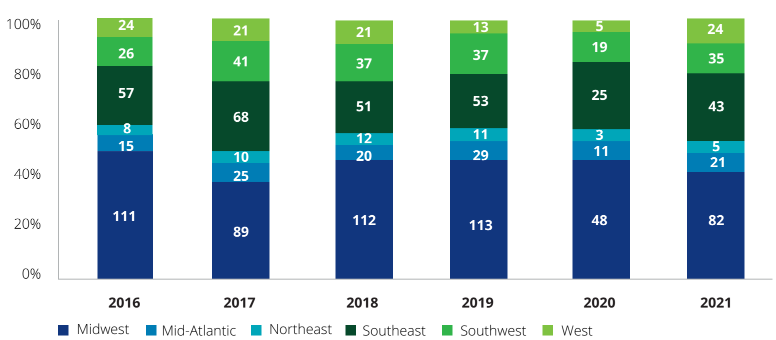
assets, had disproportionate deals of size. As a result, the West—followed by the Southwest—has the lowest number of total banks with assets over $1 billion, which potentially portends a slowdown of deal volume in those areas given available inventory. On the flip side, the Midwest and Mid-Atlantic have the highest number of banks over that asset threshold. Given that the Midwest annually has had the highest deal volume over the past several years, it would appear that this market still remains fairly fragmented. Additionally, despite having a relatively large numbers of banks over $1 billion, the Mid-Atlantic region for the past several years has lagged in deal volume as a percentage of banks of size (more than $1 billion), potentially indicating opportunities for dealmaking in the coming months and years in this region.

As of December 31, the regions' combined recorded price/tangible book value (P/TBV) of 156% was an increase of 14% year over year from the 136% recorded in 2020 (figure 2). Since 2017, P/TBV multiples have stabilized in a much tighter band than the prior five years as value becomes clearer. Price-to-earnings has been a more volatile measure, given the impact of accounting changes on GAAP earnings during this period (e.g., CECL, leasing, revenue recognition). Market P/TBV has remained fairly stable for the industry since 2018, increasing moderately in 2019 and returning to 2018 levels in 2020 despite the impact of the pandemic. Stable stock valuations help dealmaking as base lines become clearer and less market timing of deals occurs.

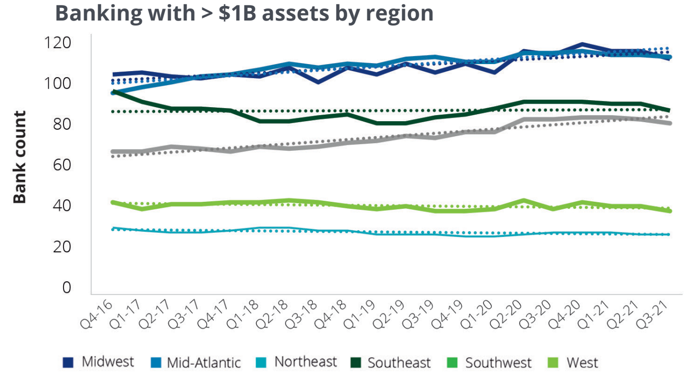
For the sixth consecutive year, the vast majority of 2021 banking M&A transactions occurred at the small-bank level, with most acquisition targets holding $500 million or less in assets (figure 3). However, deal volume also increased in the larger asset classes: $500 million to $1 billion, $1 billion to $10 billion, and more than $10 billion.[7]

**Figure 2. Banking M&A volume and P/TBV by region**

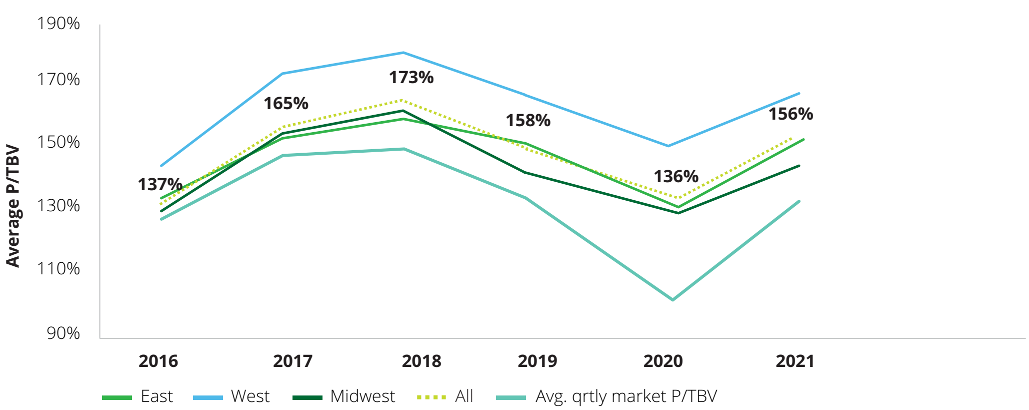
**Banking M&A by target region**




**Banking with > $1B assets by region**




**Banking deal P/TBV by region**




Note: Average deal size is based on disclosed deal values: 33%, 33%, 37%, 43%, 54% and 47% of reported deals did not disclose deal values for FY16, FY17, FY18, FY19, FY20, and FY21, respectively.
Source: SNL Financial and S&P Global Market Intelligence

## What we expect to see in 2022

***Capabilities plays and restructuring for digital transformation.*** Overall competitiveness and positioning in B&CM spiked in 2021, with both defensive and offensive M&A tactics on the rise. According to Deloitte 2021 M&A Survey respondents, a top-priority B&CM defensive tactic for the year was acquiring capabilities, while top offensive tactics included capitalizing on disruptive opportunities and accelerating digital transformation.

Since the pandemic began, banks have led financial services and other industries in instances of restructuring. Survey results show that 72% of banks undertook restructuring initiatives since the pandemic began, and almost all of B&CM intends to at least consider it in the near term—which could be a trigger for subsequent M&A. Respondents' primary reason for B&CM restructuring has not been cost-cutting; rather, it has been for digital transformation purposes. This aligns with the strengths of digital that B&CM has capitalized on over the past two years.

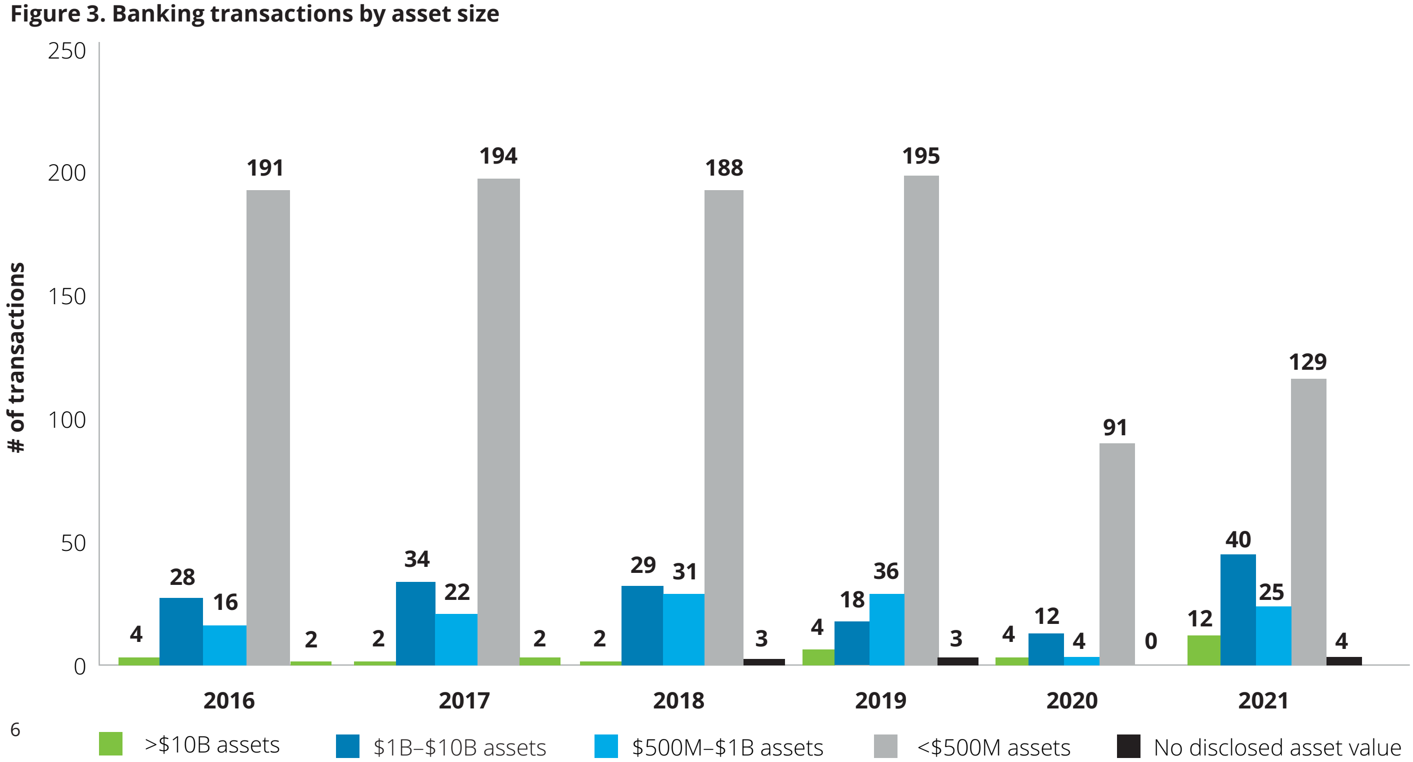
In addition to addressing changing consumer preferences in how to conduct business, B&CM organizations are considering how digital transformation can support the M&A process itself. Pre- and post-close transaction planning and execution over the next year is projected to be substantially more virtual in B&CM, including integration. Relative to the rest of financial services or other industries, banking has found it easier to execute integration virtually.

