



Standing firm on shifting sands

Global banking M&A outlook H2 2020

KPMG International

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Foreword

Standing firm on shifting sands

The year ahead

Throughout 2020, the ramifications of COVID-19 continued to increase, cascading from Asia to various parts of Europe and then to the rest of the world. In response, most developed economies enforced temporary population lockdowns to stem the public health crisis.

While the full impact is yet to be determined, it's expected that the adverse impact to business confidence and valuations is likely to continue from the virus' knock-on effects. This includes the possibility of an unexpected global recession in the most advanced economies. Stock markets have experienced massive volatility, reaching 2015 levels in mid-March 2020 with central banks worldwide injecting liquidity to shore up money markets — an unprecedented scenario — with the largest global real economies in complete lockdowns, unable to resume production activities.

With poorer valuations, liquidity shocks, and a new incoming wave of non-performing loans and related provisions worsening capital strength of the banking sector, M&A activity has undergone a slowdown in H1 2020. This will likely further accelerate the global domestic consolidation trend in late 2020 and beyond.

2019 wrap-up

In 2019, a modest increase of 3.7 percent¹ in the number of M&A transactions took place. Deal value, however, leapt by 71 percent due to three US mega-deals in the payments space — each greater than 25 billion US dollars (USD). The addition of two high-value 'mergers of equals' (also in the US) resulted in the best year, value-wise, since 2009. Domestic banking deals continued to dominate, making up for the 75 percent² of overall activity, with the US, India, China, Italy and the UK being the most active markets.

China's deal volume dipped significantly by 24 percent, while India and the UK witnessed a marginal decline of 3.3 percent and 6.2 percent, respectively.³ China's banking sector faced challenges from mounting debt levels after years of growth, technology disruption, changing capital requirements, and new regulations. Despite this, further M&A opportunities are expected in the second half of the year.

Falling economic activity has muted M&A performance in India, with distress being a key driver for M&A. However, if we look ahead, it is expected that deals could surge with more mergers and divestments in pure-play banking, and consolidation among non-banking financial institutions.

Regional differences

2020 might prove to be a mixed year for banking deals in the Asia-Pacific region (ASPAC), with certain markets showing continued inbound interest in ASEAN countries, as banks look to strengthen their capital base to support lending activities. Potential headwinds relating to COVID-19 may, however, play a part in loss of business confidence alongside the potential for an increase in non-performing loans (NPLs).

In Europe, the outlook is mixed. Institutions which were under pressure prior to COVID-19 may turn to M&A for help; however a broader drop in confidence may depress deal volumes in the short-to-medium term. In the UK, the continued uncertainty relating to Brexit — with the transition period from the EU due to end on 31 December 2020 — will add a further layer of complexity. In Italy, while NPLs have declined, profitability is far from strong; mid-sized banks are now struggling to cope with the aftermath of COVID-19. Conversely, in Central & Eastern Europe, reputable players with a non-strategic position planning an exit may have to temporarily halt their plans. After a stellar year in 2019, the volume of US deals is likely to drop due to COVID-19, flat interest rates and impending election uncertainty. Finally, while banks and PE firms in Latin American economies are still well capitalized and are looking for M&A opportunities, the timing of these transactions remains unclear.

What could drive the deals

COVID-19 will likely shrink overall investment levels however, fintech is expected to witness large M&A deals as incumbents and investors recognize the need to accelerate the digital transformation agenda. Although a delay in the approval process is expected, a softening attitude by regulators toward banking transactions might become another powerful driver. Loan portfolios or NPL resolution/disposals could remain strong in selected markets like Chile, China, India, Ireland and Italy. Lastly, private equity (PE) players, who enjoy healthy liquidity, are likely to first assess their portfolio companies and then seek targets — although regulatory constraints prevent them from making inroads into certain markets.

1 ThomsonOne and KPMG analysis

2 Ibid.

3 Ibid.



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COVID-19 is straining the financial markets and the global banking sector. Banks, at this stage, play a crucial role in maintaining a healthy credit system. They are called to guarantee the necessary liquidity to the real economy, also conveying trust and reliability to end-customers towards a path of recovery.

