



# The big reversal

M&A trends in  
financial services

2022

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## Introduction

# A tough year for FS M&A

By nearly any measure, M&A activity in financial services (FS) was much weaker in 2022 than in 2021. The number of deals dropped 21 percent to 6,589, and total deal value fell a staggering 41 percent to \$489.9 billion. Year-over-year comparisons were similarly negative for the primary FS subsectors (i.e., banking, capital markets, and insurance) and deals involving strategic and private equity players.

**Macroeconomic and geopolitical headwinds.** A macroeconomic trifecta—mounting inflation, rising interest rates, and fears of a recession—was primarily responsible for the damage.

In July, annualized headline inflation reached 9.1 percent, its highest level since 1981, and finished the year at 6.5 percent. The Federal Reserve responded by aggressively raising its benchmark federal funds rate from a rock-bottom range of 0.0–0.25 percent in January to 4.25–4.50 percent by December.

The implications of all of this for M&A were decidedly unfavorable. Steeper inflation and rates meant a higher cost of capital, a big jump in debt costs that made it harder for financial buyers to do deals, and slashed growth projections for corporate earnings and cash flows that hurt stock prices—which reduced the attractiveness of equity as a deal currency.

The war in Ukraine also had a negative impact on the environment for transactions, a harsh reminder that the threat of geopolitical shocks is always present. Fallout from the war notably included soaring prices for energy and food commodities that gave inflation an extra kick, as well as new problems for global supply chains.

**2023: A glass half-full.** We see a mixed picture ahead for FS M&A, with recession and more rate hikes from the Fed in the first half of 2023, followed by recovery and rate cuts in the second half. Sentiment should become more bullish when market participants feel confident that the Fed’s tightening has ended.

Responses to the KPMG 2022 Year-end M&A Survey indicate that FS players are more optimistic about 2023 buy side activity than their counterparts in a variety of other sectors. Fifty-seven

percent of FS respondents expected acquisitions to increase, compared to 52 percent of other respondents. By contrast, the corresponding percentages of respondents who thought sales would rise were 39 and 44, respectively.



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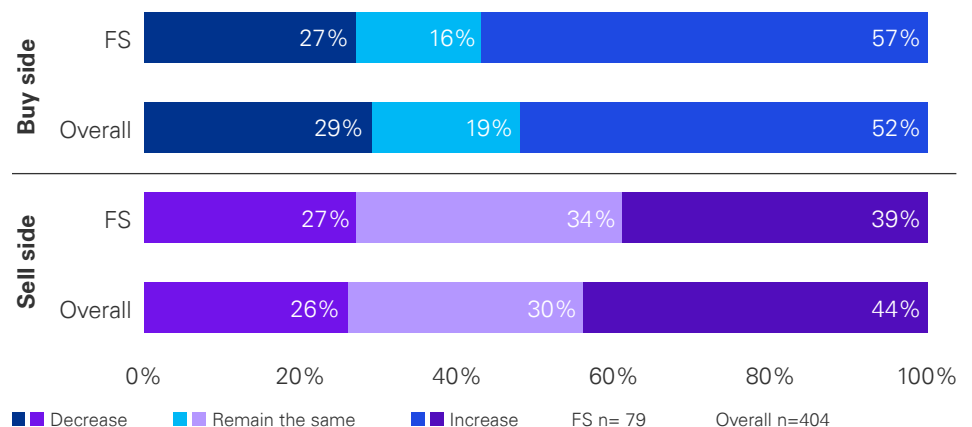
## Key statistics

**-21%** decline in FS deal volume from 8,346 in 2021 to 6,589 in 2022

**-41%** decline in FS deal volume from \$835.6 billion in 2021 to \$489.9 billion in 2022

**-44%** decline in strategic FS deal value from \$720.0 billion in 2021 to \$401.4 billion in 2022

## Compared to the last 12 months, do you expect deal activity in your industry to increase or decrease over the next 12 months?



## By the numbers

# Down, down, down

The numbers for FS M&A in 2022 were significantly worse than in 2021, whether viewed by sector, strategic versus private equity, or where deals took place.

**Sectors.** Capital markets comprised 78 percent of 2022 deal volume. The respective shares for insurance and banking were 17 percent and five percent.