***Continued development of suitable merger partners at the regional level.*** One of the biggest headwinds in the banking M&A market at the regional level tends to be the dearth of suitable "in-market" merger partners to drive sufficient synergies to justify the purchase price premium. Over the past eight quarters, 13 banks with more than $10 billion in assets have been sold and removed from the candidate pool.[8] However, on the plus side, the corresponding period has seen an uptick in the number of total banks with more than $10 billion in assets.[9] Continuation of this trend will drive future deal volume. Additionally, as large regional banks push the $100 billion asset threshold, they will be motivated to find relevant acquisitions to provide them the necessary scale to tackle the increased supervisory, governance and controls, capital planning and stressing, liquidity, and overall reporting requirements.

***Stalled loan growth, soaring deposits complicate net interest margin improvements and mergers.*** Loan growth in the industry over the past eight quarters has been just 5.8%. Probing a bit deeper, consumer lending is up 2.4% during this period, real estate lending has grown 4.9%, and C&I lending is up only 1.2%.[10] The primary source of loan growth in the banking industry during this period has been lending to non-depository financial institutions. When you layer on the fact that during that same period domestic deposits have grown more than 35%, it's not surprising that cash holdings at banks have also risen more than 12%, held-to-maturity securities are up more than 82%, and available-for-sales securities are also up more than 39%.[11]

The downward shift in net interest margins from 2019 to 2021 makes it challenging for banks to achieve the types of returns their stakeholders expect and to determine what is included in planning documents to regulators. Margins at this level put pressure on management teams and boards and heighten the likelihood of leveraging an M&A partnership to improve the financial future of the enterprise. Franchises with a differentiated lending pipeline and product offering clearly have a valuation advantage in a market hungry for loan origination, especially with a glut of deposit dollars flooding the market.

**Figure 3. Banking transactions by asset size**




Source: SNL Financial and S&P Global Market Intelligence

# Investment management and wealth management

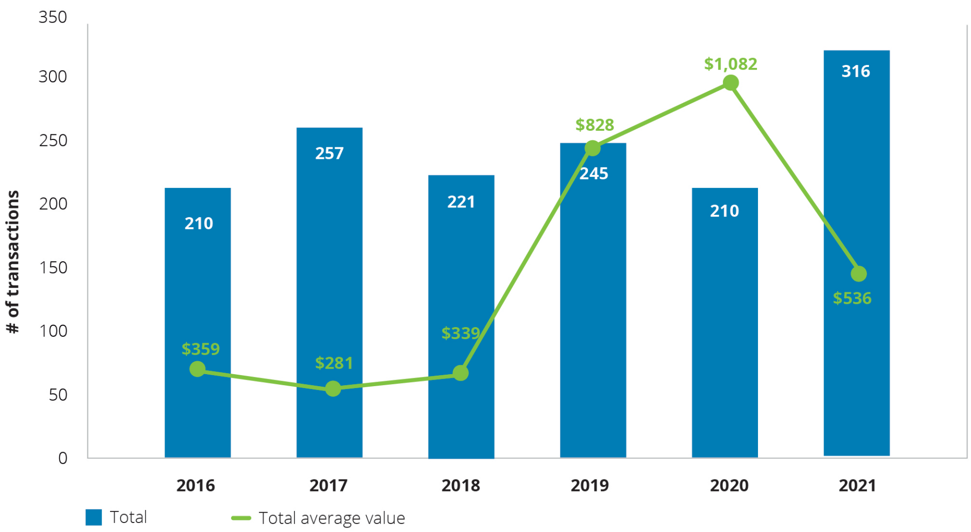
## 2021 review

The IM and WM space saw more M&A activity in 2021 than it has in several years, with a trend of strategically targeted acquisitions for value creation versus straightforward mergers. IM and WM deal volume, as of December 31, increased 50% YoY—316 deals versus 210 in 2020. Volume again skewed heavily to asset management (AM) and WM (280) versus broker-dealer transactions (36).

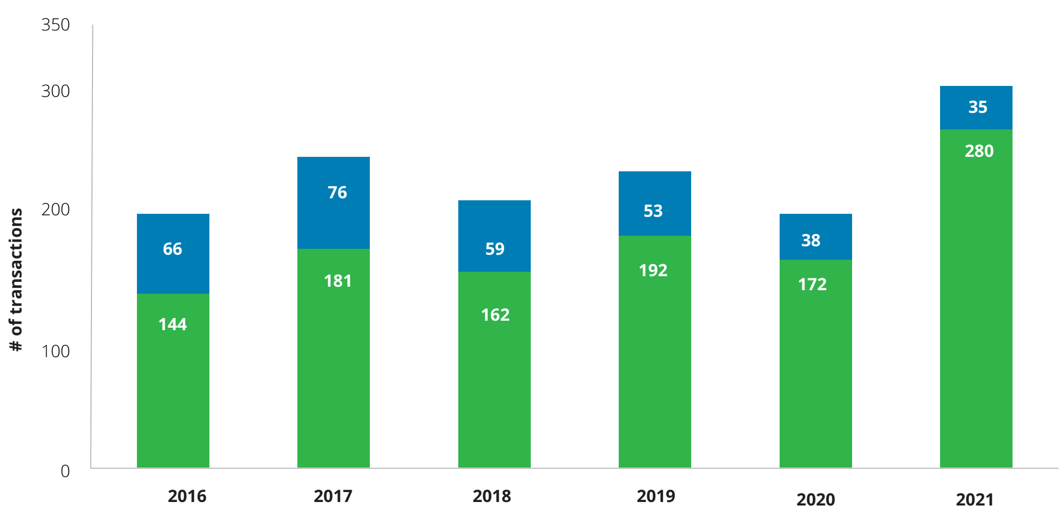
Compared with 2020's megadeals, which included Morgan Stanley's acquisition of E-Trade and Eaton Vance and Franklin Templeton's acquisition of Legg Mason, few of 2021's announced IM/WM transactions would be described as transformative; many were smaller, accretive acquisitions by firms seeking greater scale in current markets or expanding into areas offering higher returns. This focus is reflected in 2021 average deal value, which fell from 2020's record-setting high of $1.08 billion to a more modest $536 million (figure 4).