Banking institutions are faced with a series of operational issues, including exceptional losses due mainly to high loan impairments, credit origination and risk management, digital customer relationships and agile commercial models, the drive for operational efficiency and business continuity management as well as funding and liquidity. //

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Global banking M&A: wrap up 2019

Global banking deals⁽¹⁾
(volume announced)



Global value of banking deals announced⁽²⁾
(USD billion)



Non-domestic banking deals⁽³⁾
(percent of total banking deals)

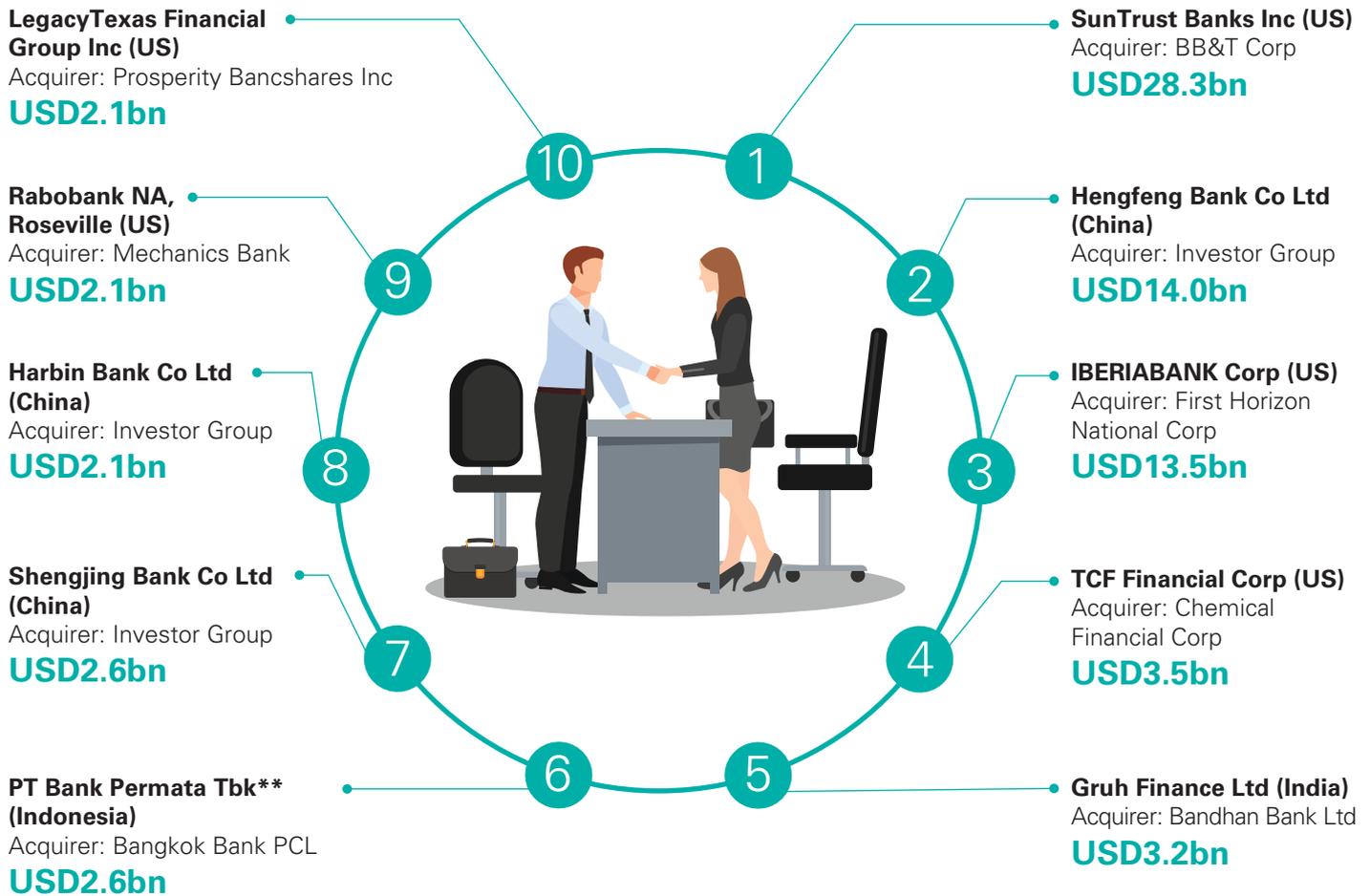


Notes:

1. Deals announced include pending and completed deals.
2. Deal value represents total value of announced transactions where value is disclosed publicly.
3. Non-domestic banking deals include regional and inter-continental (excludes domestic) deals.
4. Banking deals include payment deals.
5. High-value payment transactions witnessed in 2019.

