LEXOLOGY
Getting the Deal Through

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START READING

Introduction

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After a record-breaking year in 2021, global M&A activity in the financial services sector and bank M&A slowed in 2022 as a result of macroeconomic headwinds, higher inflation and associated rising interest rates, a strengthening US dollar and growing expectations for an economic downturn. Geopolitical uncertainty and other non-monetary factors also contributed to weakened deal making, including supply chain issues, the war in Ukraine, higher energy prices and China's severe lockdowns in response to the ongoing covid-19 pandemic. The direction of travel for the business and regulatory landscape continued to lead towards technological innovation and digitisation as consumers increasingly rely less on physical channels. The dynamic regulatory environment that we experienced over the course of 2022 will carry on into the new year, and could dampen deal activity as a result of concerns that stricter review standards could make attaining regulatory clearance in the United States more difficult, particularly for larger bank deals.

According to data from Bloomberg, globally completed M&A deals in the financial services sector totalled $528 billion in equity value in 2022, a 46.4 per cent decrease from 2021. The number of deals fell from 12,524 in 2021 to 11,170 completed deals in 2022. There were 3,652 pending deals totalling approximately $394 billion as of year-end. The value of completed global M&A activity in the bank sector also slowed down this year with approximately $17 billion in equity value, a 78 per cent decrease compared to 2021. The number of completed deals fell from 280 in 2021 to 184 in 2022. As of year-end, there were 171 deals totalling $55 billion in equity value that had been announced but have not yet closed.

In the United States, M&A activity in financial services also fell, totalling $263 billion in equity value for completed deals in 2022, a decrease of 41 per cent from 2021. The number of completed deals fell from 6,272 in 2021 to 6,056 for 2022. As of year-end, there were 1,076 deals still pending, totalling approximately $101 billion in equity value. As with global bank M&A activity, US bank M&A activity also fell in 2022, with approximately $4 billion of completed deals, an 88 per cent drop compared to the previous year. As of year-end, 67 deals had been completed, a drop of approximately 50 per cent from 124 in 2021. There are 68 deals totalling approximately $20 billion that have been announced but have not closed as of year-end.

In the fintech market, venture capital and private equity investment also fell in the first half of 2022. According to the Pulse of Fintech report published by KPMG, during the first half of the year, global fintech investment and deal volume fell from the second half of 2021, totalling $108 billion with 2,980 deals. The payments space had the largest share of the investment in fintechs, totalling $43.5 billion, followed by cryptoassets, totalling $14.2 billion. Geographically, the Asia-Pacific region had record high levels of investments during the first half of the year, fuelled by several large transactions, including the $28 billion acquisition of Australia-based Afterpay by Block.

Despite headwinds from rising costs of capital and falling asset prices, the financial services sector continues to consolidate and undergo rapid technological transformation, driven by shifting consumer demand for digital financial services and investor demand for cryptoassets. Companies are increasingly interested in building platforms and super apps with embedded financial services, and technology companies continue their push into the financial services sector, seeking to lessen friction points for consumers. With the rise in the number of digital transactions, there is also growing focus on cybersecurity, fraud detection, KYC, B2B services such as banking-as-a-service and cryptoassets. These changes in the private sector have greatly accelerated the innovation agenda of the public sector, as regulators around the world are gaining a heightened awareness of gaps in the regulation and oversight of new digital services and products and the new competitive landscape that is emerging.

In the United States, the growth of the fintech industry challenges traditional banking models and has led to an increased focus on competition issues more broadly by regulators and lawmakers alike. While it is not clear what the final outcome will be, over the next few years, bank merger activity is likely to face greater scrutiny under US antitrust and bank merger standards, particularly for deals at the larger end of the spectrum. In July 2021, President Biden signed an Executive Order that, among other things, called for the federal banking agencies to revitalise competitive review of bank mergers under US banking laws. Merger review modernisation efforts are a top priority now that leadership at the agencies effectively has been finalised. Recent applications and public statements by staff suggest that US bank regulators may be more focused on the impact of a merger on the 'convenience and needs' of the community to be served by the combined institution. Another important topic under consideration by US bank regulators is whether banking markets should be redefined in light of the broadening of the competitive landscape for banking services; for example, more systematically including credit unions in all competitive analyses, factoring in deposits at digital banks in relevant markets and considering non-bank financial firms in all competitive analyses.

Other topics on the US bank regulatory agenda that could impact bank M&A activity include implementation of regulatory capital requirements to align with the final set of 'Basel III' standards (or 'Basel endgame'), consideration of potential adjustments to the supplementary leverage ratio and new requirements for large, regional banks to raise additional long-term debt to absorb losses in case of insolvency.

Related to new competition, the growth of interest from the private and public sectors in blockchain and cryptoassets has led regulators around the world to focus their attention on regulation of the use of this technology in financial services. Broadly speaking, however, efforts to bring cryptoasset activities within the regulatory perimeter remain fragmented.

For example, in June 2022, the European Commission, the European Parliament and the Council of the European Union agreed on a new EU Market in Crypto-assets Regulation (MiCA). MiCA will be one of the first comprehensive regulatory regimes tailored for cryptoassets globally. Regulators and lawmakers in the United States, by contrast, have been warily watching the development of the asset class, particularly given the significant volatility and high-profile failures in 2022. In the United States, no comprehensive regulations have been advanced to date, although the federal financial regulators and the Treasury

Department have been working together since 2021 on a set of policy frameworks for regulating cryptoassets.

Inter-agency coordination is key in the United States because the federal agencies each have relevant and potentially overlapping authority. The Securities and Exchange Commission and Commodity Futures Trading Commission generally oversee the securities and commodities markets, respectively, and the federal bank regulators together exercise broad authority to decide which cryptoasset-related technologies and services US banking organisations may use and offer.

Notwithstanding the slow progress to date, we expect US cryptoasset policy development to be forthcoming, most immediately for stablecoin arrangements that are pegged to fiat currency and backed by reserve assets (as compared to so-called algorithmic stablecoins).

Other developments that are likely to affect the competitive landscape include whether new, non-traditional firms are granted access to the Federal Reserve's payment system (following the Federal Reserve's adoption of new guidelines for access requests and legal challenges to the agency's previous actions and inactions), and the industry impact following the rollout of the FedNow Service, the new instant payment service that the Federal Reserve has been developing. Also, in October 2022 the Consumer Financial Protection Bureau kicked off its process to publish a long-anticipated rule to provide consumers with rights to access information about their financial accounts, which could mandate certain financial data portability and provide more consumer choice ('open banking' standards).

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