Capital markets transactions were down 19 percent and 33 percent in volume and value, respectively. The corresponding declines were 24 percent and 66 percent for insurance, and 38 percent and 74 percent for banking.

The year's biggest deal, by far, was in capital markets: Prologis's \$23 billion acquisition of fellow real estate investment trust Duke Realty.

**Strategic versus PE.** Strategic deals accounted for 87 percent of 2022 deal volume and 82 percent of value, with PE accounting for the remaining 13 percent and 18 percent, respectively.

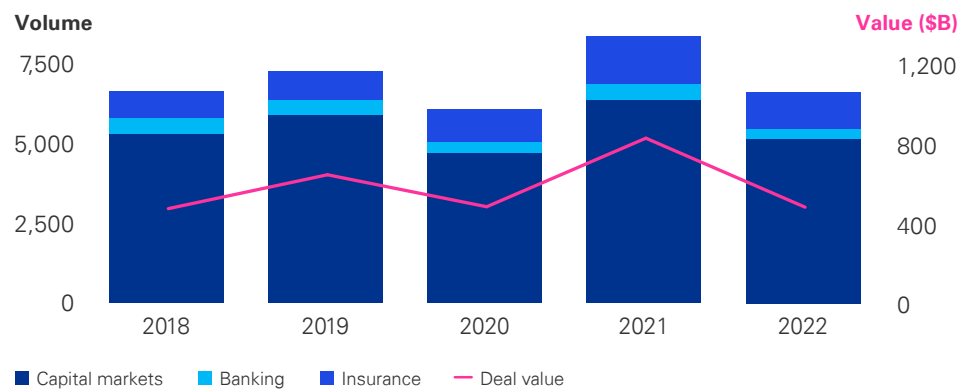
Volume and value declines compared to 2021 were 21 percent and 44 percent for strategics, and 22 percent and 24 percent for PE deals.

**Location.** The number of domestic deals fell 19 percent in 2022, while inbound (i.e., overseas companies buying U.S. targets) slumped 30 percent and outbound (U.S.-based companies buying overseas targets) dropped 25 percent.

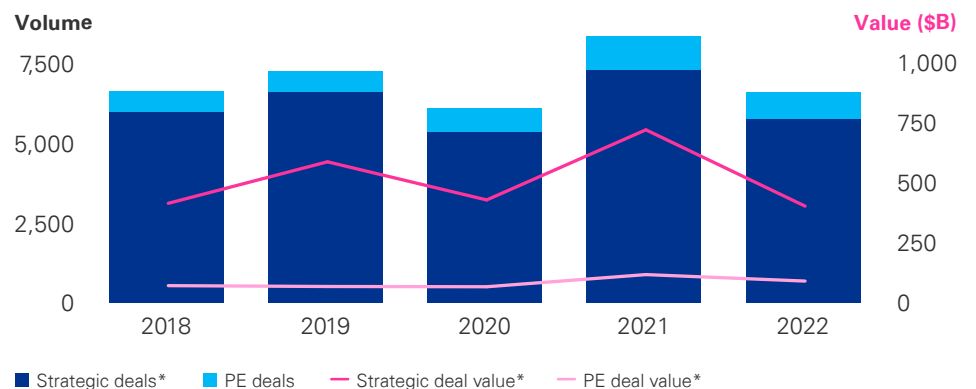
## Top FS deals 2022

Acquirer	Target	Value (billions)
Prologis	Duke Realty	\$23.0
GIC and Oak Street	STORE Capital	\$14.0
Toronto-Dominion Bank	First Horizon	\$13.4
Intercontinental Exchange	Black Knight	\$13.1

## U.S. FS activity by sector



## Strategic and PE FS deals



\*Includes SPAC deal volume and value

Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced between 1/1/2022 and 12/10/2022. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

## By the numbers



Capital markets M&A trends

## Relative outperformance

While capital markets M&A activity significantly fell in 2022 compared to 2021, the subsector outperformed banking and insurance in multiple ways:

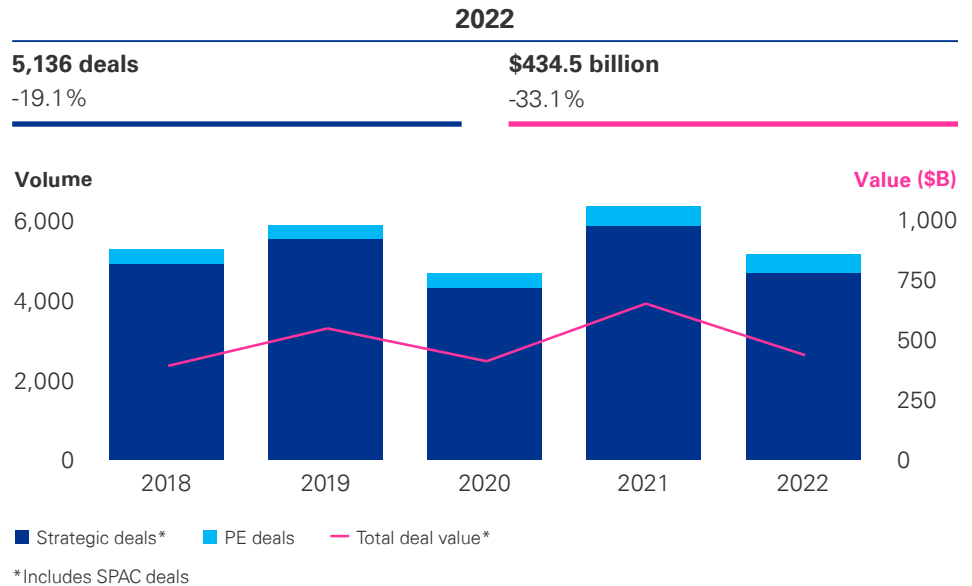
- Its 2022 volume and value declines were lowest.
- It accounted for all of the year's top 10 private equity deals and eight of the top 10 strategic deals.
- It was the only subsector in which each of the top 10 private equity and strategic deals exceeded \$1 billion in value.
- Its annualized growth rates for deal volume and value over the past five years were the highest, by far.
- It was the only subsector whose five-year growth rate for volume was positive.

**A mixed picture.** We see a combination of negatives and positives for capital markets M&A in 2023.

Investment banking and corporate finance providers should face a particularly tough environment in the first half of the year or so, as rising interest rates continue to dampen the appetite for deal making. Fee income should suffer accordingly.

We expect conditions to improve later in the year, though, as recession turns into recovery and the Fed begins to cut rates. Long-term consolidation trends should help drive transactions in asset management, alternative investments, and real estate.

## Capital markets deal value and volume



## Top capital markets deals 2022

Acquirer	Target	Value (billions)
Prologis	Duke Realty	\$23.0
GIC and Oak Street	STORE Capital	\$14.0
Intercontinental Exchange	Black Knight	\$13.1
Blackstone	American Campus Communities	\$12.8

## By the numbers



Banking M&A trends

# Deal drivers remain in place

Despite the huge declines in banking M&A volume (down 38 percent) and value (down 74 percent) during 2022, several trends that had driven long-term activity remained in place. Each of the year's three largest banking deals represented one of these trends:

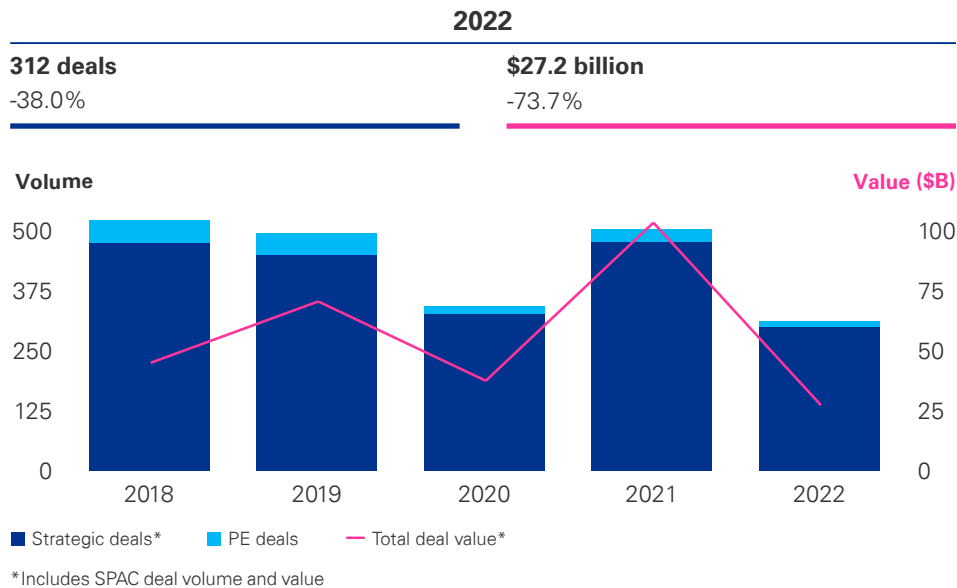
- Non-U.S. banks in U.S. retail market.** Canada's Toronto-Dominion Bank expanded its U.S. retail presence by buying First Horizon Corp. for \$13.4 billion. Other non-U.S. banks, such as BNP and HSBC, chose to exit the U.S. retail market instead.
- Regional consolidation.** In a classic example of regional consolidation, two New Jersey banks—Provident Financial Services and Lakeland Bancorp—announced a \$1.3 billion merger. The resulting entity would be one of the state's biggest super-community banks.
- Big fintechs get bigger.** SoFi Technologies acquired Technisys for \$1.1 billion in a combination of technology-driven neobanks.

**Bad news and good news.** In our view, 2023 should be a year of bad news and good news for banking M&A.

The bad news is that rising interest rates and a weak economy should perpetuate the caution that permeated most of 2022.

The good news, though, is that many banks and fintechs know they have to get bigger or sell themselves to be competitive, regardless of the economic environment. Deals should get done accordingly.

## Banking deal value and volume



## Top banking deals 2022

Acquirer	Target	Value (billions)
Toronto-Dominion Bank	First Horizon	\$13.4
Provident Financial Services	Lakeland Bancorp	\$1.3
SoFi Technologies	Technisys	\$1.1
Washington Federal	Luther Burbank	\$0.7

## By the numbers



Insurance M&A trends

# Consolidation continues

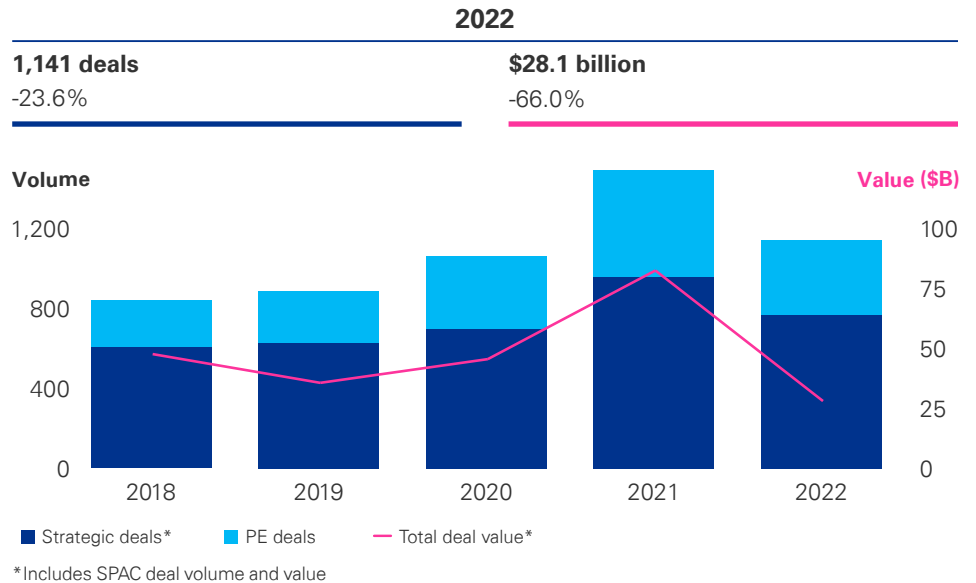
While insurance M&A dropped with a thud in 2022, the industry's long-running consolidation trend continued to drive activity. Each of the year's four \$1 billion-plus transactions was a good example:

- In the biggest deal—Berkshire Hathaway's \$11.6 billion acquisition of Alleghany Corp.—a thriving buyer benefited from a competitor's decision to sell.
- Consistent with the insurance brokerage business's eat-or-be-eaten mindset, Brown & Brown bought Global Risk Partners for \$1.9 billion and Howden Group paid \$1.6 billion for TigerRisk Partners.
- Independence Pet Group acquired the U.S. and Canadian pet insurance units of Fairfax Financial for \$1.4 billion. Independence was established in 2021 as an aggregator in the highly fragmented pet insurance specialty business.