Source: ThomsonOne

Top 10 core banking deals in 2019*



*Top 10 core banking deals (excluding payments, fintech transactions and other banking related/support services) only basis deal value. Deal value is ranking value including net debt of target.

**Cross-border deal.

Source: ThomsonOne

Top five active transaction markets in 2019



Note: Active transaction markets refer to the top five targeted nations basis deal volume. Deal value represents total value of announced transactions where value is disclosed publicly.

COVID-19

Overall impact on the banking sector



Profitability and credit management/cost of risk

- The low interest rate scenario, along with the significant impact of the COVID-19, is reducing the core banking profitability in mature markets. Financial institutions are thus shifting towards commission-based income from the likes of payments and tech businesses.
- One of the immediate effects of the health emergency on the real global economy is the increased credit risk of corporate and retail clients of the banks. In order to continue financing the real economy and support its recovery, banks are called to distinguish between purely temporary phenomena, destined to be reabsorbed in a short time, and longer lasting impacts which would require actions of management and reclassification.
- The primary aspects to be considered are:
 1. the forward-looking information update — in particular, the way in which new information must be incorporated into risk parameters needs to be carefully analyzed, given the peculiar nature of COVID-19. This may last for a lesser time than cyclical downturns induced by economic-financial causes
 2. the update of the 'default rates' which needs to take into account any waivers granted by the authorities in relation to only temporary phenomena of expiry of the creditworthiness
 3. the definition of the most appropriate timescales for updating the 'recovery rates' in order to be able to factor in the positive effects — albeit inevitably in the medium term — deriving from the credit recovery policies which could introduce forms of deferred payments or agreements on longer maturities (restructuring debt, etc.).
- The contraction in economic activity is having adverse consequences on credit quality as banks are increasing loan loss provisions. A few European banks, have already posted significant losses in Q1'20 (Jan–Mar) to face a potential surge in bad loans.



Securitization landscape

- The corrective actions of governments aims to mitigate the risk profiles through further incentives for disposals.
- It is likely that the future market of synthetic securitizations may require a revitalization after recent developments and important economic impacts that could come as a result.
- Over the past few years, several European banks have finalized important disposal operations of impaired loans, contributing to a significant reduction of the NPL ratio. Among the prominent evolutionary trends in the market, it is possible to identify the strong interest on the unlikely-to-pay (UTP) loans, the birth of a fervent secondary market for bad debts and the amalgamation of homogeneous large-ticket asset classes in the construction of portfolios intended for the market i.e. so-called single names.



Customer relationship and commercial models

- Although COVID-19 may lead to a crisis in the overall economy, the impact on the banking system and on the bank-customer relationship can also be defined as a 'positive discontinuity' for the purpose of digitization of the sector and the ability to offer an excellent customer experience.
- Banks, even the most territorial and branch-centric ones, are forced to encourage the use of channels that have never been their strategic priority. This phase would be particularly complex, which banks need to address by demonstrating real proximity with their customers.
- The clear understanding by banking operators of their gap in the provision of services, becoming more tangible than ever before with COVID-19, could make them even more inclined to accelerate the digital transformation path through partnerships and collaborations within the fintech community.



Operational resilience and business continuity management

- The provision of technological innovation can play an important role in guaranteeing the business continuity of the banks: the activation and enhancement of robotics solutions or artificial intelligence (e.g. Advanced BOTs that support the processes of adoption of the technologies displayed on the channels direct) and mobility (e.g. platforms for the management of promoters and systems authorizations), if applied to critical processes, would allow for an easier protection in case of absence of staff.
- Given the necessity to have an unpredictable availability of infrastructural resources, there is a clear opportunity also for the financial sector to evaluate the benefits of applicable Cloud technologies.

