Financial services M&A to accelerate in 2011: PwC US

By Editor Test *Wed, May 4, 2011*

Divestitures should drive a significant portion of deal activity in 2011, PwC said. Large banks and insurance companies that need to bolster capital levels are divesting non-core operations and margin-dilutive subsidiaries.

Growing confidence and pent-up demand should quicken the pace of mergers and acquisitions among financial services companies this year, according to the 4th fannual M&A analysis and outlook for the financial services sector, Positioning for Growth: 2011 U.S. Financial Services Insights, from PwC's U.S. transaction services practice.

According to the publication:

- Well-capitalized corporate buyers are seeking margin growth and the realization of synergies through strategic acquisitions that expand their footprint and product capabilities;
- Private equity firms, which have been focused on improving existing portfolio companies, will play an increasingly significant role in financial services M&A, as the impetus to put capital to work is bolstered by the revival of the bond markets and a growing market appetite for leveraged deals;
- Recent and prospective regulatory changes will drive small- and medium-sized banks to seek scale through acquisitions, creating significant M&A opportunities in 2011.

The value of announced financial services M&A deals rose to $50.9 billion in 2010 from $36.1 billion in 2009, but remained significantly below the $153.2 billion of deals announced in 2008, according to PwC. A total of 840 deals were announced in 2010, compared with 613 deals in 2009 (for which values were disclosed for 267 and 175 of the deals in 2010 and 2009, respectively).

Divestitures should drive a significant portion of deal activity in 2011. Large banks and insurance companies that need to bolster capital levels are divesting non-core operations and margin-dilutive subsidiaries.

In addition, regulatory changes such as the Volcker Rule, which restricts proprietary trading and certain investment management activities by banks, are likely to drive M&A activity in the asset management space as institutions consider divestitures to avoid restrictions imposed by the pending legislation.

Banking: Shifting Gears from Recovery to Growth

- Investor confidence will increase as asset quality stabilizes and earnings improve. However, non-performing asset levels remain at worrisome levels and high-quality organic loan growth will remain a challenge in the near term, driving banks to seek growth opportunities via acquisition.
- Large banks seeking to bolster capital levels and meet regulatory requirements stemming from significant recent regulatory changes are expected to continue to divest non-core operations and loss-making subsidiaries, attracting attention from both corporate and private equity investors.
- Tightening margins from regulatory restrictions surrounding the permissibility and pricing of certain

products and fees will force small- and medium-sized banks to seek consolidation opportunities in an effort to build scale and derive value from synergies.

- FDIC-assisted bank transactions again played a prominent role in deal-making during 2010. However, while the number of FDIC-assisted deals increased in 2010, the institutions were smaller in size than in 2009. Recent activity indicates that the FDIC is offering less favorable deal terms and may be providing banks with more time to raise additional capital or seek suitable buyers.

Asset Management: Continued Deal-Making, Albeit at a Slower Pace

- The recovery in the equity markets since early 2009 resulted in significant increases in management and performance fee income among asset managers, pushing valuations higher and encouraging greater M&A activity.
- Divesture activity among asset managers is likely to increase due to financial reform regulations such as the Volcker Rule, although its immediate impact may be mitigated by the likelihood of a transitional period.
- Most consolidation activity will involve small- to medium-sized asset managers, as pure-play firms seek greater cost efficiencies, expanded scale, new distribution channels and broader product offerings. Private equity funds, already prominent acquirers in alternative investments, are likely to continue to be active investors in this space.
- Expect foreign buyers, particularly from Asia, to continue to play a key role in the U.S. asset management M&A space in 2011.

Insurance: Headwinds Face Insurers Seeking to Sell Operations

- Despite expectations that insurance company deal-making would increase in 2010, activity remained slow, with many deals failing to close because of differences in valuation and doubts about the direction of regulatory and tax reform, especially since many of the rules resulting from the Dodd-Frank Act, such as those on systemic risk, are still being drafted.
- Hesitancy in the insurance M&A market is expected to continue due to uncertainty surrounding legislative tax initiatives. Obama Administration proposals relating to the insurance industry, such as health care reform and foreign proposals, could impede short term deal activity. Furthermore, the Neal Bill, which was introduced in prior years but never ultimately enacted, still appears to be a concern to investors.
- Rather than seeking growth via acquisitions, insurers with excess capital may look to other options, such as funding stock buybacks, increasing dividend levels or deploying capital to build scale and operational efficiencies.
- Excess capacity and a residual soft P&C market could result in increased consolidation of underwriters, especially in Bermuda, and potentially intensify interest in vertical acquisitions of managing general agencies, managing general underwriters or captive agents.

Non-Bank Financial Services Companies: Continuing to Drive Significant M&A Activity

- Non-bank financial services companies, such as automobile financiers, commercial and consumer finance companies, broker-dealers, credit card companies and exchanges accounted for some of the year's biggest deals. The $6.3 billion purchase of Chrysler Financial Corp. by TD Bank and the $3.3 billion acquisition of Americredit Corp. by General Motors Co. were two of the three largest financial services deals announced in 2010.

- Total announced deal volume in 2010 among non-bank financial services companies increased 64 percent, to 242 deals, from 148 in 2009. The value of disclosed deals nearly doubled, from $10.8 billion in 2009 to $21.4 billion in 2010. Private equity firms played a growing role in this space, with the value of their deals reaching $1.9 billion in 2010, up from $22 million in 2009. The less onerous regulatory environment for many non-bank financial services companies, coupled with a continued need for capital, will continue to drive M&A activity in this sector in 2011.
- Further consolidation is probable among stock exchanges, which are likely to pursue M&A opportunities in order to gain market share and generate cost synergies in a highly-competitive global marketplace.

PwC's report, "Positioning for Growth**:** 2011 U.S. Financial Services M&A Insights," is available online at http://www.pwc.com/ustransactionservices.