**More consolidation ahead.** Higher interest rates are a double-edged sword for insurance carriers. On one hand, they reduce economic growth and increase caution about M&A. On the other, they help to boost the income from carriers' massive bond portfolios, which strengthens their ability to pay claims and make acquisitions.

We expect consolidation involving carriers, brokers, specialty providers, and insurtechs to continue in 2023, albeit at a measured pace. Activity should pick up as rates stabilize and the economy improves.

## Insurance deal value and volume



## Top insurance deals 2022

Acquirer	Target	Value (billions)
Berkshire Hathaway	Alleghany	\$11.6
Brown & Brown	Global Risk Partners	\$1.9
Howden Group	TigerRisk Partners	\$1.6
Independence Pet Group	Crum & Forster Pet Insurance Group, Pethealth	\$1.4

## By the numbers



PE M&A trends

## Assessing the damage

The volume and value of private equity M&A shrunk 22 percent and 24 percent, respectively, in 2022 from 2021. No FS sector was spared:

- The damage was greatest in banking, where PE volume and value plummeted 54 percent and 55 percent.
- In insurance, volume fell 31 percent and value lost a stunning 85 percent.
- Capital markets volume dropped 10 percent and value 25 percent.

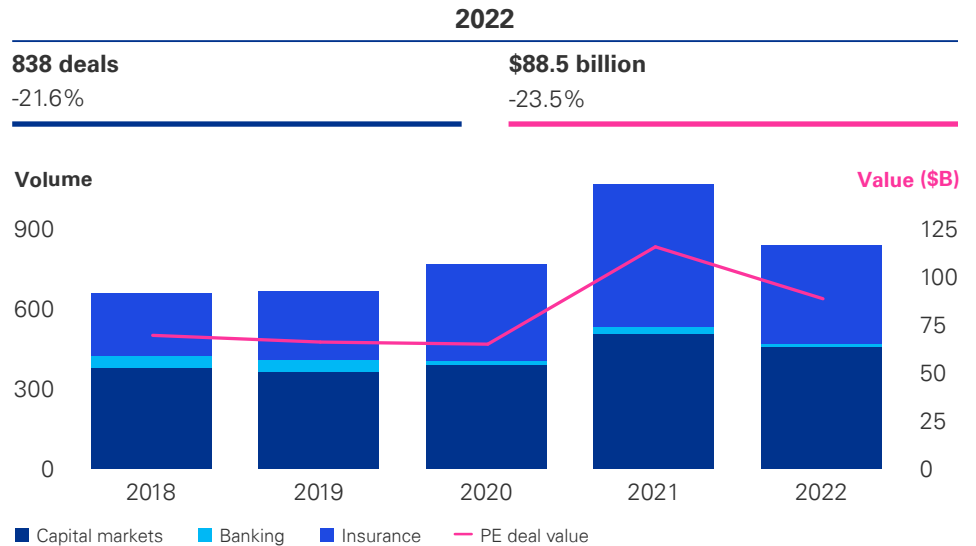
All of the year's 10 largest PE deals were in capital markets. The most active subsectors included insurance brokerage, asset management, insurtech, and payments.

PE accounted for just two of the top 10 FS transactions, both of which involved real estate investment trusts. These were the \$14.0 billion acquisition of STORE Capital by a Singaporean sovereign wealth fund and a real estate investment firm; and Blackstone's purchase of American Campus Communities for \$12.8 billion.

**Looking ahead.** We're cautiously optimistic about the near-term prospects for PE M&A. Firms have plenty of dry powder—nearly \$2 trillion at year-end 2022—and executives have expressed eagerness to get back into the market.