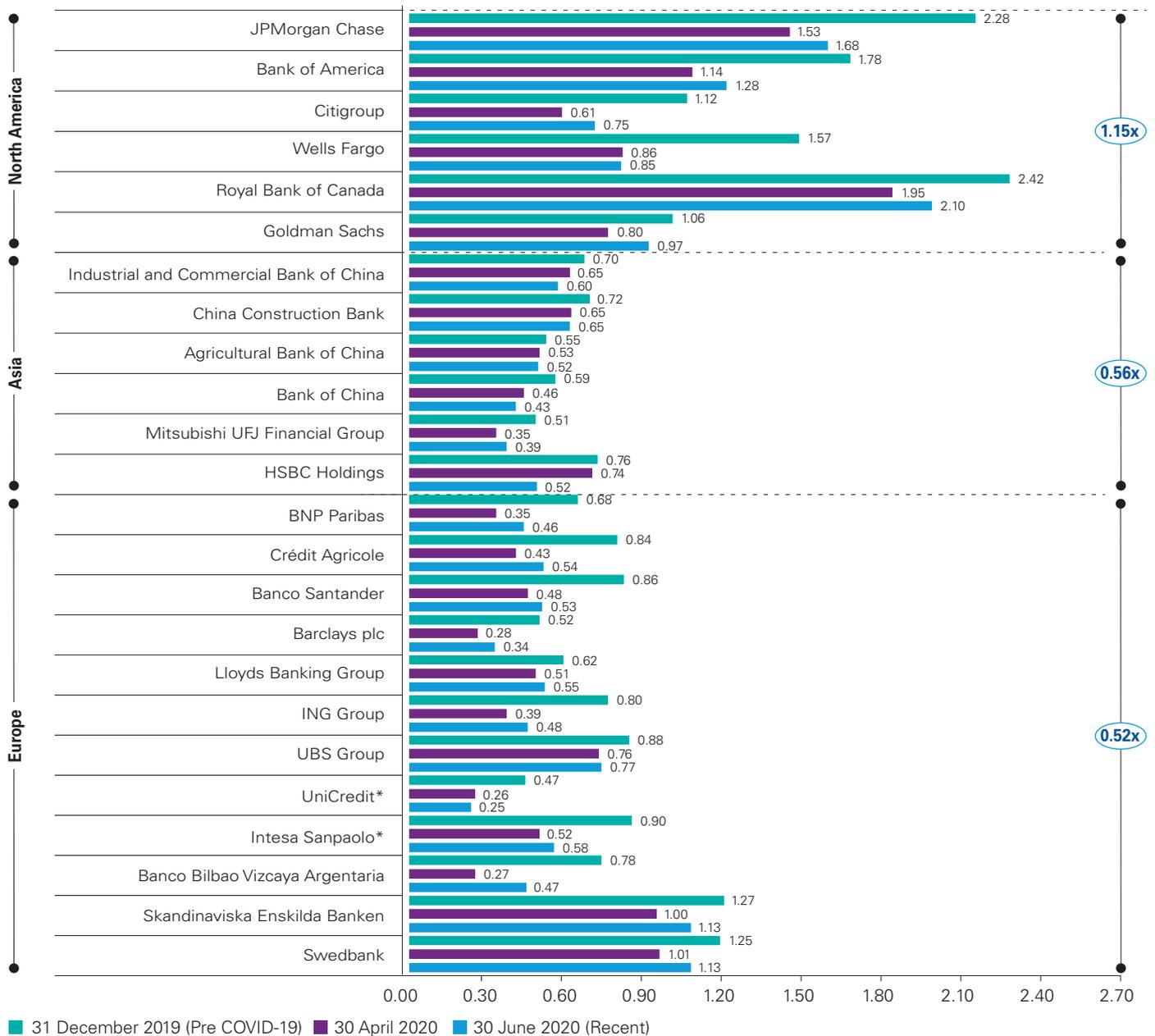
COVID19: Overall impact on the banking sector (continued)

High volatility in stock markets depressed banks' valuation...