**Figure 4. IM/WM M&A metrics**

**IM and securities M&A metrics**




**IM and securities M&A volume**




| Top 2021 IM/WM transactions by deal value | | | | |
|---|---|---|---|---|
| **Target** | **Buyer** | **Announcement date** | **Value ($M)** | **AUM ($M)** |
| Oak Hill Advisors, L.P. | T. Rowe Price Group, Inc. | October 28, 2021 | $4,218 | $52,814 |
| Wells Fargo Asset Management | Investor group | February 23, 2021 | $2,100 | $603,000 |
| Exeter Property Group, LLC | EQT AB (publ) | January 26, 2021 | $1,956 | $5,640 |
| Lexington Partners L.P. | Franklin Resources, Inc. | November 1, 2021 | $1,750 | NA |
| Oak Street Real Estate Capital, LLC | Blue Owl Capital Inc. | October 18, 2021 | $1,600 | NA |

Note: Average deal size is based on disclosed deal values: 77%, 85%, 79%, 80%, 84%, and 90% of reported deals did not disclose deal values for FY16, FY17, FY18, FY19, FY20, and FY21, respectively.
Sources: SNL Financial and S&P Global Market Intelligence

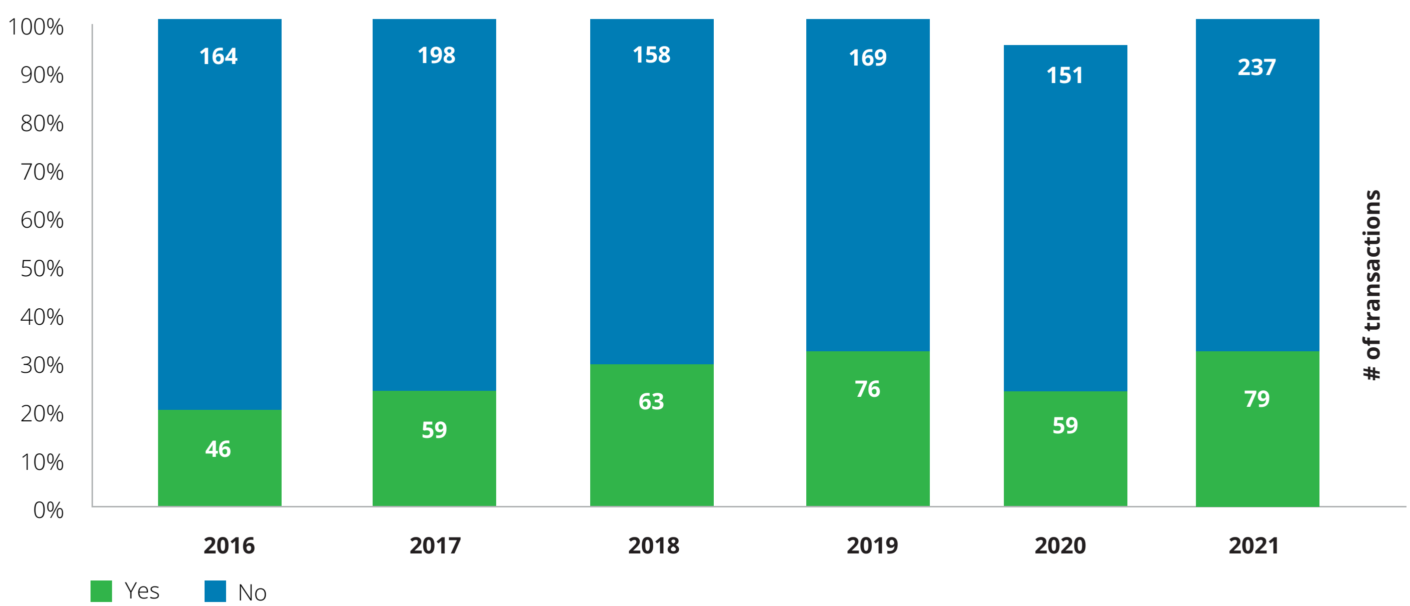
Of the year's largest announced IM/WM transactions, only two exceeded $2 billion: Asset Management (AM) firm T. Rowe Price acquired fund manager Oak Hill Advisors in a $4.2 billion deal, expanding into the alternative investments market,[12] and private equity (PE) firms GTCR and Reverence Capital acquired Wells Fargo Asset Management (WFAM) for $2.1 billion.[13] EQT AD nearly topped the $2 billion mark with its acquisition of Exeter Property Group.[14] Other notable announced deals included Franklin Resources' $1.75 billion purchase of Lexington Partners[15] and the Blue Owl Capital acquisition of Oak Street Real Estate Capital for $1.65 billion.[16]

In two outbound deals by US entities,[17] Ameriprise Financial acquired BMO Financial Group's EMEA asset management business for approximately $829 million, growing Ameriprise's fee-based businesses and adding a substantial presence in the European institutional market.[18] Similarly, Goldman Sachs bought Dutch insurer NN Group's AM arm for $1.98 billion (approximately 1.7 billion euros)—the company's biggest acquisition since 2018—to expand in regions outside the United States.[19]

PE firms continued their run of IM/AM investments and acquisitions in 2021 (figure 5). Examples of opportunistic deals on the IM side include the aforementioned GTCR and Reverence Capital purchase of WFAM, and Hamilton Lane's announced acquisition of a $90 million stake in Russell Investments (PE firm TA Associates owns a majority stake in Russell).[20] Continued deal volume on the WM side includes the acquisition of WM interests, such as Warburg Pincus's acquisition of a minority stake in Edelman Financial Engines[21] and Onex's minority equity interest in Wealth Enhancement Group,[22] as well as bolt-on acquisitions by WM portfolio companies that have ownership stakes by PE firms. Active buyers Wealth Enhancement Group, Mercer Advisors, Hightower Advisors, CapTrust Financial, and Allworth Financial are examples of wealth managers that have ownership stakes by PE firms.[23]

2021's increased deal volume signals to the IM/WM market that it should expect to see continued, significant M&A activity in 2022, especially as investment and asset managers explore ways to boost profitability amid fierce competition and lower fees in response to customers' pivot toward more passive investing.[24]

**Figure 5. IM/WM transactions with PE involvement**




Source: SNL Financial and S&P Global Market Intelligence

## What we expect to see for 2022

***More M&A around capabilities plays.*** Investment and wealth managers are on the hunt for acquisitions—especially smaller ones—to add digital technologies and/or help diversify their product and services portfolios. Target candidates typically sit at two ends of the spectrum: At one end, the illiquid alternative space is garnering significant attention, with real estate and private credit gaining steam. Franklin Templeton's announced purchase of Lexington Partners, known for acquiring secondary stakes in PE funds, is one example.[25] The coming year may see more players in this space. At the other end of the spectrum, indexing technology that enables product customization for investors is becoming an attractive purchase. Vanguard, in its first-ever corporate acquisition,[26] announced a $1 billion purchase of direct-indexing technology firm Just Invest.[27] Vanguard and Just Invest previously worked on a direct-indexing pilot program, and the acquisition will allow Vanguard to build on that offering.[28]

***Strengthening digital engagement.*** IM/WM is a relationship-oriented business. Firms that can deliver on clients' expectations for frictionless digital interactions will likely be more successful at growing and maintaining those relationships. Results from the Deloitte Center for Financial Services' 2022 Global Outlook Survey show that 38% of respondents from digitally advanced firms expect significantly better revenue prospects in 2022, compared to just 13% for other, less digitally advanced firms, supporting the idea that digital interaction is part of the relationship.[29] The survey also shows that adding new technology capabilities is the top driver for respondents' M&A transactions, followed by increasing scale and distribution channel expansion. These firms are looking to fuel growth through enhanced products and customer experience delivered to an expanded client (and prospect) base—a consistent trend from the previous year.[30]