But at the same time, high interest rates are a significant barrier to PE business as usual. We expect this to remain the case until firms feel that rates and the economic outlook have steadied.

## PE deal value and volume



## Top FS PE deals 2022

Acquirer	Target	Value (billions)
GIC and Oak Street	STORE Capital	\$14.0
Blackstone	American Campus Communities	\$12.8
Blackstone	PS Business Parks	\$7.6
Blackstone	Crown Resorts	\$6.3



## Roll-ups: Take the organic route to create value

Inflation and rising interest rates are making it tougher for FS companies to grow via acquisitions. This is particularly true for private equity firms that have built roll-up platforms in wealth management and insurance brokerage, both of which are prized for their stable and consistent revenue streams.

With M&A a less-attractive option, how can these roll-ups create value? We believe that the organic route—i.e., maximizing opportunities with existing portfolio companies—is the right way to go.

**How did we get here?** Ironically, the current situation is a direct result of the PE industry's success while rates were historically low from the Great Recession through early 2022. Deal volume and value soared as cheap, abundant capital kept financing costs down and pushed valuations and cash flows ever higher. Roll-up strategies thrived.

But the Fed's aggressive tightening and the threat of recession have slowed the pace of activity. Buyers are being more selective and sellers expect valuations that no longer make economic sense. Debt servicing is much more expensive and many portfolio companies have limited access to financing.

Client conversations suggest that many roll-ups and sponsors intend to stay on the sidelines for at least the next few months. Deal making likely will pick up when buyers have a clearer sense of where rates will stabilize and what the economy will look like.

**Creating value now.** In the meantime, roll-ups and sponsors can adapt by creating more value from within.

They can begin with proven methods such as operational efficiencies via integration and cost reduction, and revenue synergies.

They also can invest more in two areas in which they lag many other industries. The first is a robust treasury function that can benefit from rising rates by optimizing cash management and hedging against potential cash flow shortfalls. The second is a data analytics capability that can identify and evaluate potential value opportunities.

**Addition by subtraction.** Improving company portfolios by reducing them—i.e., pruning noncore or nonperforming assets—can be an appealing option for roll-ups and sponsors that don't want to buy.

As we discuss in our recent paper, "Divesting in a Downturn," divestitures have significant potential benefits. These include reallocating resources to strengthen businesses with better prospects; redeploying capital to higher-return activities such as share repurchases or deleveraging; and mitigating diversification discounts that can arise when portfolio companies have disparate financial characteristics.

We expect interest in divestitures to increase while acquisitions wane. Spinoffs, carve-outs, and joint ventures are likely to be the most popular vehicles.

**Just one piece, please.** Sponsors that lack the appetite to acquire the whole pie should consider taking a slice instead. Partial, noncontrolling ownership stakes could take the form of straight or preferred equity, convertible debt, bespoke credit transactions, or debt-for-

equity swaps, for example. Purchases could be direct or as part of larger consortia or partnerships.



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## Are banks the future of banking?

It's hardly breaking news that the banking industry has evolved beyond its historical boundaries of branch networks, mortgages, and commercial lending. What is less clear, though, is what banking will look like in the future.

In our view, banks will have to choose among several business models to compete and differentiate themselves. Winners will be the best providers of banking services—and not those aiming to be the best bank.

**Strategy matters more.** Banking models and strategies used to be fairly homogenous, with performance typically in tight ranges. Competition was within groups of like institutions, such as globals versus globals, regionals versus other regionals, etc. Execution excellence was the key differentiator.

More recently, rapid changes in technology and customer behaviors have fostered a broader variety of strategies with a wider dispersion of potential returns. Customers can get their banking services from a bigger range of competitors, meaning that the threat of substitution is higher than ever.

Banks must decide whether they want to embrace the possibilities of the service-provider construct, or maintain business as historical—i.e., whether they want to be in the top or bottom performance tiers. Put simply, strategy matters more now than in the past.