COVID-19 has generated significant instability and high volatility in global capital markets. The financial sector has been one of the most affected, with bank valuations dropping in all countries around the world (P/NAV multiple experienced a severe downfall from 1.00x on 31 December 2019 to 0.69x on 30 April 2020). At the regional level, North American banks are still trading at P/NAV equal to an average 1.15x, while Asian and European banks (with the exception of the Nordics) are currently trading at significant discount levels (with average P/NAV at 0.56x and 0.52x, respectively).

Banking stocks were impacted during COVID-19. In the period from 01 December 2019 to 30 April 2020 — most banks saw a price slump in mid-March. European banks were adversely impacted as the Euro STOXX banks index saw a massive decline of 40.18 percent followed by STOXX North America 600 banks index (31.23 percent) and STOXX Asia/Pacific 600 Banks Index (26.09 percent) for the given period.

Price-to-tangible book value multiple (x) of the top banks, by region



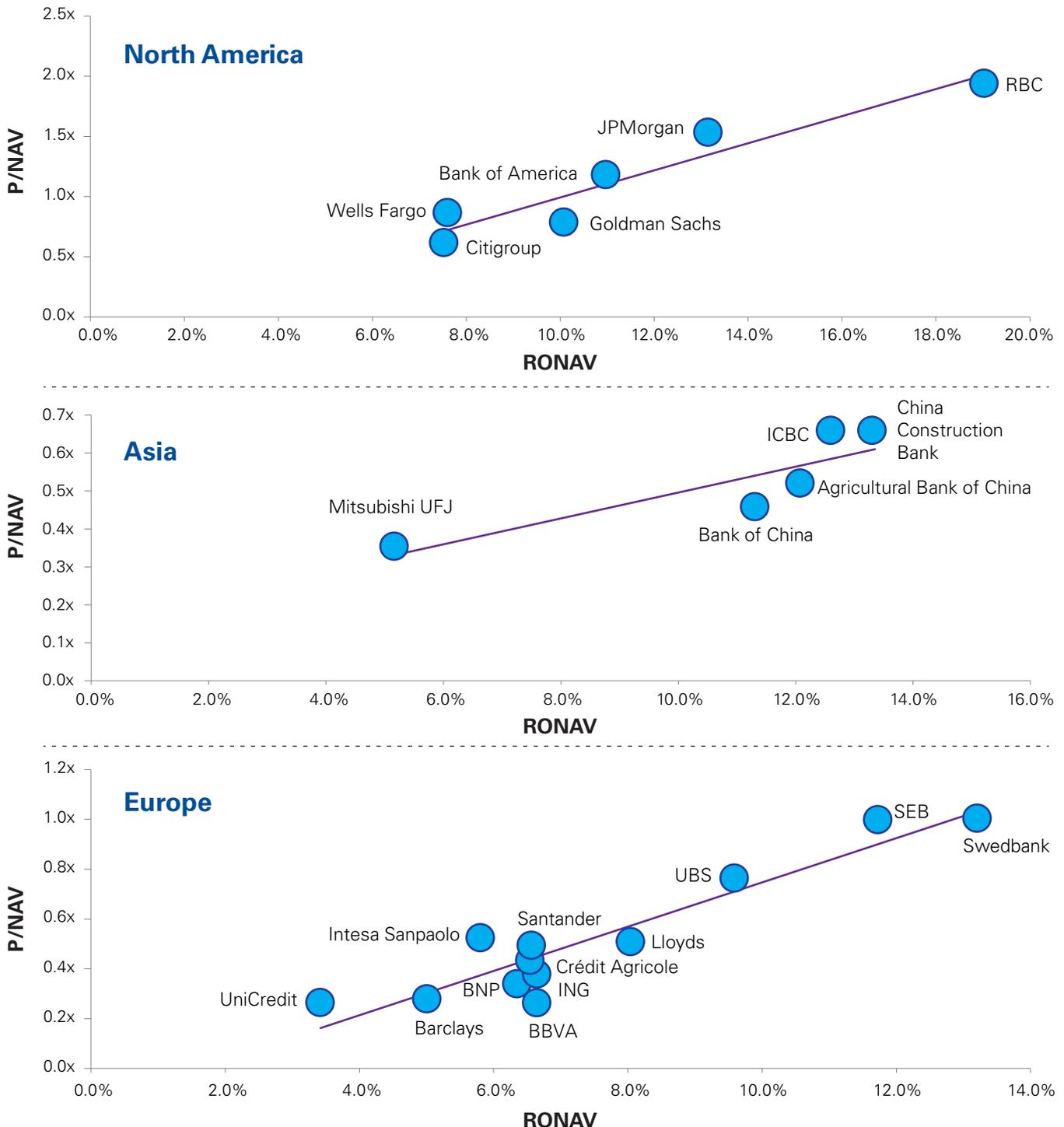
Source: Capital IQ and KPMG analysis

*Intesa Sanpaolo and Unicredit's price-to-tangible book value for pre COVID-19 period has been considered for November 2019 as no data was available for December 2019. Also, for June 2020, no data is available for Unicredit, hence data for May 2020 has been considered.

...while keeping a strong correlation with profitability

A strong correlation between bank valuation and profitability is envisaged by the regression analysis. North American banks in particular are experiencing higher valuations due to a relatively higher profitability, mainly driven by the diversification of the business activity (e.g. investment banking services), with RONAV equal to 11.4 percent on average, compared with 10.9 percent and 7.5 percent in Asian and European banks, respectively. At a regional level, assuming a RONAV equal to 10 percent, the implied P/RONAV is equal to 1.0x, 0.8x and 0.5x in North America, Europe and Asia respectively.

Regression RONAV '21 — P/NAV



Source: Capital IQ and KPMG analysis

Note: P/NAV — the price to net asset value (P/NAV) is a valuation ratio expressing the market capitalization of a company compared to its Net Asset Value. RONAV — refers to the return on Net Asset Value.

COVID-19

Eight impacts on banking M&A

After a period of record M&A activity over the past decade, the banking industry is now facing unprecedented disruption. M&A activity was down by approximately 21 percent (in terms of deal volume) in the Q1-20 (January–March) compared with that of the previous year. In terms of deal activity:

- Some acquisitions and divestitures have still been completed, particularly those near to signing and/or closing, and some others have accelerated to overcome additional disruption from COVID-19.