## Fintech, payments, and exchanges

### 2021 review

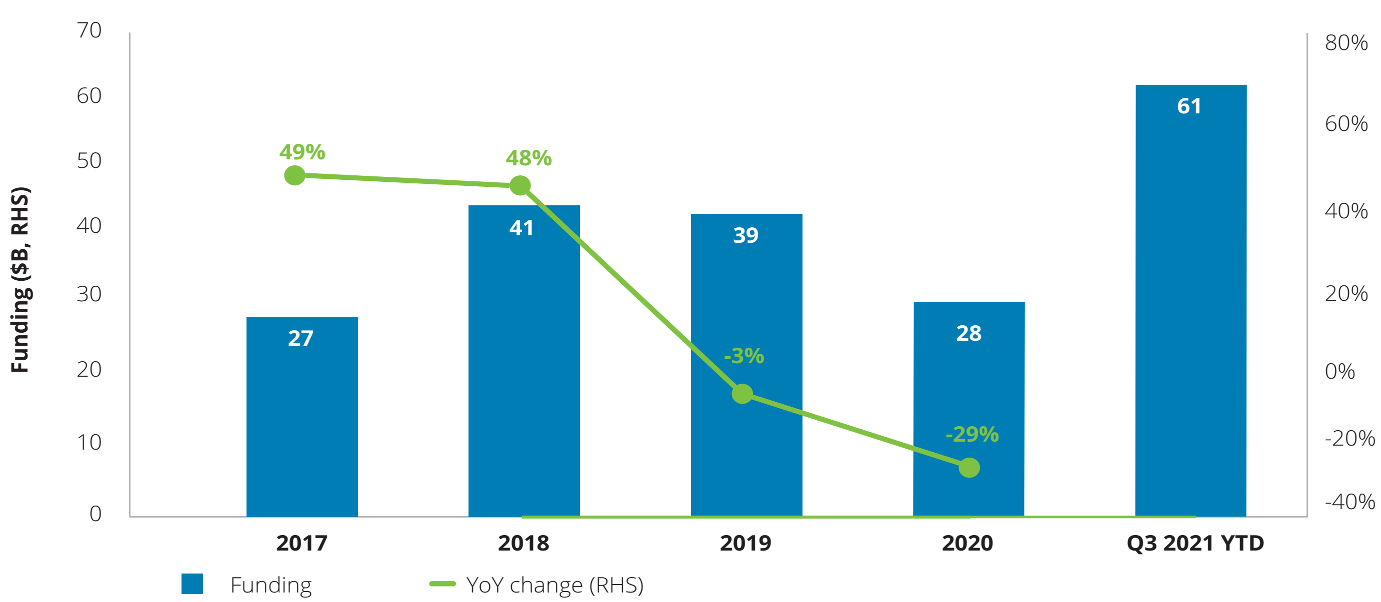
The long run in fintech startup, investment, and M&A activity extended through 2021, with continued consolidations and a flurry of new market entrants. Incubated technology businesses are continually working to create financial services solutions, and they need capital to grow. Fortuitously, there is a food chain of willing financial sponsors, from venture capitalists to small, medium, and large PE firms, to corporations. To illustrate, fintech investment increased to $36.2 billion in the third quarter of 2021, up 153% from $14.3 billion in the same period the year prior. In fact, Q3 2021 witnessed the highest fintech funding for any quarter since 1998.[31]

Fintechs that have grown in size and maturity are also attracting record levels of investments—$61 billion through Q3 2021, with 186 deals of $100 million or more—including from nontraditional investors (figure 6). Fintech companies across all sectors, with the exception of IM, experienced significant growth in funding.[32] The volume of fintech initial public offerings (IPOs) and special purpose acquisition company (SPAC) deals also continues to rise.[33] In terms of exits through IPO, Q3 2021 was again the best-performing quarter over the past 20+ years. Fifteen companies—12 headquartered in the United States and three in the United Kingdom—went public, raising a total of $7.07 billion. Eight companies went public during the same period in 2020, raising $5.67 billion in total.[34]

2021 M&A activity—both among fintechs and between banks and fintechs—again trended upward: Deal value for US-based targets as of December 31, increased 12% YoY to $1.16 billion, compared to $1.03 billion in 2020; deal volume rose 31% YoY, from 164 to 216 transactions[35] (figure 7). Investor groups were responsible for 2021's largest announced US-based fintech deals, with fintechs offering insurance and health care technology, security technology, financial media and data solutions, and human resources (HR) and payroll technology popular targets.

In addition to the domestic fintech deals we have identified, cross-border M&A posted robust deal volume in 2021, with 309 announced deals, up from 231 in 2020, and an average deal value of $1.18 billion.[36] Among the year's announced deals were Block, Inc.'s (formerly known as Square, Inc.) massive $29 billion purchase of Australian buy now, pay later (BNPL) firm Afterpay,[37] an investor group's acquisition of athenahealth for $17 billion, and Thoma Bravo's purchase of Proofpoint for $10.2 billion.[38]

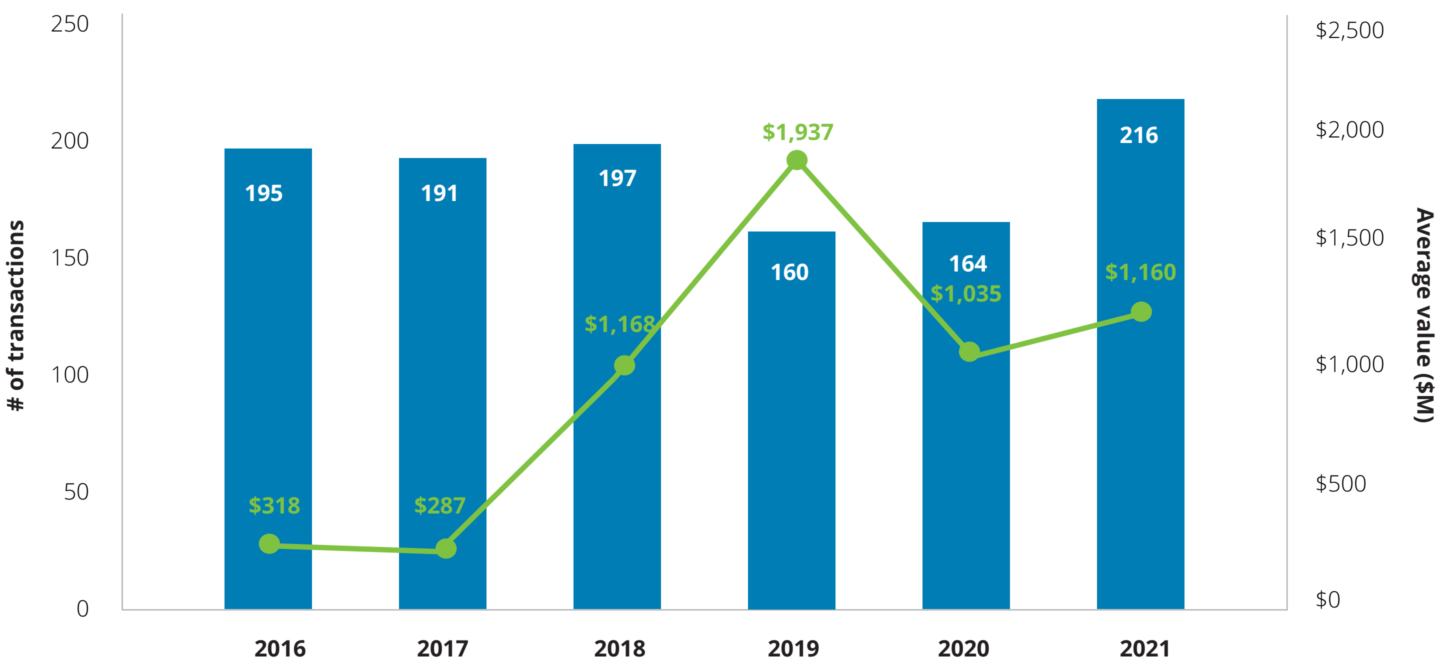
**Figure 6. Growth in fintech funding in the capital markets sector**