**Which model?** We see a number of business models for the provision of banking services:

- Banks (traditional banks, digitalized traditional banks, digital native banks, partners that provide access to

fintechs, banking-as-a-service [BaaS]/ embedded finance providers, and third-party consumer products and services platforms)

- Nonbank financial institutions (e.g., Fundbox, OnDeck)
- Corporate providers (e.g., Walmart)
- Fintech enablers, which provide banking infrastructure, automation, etc., to banks
- Fintech providers of banking tools to customers (e.g., Mint)
- Big tech (e.g., Apple, Google, Amazon)

### **BaaS and embedded finance.**

Two emerging approaches generating considerable buzz are BaaS and embedded finance, both of which feature banks as back-end utilities rather than as customer-facing service providers.

BaaS allows nonbanks to offer standard financial products manufactured by banks, while embedded finance integrates FS such as payments and lending into the infrastructures of nonfinancial businesses. By assuming the distribution function and simplifying the customer experience, each can significantly reduce banks' costs and enable the distributors to attract customers they might not have otherwise.

**M&A implications.** Banks need to choose a model that can position them for long-term competitiveness and outperformance. Their choices will have direct implications for M&A activity.

The more aggressive players will look to be buyers or position themselves for eventual acquisition, while traditional banks—especially smaller and midsize institutions—should consider selling.

The weak economic environment will likely force some sellers to act sooner than they'd prefer.

*Note: KPMG will discuss the future of banking at greater length in a series of articles during 2023.*



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Principal

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## Outlook

# Cloudy, then clear

We believe that the macroeconomic environment will be the main driver—both positive and negative—of financial services M&A in 2023. Our outlook is based on conditions changing from unfavorable in the year's first half or so to favorable in the second half.

The key to what happens depends on what the Federal Reserve does with interest rates. KPMG Economics forecasts that the Fed will hike rates by a total of 75 basis points in early 2023 to a range of 5–5.25 percent. Combined with the Fed's aggressive hiking in 2022, this should be enough to push the economy into a shallow recession. The forecast shifts to rate cuts later in the year as the recession helps inflation to cool.

We expect sentiment to improve when there's consensus agreement that rates have peaked. This would provide dealmakers and investors with the kind of all-clear signal they haven't seen since late 2021.

**Implications for equity and debt.** Public equity prices haven't yet priced in the impact of recession, in our view. If the KPMG Economics forecast is correct, then corporate earnings and earnings growth should fall, leading to lower prices,

which would lead to lower valuations. While equity would be less attractive as a deal currency, the drop in valuations could persuade financially strong, opportunistic buyers to pursue bargain-priced targets.

As for debt, acquirers that rely on it to finance deals—notably private equity firms and their portfolio companies—should stay less active in the face of rising debt costs and falling prospects for revenues, earnings, and cash flows. The picture would undoubtedly brighten as rates stabilize and recession ebbs.

**Regulatory pressure.** Dealmakers in all industries must contend with the Biden administration's tough stance on approving mergers. This is particularly true in banking, which the administration has singled out as an area whose transactions will receive greater scrutiny. Regulators exacted significant concessions, for example, in exchange for their recent approval of U.S. Bank's takeover of MUFG Union Bank.

**Consolidation marches on.** The drive for consolidation has played out across FS for years and in strong and weak economic environments alike. We see no reason for this trend to waver in 2023.

The need for growth and competitive differentiation only becomes more intense with time. Hence the big want to get bigger, and small and midsize players must continually confront their commercial mortality. Consolidation should remain a major incentive for M&A in alternative investments, asset management, banking, fintechs, insurance carriers and distributors, insurtechs, investment banking, payments, real estate, wealth management, and more.



## Key considerations as we look ahead

In pursuing M&A in an economic downturn, FS dealmakers will need to recalibrate their focus to ensure success:

### 1 Deal or no deal?

Organic growth is much harder to achieve in a down economy. If you're not at least thinking about inorganic growth, you risk being left on the sidelines.

### 2 Be prepared.

You'll need to react quickly to auctions and know your valuation approach. Have your market analysis, target wish list, and high-level business cases ready to go.

### 3 Be mindful of regulators.

M&A regulators are being especially strict on bank deals. Potential acquirers should pay extra attention to regulatory considerations and structure their deals accordingly.

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## How we can help you

KPMG helps its clients overcome deal obstacles by taking a truly integrated approach to delivering value and leveraging its depth in the FS industry, data-supported and tools-led insights, and full M&A capabilities across the deal lifecycle.

With an FS specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

### With special thanks to:

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