- Some deals have been put on hold due to the high volatility in the financial market, as well as uncertainty over business resilience, while a few others have been canceled.

Within this context, we expect banking M&A activities to increase in the second half of the year, primarily driven by domestic consolidation aimed at improving bank efficiency and at creating larger scale in order to compete with international peers.

In addition, acquisition of fintech and digital solutions capabilities will have a key role in the M&A landscape to help banks re-design their business models in order to survive in the long run in a low interest environment.





1. Acceleration in global domestic consolidation

Domestic consolidation is likely to pick up pace with the objective of increased operating efficiency at the national level in order to compete worldwide.



2. Rescue and restructuring deals to soar

Troubled banks may face rescue, restructurings and nationalizations deals as governments/central banks inject liquidity.



3. NPL growth may overtake loan growth

Banks with high exposure to stressed industries (hotels, restaurants, travel, oil & gas, etc.) are likely to face an increase in NPLs and a worsening of the asset quality. This could serve as potential opportunity for asset management companies and PE investors.



4. PE firms to reassess their investment plans

Distressed valuation in the banking space may represent a good entry point for some PE firms that are currently evaluating areas to invest their liquidity.



5. Fintech acquisition by traditional players

As funding sources dry up, struggling fintech firms with limited market experience (especially online lenders) may be forced to seek collaboration or acquisition by traditional financial institutions and PE funds.



6. Revival of distressed M&A

There could be several opportunities for distressed investors given the deep discount that financial institutions are facing in the stock market. Moreover, buyers having surplus funds could take advantage of low prices in the current scenario.



7. Specialty finance and challenger-banks

Specialty finance and challenger-banks are the new business model with a strong potential for superior profitability; this new banking model is likely to get the opportunity to acquire market shares in the lending space and could be involved in potential M&A transactions.



8. Boost for digital solutions

COVID-19 represents an opportunity to foster greater use of digital capabilities. Fintech and digital solution players, such as payments solutions and instant lending companies, are likely to get involved in M&A transactions with traditional banks to increase their operational efficiency.