Source: Deloitte analysis of Venture Scanner database

Increased sophistication along the payments and lending value chain and forays by banks, technology giants, and nontraditional players into payment services—either as a new source of digital assets or a mechanism to expand customer engagement—is creating an appetite for M&A among medium-to-large payments companies. Most are looking to acquire capabilities being demanded by consumers (e.g., cross-border and real-time payments, payment gateways) and to extend their reach beyond the United States into new markets. Because payments companies are regulated differently from banks, they have fewer regulatory issues when growing their global networks. For example, a few years ago PayPal bought a majority stake in the Chinese payments group GoPay, making it the first foreign company to hold licenses to provide domestic and cross-border payment services in China.[39] In 2021, PayPal announced its $2.7 billion acquisition of Japanese BNPL firm Paidy, helping it expand in a country where online shopping volume has more than tripled over the past 10 years.[40] Meanwhile, India has emerged as one of the world's largest battlegrounds for mobile payments, with scores of heavily backed companies, including tech giants Google, Amazon, and Facebook, competing to increase their share in a market estimated to be worth $1 trillion by 2023.[41]

**Figure 7. Fintech M&A metrics**




**Top 2021 IM/WM transactions by deal value**

| Target | Buyer | Announcement date | Value ($M) | General industry |
|---|---|---|---|---|
| athenahealth Inc. | Investor group | November 22, 2021 | $17,000 | Insurance & Healthcare Technology |
| Proofpoint, Inc. | Thoma Bravo, LLC | April 26, 2021 | $10,244 | Security Technology |
| Inovalon Holdings, Inc. | Investor group | August 19, 2021 | $7,020 | Insurance & Healthcare Technology |
| CoreLogic, Inc. | Investor group | February 4, 2021 | $5,861 | Financial Media & Data Solutions |
| Cornerstone OnDemand, Inc. | Clearlake Capital Group, L.P. | August 5, 2021 | $3,925 | HR and Payroll Technology |

Note: Average deal size is based on disclosed deal values: 66%, 64%, 61%, 62%, 63%, and 67% of reported deals did not disclose deal values for FY16, FY17, FY18, FY19, FY20, and FY21, respectively
Source: SNL Financial and S&P Global Market Intelligence

## What we expect to see for 2022

***Tech and talent deals.*** The majority of 2022 fintech-related M&A likely will be driven by organizations' growing technology and talent needs. Incumbent banks and IM/WM firms are on a quest for fintech products, people, and capabilities. Many B&CM organizations are struggling to attract the type of talent that can help them grow and keep pace with fintechs. They see M&A as the mechanism to quickly achieve key platform capability, customer acquisition, and talent goals.

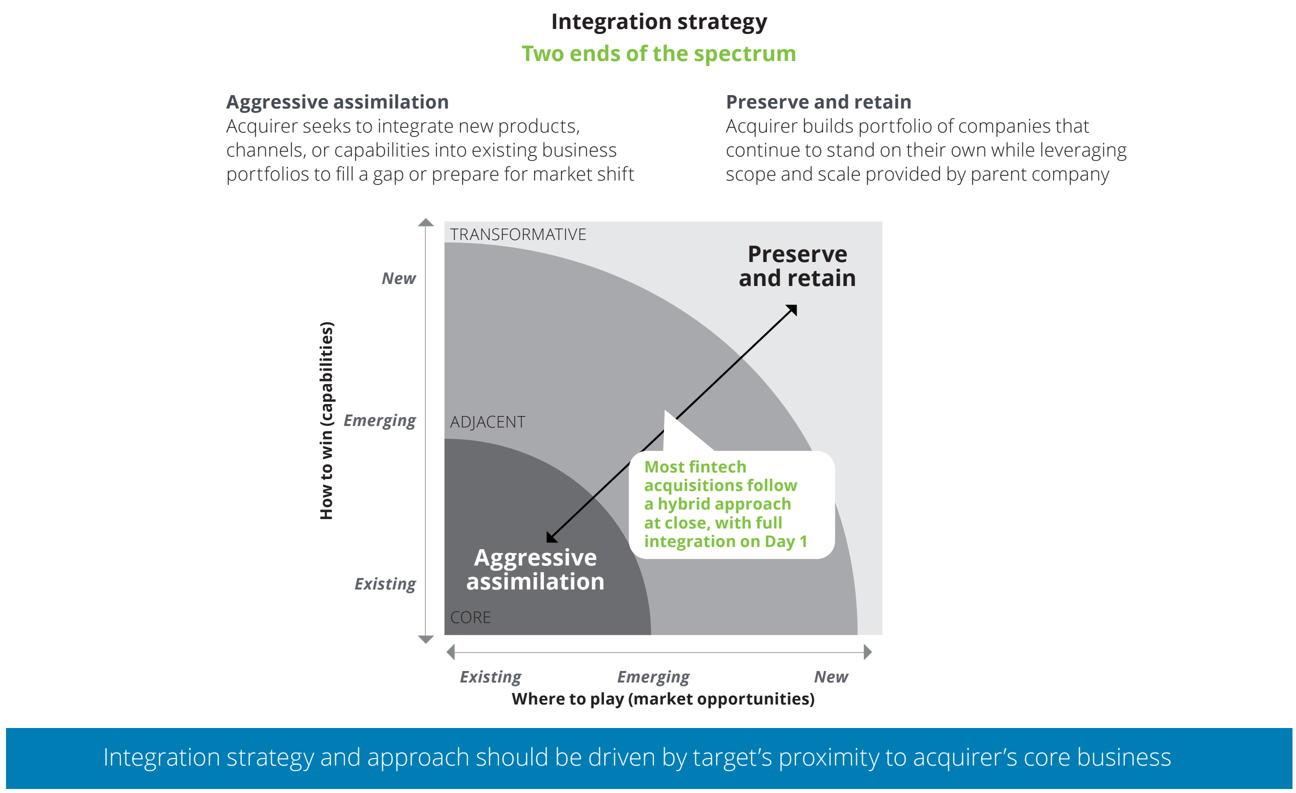
Meanwhile, we expect fintechs to continue seeking funding sources to help them scale operations. They also are acquiring other fintechs to rapidly expand their capabilities and transition from niche players to end-to-end service providers, further disrupting incumbent financial institutions. Examples include Robinhood's announced purchase of Say Technologies (shareholder-company relations technology),[42] and Stripe's announced acquisitions of Recko (automating payment reconciliation processes)[43] and OpenChannel (to open up their rails to third-party developers).[44] These are primarily smaller strategic deals that will continue to enhance Robinhood's and Stripe's portfolios. Fintechs are also looking to acquire and retain key personnel as the "war for talent" continues to intensify.

Integration diligence and planning are critical to ensure that a newly acquired fintech's products and people can be successfully integrated into the acquirer's established environment and culture without destroying their value. To retain key talent and preserve an innovation mindset (the primary reason for the acquisition), the incumbent may have to adopt certain characteristics of the fintech (e.g., nimble decision-making, evolving risk parameters to develop new products while managing heavy regulatory scrutiny).

Fintech integration strategies span two ends of a spectrum, with most acquisitions taking a hybrid approach (figure 8):

- **Aggressive assimilation.** The acquirer seeks to integrate new products, channels, or capabilities into existing business portfolios to fill a gap or prepare for market shifts.
- **Preserve and retain.** The acquirer builds a portfolio of companies that continue to stand on their own while leveraging scope and scale provided by the parent company.

**Figure 8. Fintech integration strategies**



Cultivating a deep understanding of a target's business model, maturity level, and revenue drivers are key to enabling continued growth post-acquisition. Critical success factors include product diligence, talent and cultural alignment, managing operational friction, and maintaining growth momentum. Generally, the integration strategy and approach to success factors should be driven by the target's proximity to the acquirer's core business.

***Growing crowd in the BNPL lending space.*** Payments, retail, and banking are converging in the BNPL lending space, which provides point-of-sale financing products that allow consumers to split the purchase price at checkout, or finance the purchase.[45] Major fintech BNPL lenders have seen rapid growth during the pandemic driven by the e-commerce boom and merchants' desire to connect digitally with younger consumers, especially millennials and Generation Z, who are wary of taking on credit card debt.[46]

Payments industry leaders are spending billions of dollars in M&A to include BNPL offerings among their growing global portfolios. Block, Inc. announced its $29 billion acquisition of Australian BNPL firm Afterpay, its largest acquisition ever;[47] Goldman Sachs agreed to buy GreenSky for about $2.2 billion;[48] and, as mentioned earlier, PayPal announced its $2.7 billion acquisition of Japanese BNPL firm Paidy.[49] Traditional banks are responding in force, so they aren't pushed out of the BNPL market by both payments companies and retail and technology giants. Installment loans are, by intent, meant for a single purchase, and banks are well equipped to turn this interaction into a long-term relationship by cross-selling products to consumers or capital to merchants.[50] Community banks that lack the scale to run credit card businesses of their own see BNPL as a viable way to build a consumer lending product and acquire new customers. Even large credit card-issuing banks—including Capital One—are accepting that BNPL can coexist with other consumer credit options and could be a complementary product line to grow loans, rather than a threat to their existing offerings.[51]

***Acceleration of decentralized finance and cryptocurrency.*** In conjunction with the accelerating digitization of the FSI ecosystem, numerous financial services firms are migrating away from centralized institutions to self-executing blockchain contracts (i.e., smart contracts)[52] and digital assets including bitcoin, stablecoins, and other cryptocurrencies. Fintechs are at the forefront of this surging market: Cryptocurrency/blockchain is the fastest-growing fintech sector for both early- and late-stage funding, as investors anticipate that technologies broadly enable a decentralized financial system.[53] Banks, meanwhile, are exploring adding digital wallet-type capabilities to hold cryptocurrencies and non-fungible tokens (NFTs) for their clients. We expect to see significant consolidation and alliances in this space as capabilities evolve and the regulatory landscape becomes clearer.

***Line between fintechs and banks is blurring.*** A number of fintech companies have been finding ways to scale and diversify in order to compete with large legacy banks. Fintechs are acquiring banking products to sell to their clients; some are even whole banks or bank charters acquiring entire banks. For example, SoFi in March 2021 announced its acquisition of Golden Pacific Bancorp, advancing its journey to become a national bank.[54] The line is further blurring as fintechs become regulated. Still, the costs, necessary skill sets, and regulatory complexities of obtaining a banking charter—whether by acquiring or merging with a legacy institution—can be considerable, so fintech leaders should first assess their long-term goals and select the preferred path to get there. The resulting choices will either drive the organization closer to being chartered or open leaders' eyes to more attractive, feasible partnership or buying opportunities, such as Banking-as-a-Service (BaaS).[55] Will fintechs completely replace banks? The more likely outcome is that traditional banks will adapt to compete. This means further investing in digital native capabilities, as well as adopting a more customer-centric mindset[56]—something that fintechs naturally do well.

# Trends and drivers of 2022 M&A activity

The following trends and drivers are worth watching for their potential impact on B&CM M&A headwinds or tailwinds during the coming year.

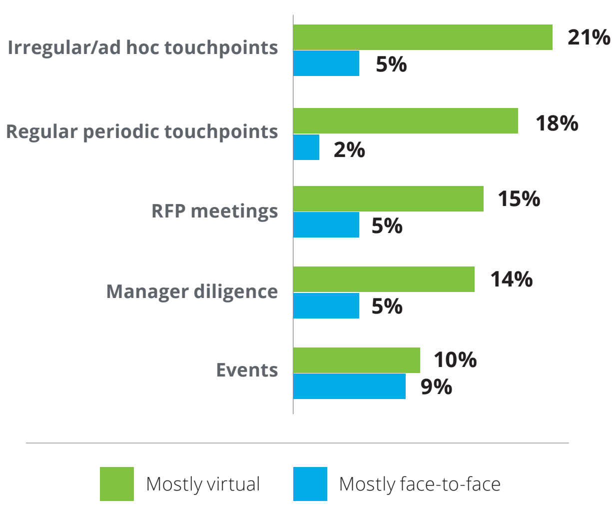
## Reassessing and reinvigorating portfolios

Regularly assessing their product and capabilities portfolios should be standard operating procedure for B&CM firms as they strategize which markets and businesses they want to be in amid a shifting competitive and regulatory landscape. Two focal areas are emerging as organizations seek to differentiate their offerings and value proposition.

As many banks and asset management firms target market transitions to digitally savvy millennials and Generations X, Y, and Z, established players are investing in multiyear transformations to meet their customers where they are: virtually (figure 9). Capital One and Goldman Sachs, for example, have been actively engaging their customers through digital channels and positioning themselves to meet customers' omnichannel needs. The good news is that a virtual environment powered by digital platforms and solutions tends to be a more efficient and effective way of engaging with customers than, for example, through branch banks or traditional insurance channels. And while new entrants already have the advantage of no debt in legacy infrastructure—they were built with digital capabilities in mind—many FSI incumbents are using M&A to obtain the capabilities or the entrants themselves to fill gaps in their digital portfolio.

**Figure 9. Customer engagement preferences influencing portfolio decisions**

**Asset owners' expected engagement model**




**Expected impact to managers from the virtual environment**

1. Structured sit-downs and routine or operational meetings are **replaced by more casual, targeted iterative touchpoints** driven by the client need
2. Managers are rethinking how to optimize virtual meetings and considering **higher-quality productions** for meetings
3. **Managers and executive leadership to participate** virtually in order to foster partnerships
4. **Custom content and services and database fulfillment** become more integral to the process as the asks evolve

Source: Casey Quirk Large Asset Owner Survey, CFA Institute

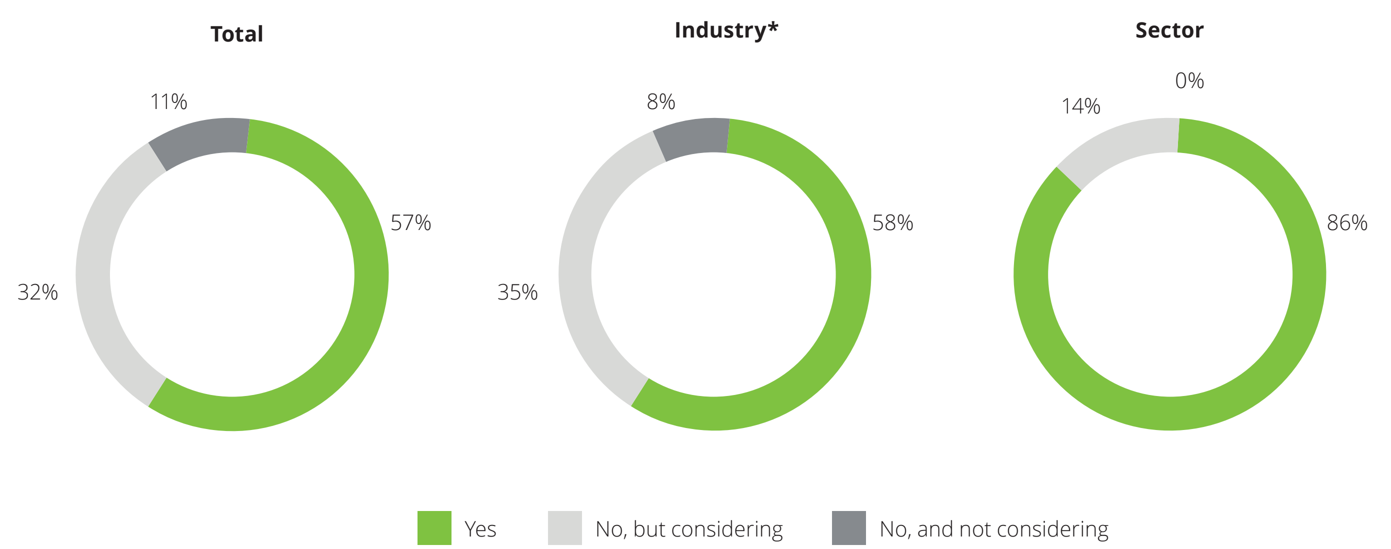
***Less diversification, more specialization.*** For years, banks—especially larger ones—wanted to offer the entire financial services product set. Generating fee-based income has long been strategic for banks given the limited impact those businesses have on equity and regulatory capital usage. It's common for banks to offer insurance and securities brokerage and for larger banks to provide investment management. However, these people-intensive businesses are highly competitive with thinning margins, causing more banks to reassess their strategy and portfolio of businesses, doubling down on platforms of scale, and—acknowledging that they don't have to be all things to all people—exiting businesses where they struggle to differentiate.

Over the past two years, we have seen more banks reassess their business portfolio and make some strategic exits. Wells Fargo and BMO Financial Group in 2021 sold large AM businesses.[57] Some US banks with insurance verticals are choosing to exit the business and invest those resources elsewhere. Berkshire Hills Bancorp is the latest bank to offload its insurance operations, selling to Brown & Brown of Massachusetts for $41.5 million.[58]

AM firms are also exhibiting a relentless focus on strategic priorities. Historically, the sector has been characterized by firms managing numerous product verticals. We are now seeing some AM firms reassess their positioning (What are we known for? Where can we compete?), invest more heavily in a few areas, and deemphasize or exit others. For example, BrightSphere Investment Group (BSIG) has sold multiple business lines, including a 75% stake in Campbell Global in 2021. The transactions transform BSIG from a "multi-boutique" asset manager to Acadian Asset Management, a single, full-scale differentiated business in quantitative strategies and solutions.[59]

According to our 2021 M&A Survey, divestitures are weighted heavily in B&CM, with 86% of B&CM entities executing divestitures in 2021 and the remaining 14% considering (figure 10). This is far heavier than all M&A and the rest of the financial services industry. We anticipate that B&CM firms will continue to shed non-core assets to focus on areas of competitive advantage.

**Figure 10. B&CM divestiture activity, in the past 12 months**




*Please note: rounding of percentages may prevent exact summation to 100
Source: Deloitte 2021 M&A Study, ONR

## 'Megadeals' create inventory concerns for potential merger partners

2021 was a banner year for banking megadeals, including the earlier-mentioned M&T acquisition of People's United for $7.6 billion and US Bancorp's acquisition of Union Bank from MUFG for $8 billion. The year's total volume of 23 megadeals[60] and value of $67.1 billion[61] was the highest since 2007.

The deal environment remains robust for numerous reasons. Compared to other banking systems around the globe, the United States, in terms of the ratio of total population relative to total banking enterprises, has significantly more banks, which would imply a greater need for merger activity relative to other countries. Additionally, slowed loan growth, stabilization of bank valuations, global players retrenching capital to home markets, and technology costs for banks to modernize and digitize universally point to additional merger activity.

The biggest headwind is finding a suitable partner for the merger journey. Broadly, we have seen numerous fit-for-purpose targets acquired in 2021. However, an increase in buying activity doesn't necessarily mean there is adequate availability of suitable supply, especially at the large end of the banking spectrum. Given the organization costs and distraction of management for core operations, financial stability concerns, and concentration risks, a target needs to be at scale to make the M&A endeavor fruitful. When you factor in footprint overlap (or lack thereof), customer concentration, and loan-to-deposit ratio challenges, the dance card slims further. Moreover, banking inventory is primarily refreshing at the regional part of the asset spectrum—institutions in the $10 billion to $200 billion range are merging to gain the scale they need to thrive.

While there are clear financial and marketplace factors that would drive M&A activity, when you move from idea to action, it becomes more challenging to find a merger partner that fits the criteria needed for a successful union. Very few banks are running at a loan-to-deposit ratio of close to 100%, as the industry average has dropped from more than 70% in 2019 and continued dropping through the 60% level throughout 2020 to a level in the high 50s for 2021. Loan-heavy banks are truly becoming unicorns in this environment.

## As fintech goes mainstream, alliances move into the spotlight

With an average annual growth rate of nearly 25%, the fintech sector is among the fastest-growing worldwide, and the latest estimates suggest that it should hit almost $310 billion in value by 2022.[62] Innovative fintechs that have proven their viability are increasing in size and value; many have the technology capabilities and financial wherewithal to compete against traditional banks. An outsized number of fintech players have used a SPAC to reach the public markets in the past 12 months. Fintechs that want to offer end-to-end capabilities to their clients but prefer not to deal with the regulatory burden of being a bank are partnering with banks to provide digital banking solutions; primarily, white-label-type products. And by partnering with fintech companies, banks can strengthen the customer experience and provide tools such as chatbots and artificial intelligence (AI) that improve the customer experience.[63]

While bigger fintechs may have less of a need to partner, many smaller ones at the forefront of innovation may be interested in a collaboration.[64] For example, fintechs are less likely to compete directly with banks for institutional clients and, thus, be more eager to engage as enablers. For example, City National Bank is working with Extend to launch its new virtual commercial card offering;[65] Apollo Bank announced a partnership with CheckAlt to adopt its lockbox technology to strengthen its corporate payments and treasury management offering;[66] and Virgin Money is reportedly working with fintech Codat to facilitate data connectivity between corporate customers and the bank.[67]

Unfortunately, cultural gaps and process barriers can disrupt fintech firms' collaboration with their bank partners. The latter typically have complex processes and infrastructures that contrast with the fast-paced style of fintechs. Such differences create cultural gaps that can hinder collaboration. More than 50% of fintech executives admit to not having identified the right partner bank for collaboration.[68] From a fintech perspective, it is essential to emphasize agility and set and monitor key performance indicators to improve collaboration with incumbent banks. Governance and risk management, leadership involvement, and proactive innovation are other aspects of a successful collaboration.[69]

## Evolving accounting, regulatory, and tax influences on M&A activity

As a general rule, the larger and more novel a B&CM M&A transaction is, the longer the regulatory approval process takes. Even so, 2021 deal applicants have been experiencing longer close cycles than normal as understaffed and overtaxed US financial regulators wade through the rigorous, complex review and approval process. A combination of increasing deal volume, delays in agency appointments and regulatory agency changes and confirmations, and mounting political pressure could trigger a further slowdown in large-bank M&A.

The US federal banking agencies are in a significant state of flux, which has the potential to make 2022 a more challenging year. Impactful events include the resignation of a Federal Reserve Board (FRB) Governor (Vice Chair for Supervision) who led recent supervisory changes;[70] the expiring term of another FRB Governor (Vice Chair) which ended on December 31, 2021; and the resignation of the Federal Deposit Insurance Corporation (FDIC) Chair following an unprecedented and public FDIC Board struggle.[71] With many important policy and supervisory matters on the regulatory agenda, key positions at the FRB, Office of the Comptroller of the Currency (OCC), and FDIC remain open, further complicating the ability to anticipate consistency, on an interagency basis, in perspectives on significant issues such as M&A approvals.

In light of these factors, we advocate a position of keeping an eye on the basics—good governance, risk management, internal controls, financial strength—as table stakes to enable meeting statutory factors laid out in the regulatory process, with proactive and transparent engagement.

- **Review of bank merger policy.** The OCC, Consumer Financial Protection Bureau (CFPB), and parts of the FDIC are seeking to launch a review of bank merger policy; specifically, greater scrutiny of how certain acquisitions could affect the government's efforts to promote financial stability and protect consumers[72]—actions that align with CFPB priorities. Meanwhile, House Financial Services Committee Chair Maxine Waters, D-Calif., sent a letter to Federal Reserve Chair Jerome Powell and the leaders of the FDIC and the OCC requesting a moratorium—until the regulatory review is concluded—on the approval of mergers that would result in a bank holding more than $100 billion of assets.[73] Ms. Waters called for several policy changes, including lowering the concentration thresholds for enhanced scrutiny of mergers; more rigorous evaluation of financial stability risks; and stronger consideration of potential conflicts of interest.[74]
- **EPS tailoring rule.** On February 3, 2021, the Board of Governors of the Federal Reserve System (Board) adopted a final rule (effective April 5, 2021) that established tailoring metrics and asset-size thresholds for domestic and foreign bank holding companies.[75] The Enhanced Prudential Standards (EPS) tailoring rule fine-tunes requirements for capital, stress testing, liquidity, large exposures, and reporting.[76] It assigns banks to one of four categories, each with its own set of tailored requirements, as measured by size and other risk-based measures. This forces key thresholds that may have a material impact on the financials of a deal.

Other regulatory developments with the potential to either help or hinder 2022 B&CM M&A include:

- **Federal Reserve actions on inflation and interest rates.** The Federal Reserve at its December 14-15 meeting announced that the central bank will double the rate at which it tapers spending on government bonds and signaled three interest rate hikes in 2022.[77] The Fed's actions are in response to pandemic-related supply-and-demand imbalances and the economy's reopening, both of which have contributed to elevated inflation.[78] However, the markets generally expected these moves and responded positively to the increased economic certainty they provide, which is supportive of continued M&A activity in the coming year.
- **Community Reinvestment Act revamp.** Citing the COVID-19 pandemic's harsh impact on low-income and underserved communities and their unequal recovery, Acting Comptroller of the Currency Michael Hsu, in early 2021, identified a revamp of the Community Reinvestment Act (CRA) as one the agency's top priorities.[79] The CRA, enacted in 1977, encourages insured depository institutions (IDIs) (e.g., national banks and federal and state savings associations, including community banks) to help meet the credit needs of the communities in which they are chartered, including low- and moderate-income (LMI) neighborhoods.[80] On December 14, 2021, the OCC issued a final rule that is based largely on the 1995 CRA rules, as revised, that were issued by the OCC, Board, and the FDIC. This action rescinds the CRA final rule published by the OCC on June 5, 2020, and facilitates the OCC's planned future issuance of updated interagency CRA rules with the Board and FDIC.[81] The final rule is an important step in the interagency process because it reestablishes generally uniform rules that apply to all IDIs and better positions the agencies to identify joint solutions to the common issues affecting IDIs and the communities they serve. The final rule takes effect on January 1, 2022, with a separate compliance date of April 1, 2022, for the rule's public file and public notice requirements.[82]

Because B&CM companies operate in a heavily regulated industry, they are accustomed to navigating a lengthy notification and approval process for each M&A deal they transact, particularly when the newly combined entity may cross an asset threshold and trigger new compliance expectations. If an acquiring organization's regulatory position and infrastructure are solid, the biggest challenge it may face is the work it takes to compile a thoughtful, compelling M&A proposal that shows how it plans to bring the entities together to serve communities, manage risk, and meet regulatory requirements. Diligence efforts should focus on the core basics of asset quality, BSA/AML compliance, internal controls, governance, consumer protection, and risk management. Given increasing and new risks arising from the COVID-19 pandemic, climate change, and cyberthreats (which are heightened by the move to digital banking and cryptocurrencies), they also should emphasize financial and operational resilience, information security and privacy, and third-party vendor management.

## Tax policy developments

Concerns about the potential for higher US capital gains and corporate tax rates have eased somewhat with the House of Representatives passing its version of the Build Back Better Act[83] (the "BBB") with a different mix of proposals to raise revenue. The measure is currently pending in the Senate, where it needs consensus among the Chamber's 50 Democrats (something necessary to pass the bill using the budget reconciliation process in the face of united Republican opposition). Unlike President Biden's budget proposal, the BBB generally does not include increased corporate rates (substituting instead a minimum tax on the book income of certain large corporations), nor does it include higher individual capital gains rates (except for high-net-worth individuals with income above $10 million). As such, previous concerns about headwinds for B&CM merger activity in 2022 do not appear to be a major deterrent, as corporate rates are generally not anticipated to change. However, for those high-net-worth individuals who may trigger gains on B&CM stock through sales, there may be some headwinds due to the new capital gains surtaxes above the $10 million and $25 million thresholds.

As passed by the House, some of the BBB's corporate and international tax provisions would include:

- **Corporate minimum tax.** The House bill includes a corporate alternative minimum tax (AMT) proposal that would impose a 15% minimum tax on "adjusted financial statement income" (AFSI) of applicable corporations. Under the proposal, an applicable corporation's minimum tax would be equal to the amount by which the tentative minimum tax exceeds the corporation's regular tax for the year.[84]
- **New tax on stock buybacks.** The House bill would add a new section 4501 to provide that a covered corporation (i.e., a domestic corporation, the stock of which is traded on an established securities market) is subject to a tax equal to 1% of the fair market value of any stock of the corporation that is repurchased by the corporation (and certain of its affiliates) during any taxable year (subject to certain exceptions).[85]
- **Limitation on business interest expense deductions.** In addition to the existing limitation on business interest deductions under section 163(j), the House bill would impose an additional limitation under new section 163(n) designed to limit interest deductions for a domestic corporation that is a member of an international financial reporting group. Under this provision, the interest deduction is limited to an allowable percentage of 110% of the net interest expense reported on the group's applicable financial statement.[86]
- **Modifications to limitation on deduction of excess employee remuneration.** Section 162(m) generally limits the deduction allowed to a publicly held corporation for compensation paid to covered employees for a taxable year to $1 million. The American Rescue Plan Act of 2021 expanded the definition of covered employees under section 162(m). Under the updated House bill, section 162(m)(1) would be amended to apply an aggregation rule that is similar to the rule applicable to certain health insurance providers under section 162(m)(6)(C)(ii).[87]
- **Substantial modifications to the tax rules impacting multinationals.** Among the many changes here, the House bill would raise the tax rate on Global Intangible Low Tax Income (GILTI) to approximately 15%,[88] require companies to calculate their GILTI on a country-by-country basis, and reduce by half the current 10% tax-free return on tangible assets (other than tangible assets held in US possessions), known as Qualified Business Asset Investment (QBAI). The bill also makes major changes to the Foreign Derived Intangible Income regime, modifies the foreign tax credit provisions, and modifies various rules and raises the rate imposed under the Base Erosion Anti-Abuse Tax (BEAT).

Substantial domestic tax law changes coupled with regulatory reforms over the past five to 10 years suggest that B&CM companies, especially those in a heavily regulated sector, will need to think about how they operate their businesses to achieve parity between their tax footprint and business objectives. Leaders should review tax restructuring as part of their ongoing business planning—look at the entity's tax structure and narrative. For example, if the portfolio includes international assets, it may be necessary to readjust for them. Broad changes in tax laws may be unsettling, but they also provide a good opportunity to effectuate legal entity restructuring and other tax-efficient moves.

# Keeping the M&A growth engine humming

B&CM M&A activity in 2021 has outstripped expectations, with volumes we haven't seen in more than 20 years. There are numerous macroeconomic, strategic, and financial drivers to extend positive momentum into 2022 and keep the M&A growth engine humming: acquisition currencies are strong; the loan performance environment is stable; there is increased certainty around interest rate increases and anti-inflation measures; buyers still sitting on the sidelines have ample capital to pursue desirable targets; and pricing is high, but people are willing to pay for scale, products, and capabilities (especially those that support their digital ambitions or provide entry into the alternatives market). And then there is the FOMO factor: Bank boards and C-suite executives are seeing their peers merge and fear that if they haven't found a dance partner, they will miss out on opportunities to compete effectively in the rapidly evolving financial services marketplace.

Strategic buyers in 2022 may be challenged to find acquisitions that are attractive and accretive. Deal advocates will need to articulate both quantitatively and qualitatively how they intend to extract full value from an asset to gain board and market support. When many players are pursuing the same targets, the supply-and-demand imbalance could force some to either overpay or drop out of contention—those with a higher stock price valuation may have an edge in competitive deal situations. It will be compulsory for the buyer's management team to assess where the company is now, identify which capabilities it lacks in areas of rising demand versus peers and new entrants, and clearly articulate how M&A can enable it to compete and succeed in 2022 and beyond.

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