Global banking M&A: Outlook for H2 2020

Uncertain conditions offer springboard to deals

In 2019, the very conditions that were expected to dampen M&A appetite led to actual growth. Therefore, there are plenty of reasons to be (cautiously) upbeat in H2 2020 despite COVID-19, such as an increase in domestic consolidations, scope of more rescue and restructuring deals, a surge in digital transactions, ease of regulatory transaction barriers, increased collaboration between fintechs and financial institutions, PE and a thriving NPL market.

Fewer big-ticket deals in core banking

Mega-deals kept the M&A market bubbling in 2019, supported by underlying growth drivers, low cost funding and strategic motivation. In the second half of 2020, a few large transactions may happen in core banking with adjacent or aligned sectors, such as payments, specialty finance and software companies servicing financial institutions, being far more active.

Asia-Pacific market retains optimism

Considering the economic headwinds caused by COVID-19, the emergence of NPLs may drive deal activity in the region in the latter half of 2020. Alongside this, fundamental macro drivers, including digital and mobile penetration, an emerging consumer middle class, growth in B2C platforms, and support for fintech business models, would provide deal opportunities as markets stabilize, particularly among the PE and alternative credit communities.

European deals to suffer from a lack of confidence

Across the European continent, a fall in market confidence in the wake of COVID-19 is likely to hit deal volumes. Where businesses are suffering from distress, there could be opportunities for buyers — both existing market participants and PE — to make acquisitions at attractive valuations.

Limited growth in the US

Faced with the market disruption caused by COVID-19 combined with flat interest rates and upcoming election uncertainty, growth opportunities in the world's largest banking M&A market may be limited. However, distress created by COVID-19 may create unexpected deal opportunities for well-capitalized institutions.

Expected banking M&A growth (percent) of key markets in H2 2020



Source: KPMG internal survey

Note: Key countries including CEE as a region (#24) have been considered for the study. The expected growth in banking deal activity for each country is with respect to deal volume.



Steady growth (10–15%)

Strong growth (15–25%)

Very strong growth (>25%)

Negative growth <0%

Regional banking M&A: Outlook for H2 2020



Asia Pacific

A slowdown in near-term transaction volume is anticipated in 2020. Simplified business models leading to divestments, regulatory-driven consolidation to enhance the stability of domestic banking sectors, takeover of troubled banks, and emerging NPL portfolio opportunities however are trends which could drive local and inbound interest.

Australia

There's potential for transaction volumes to be buoyant as regulatory complexity causes banks to rationalize their business models. In the wake of the report of the Royal Commission into Misconduct in the banking sector, major banks and financial institutions are divesting non-core businesses like wealth management, financial advice and insurance. While divestments might be delayed until 2021, the trend to simplify banking business models presents opportunities for non-bank, insurance and PE buyers.

China

Tier II/III local commercial banks are contemplating IPOs, strategic investments and perpetual bond issuance to meet the rising need for greater capital buffers. Meanwhile, the government takeover of troubled banks is likely to continue. Further restructuring and M&A opportunities are expected as smaller regional banks are experiencing increased NPL ratios. The good news for foreign companies and investors is the emergence of a cohesive regulatory framework designed to protect consumer interests and economic stability. This could ease the barriers to inbound M&A in the medium-term.

India

The second half of 2020 is likely to be an extremely active year for banking M&A, driven by confidence capital raise during/post COVID-19, policy and regulatory changes (like the insolvency law for financial services companies). Several restructuring opportunities might be the result, including: mergers of weaker banks and small finance banks into universal banks; strategic investments by PE in weaker banks; divestment of non-core assets by banks (especially their stakes in insurance companies); distressed sales of weaker non-banking finance companies; and, increased primary market movements, driven by small finance banks and PE backed midsized-to-large lending institutions.



Despite the economic impacts of COVID-19, we anticipate deal activities in ASEAN to improve. Banks are looking to strengthen their capital base for new lending and to support emerging NPLs and continued interest is being shown by PE and other VCs in non-bank financial institutions, payments and emerging fintech and platform businesses supporting the stability of the banking sector across the region, as well as the emerging lending opportunities arising from infrastructure and new supply chains and financial inclusion across the region. //

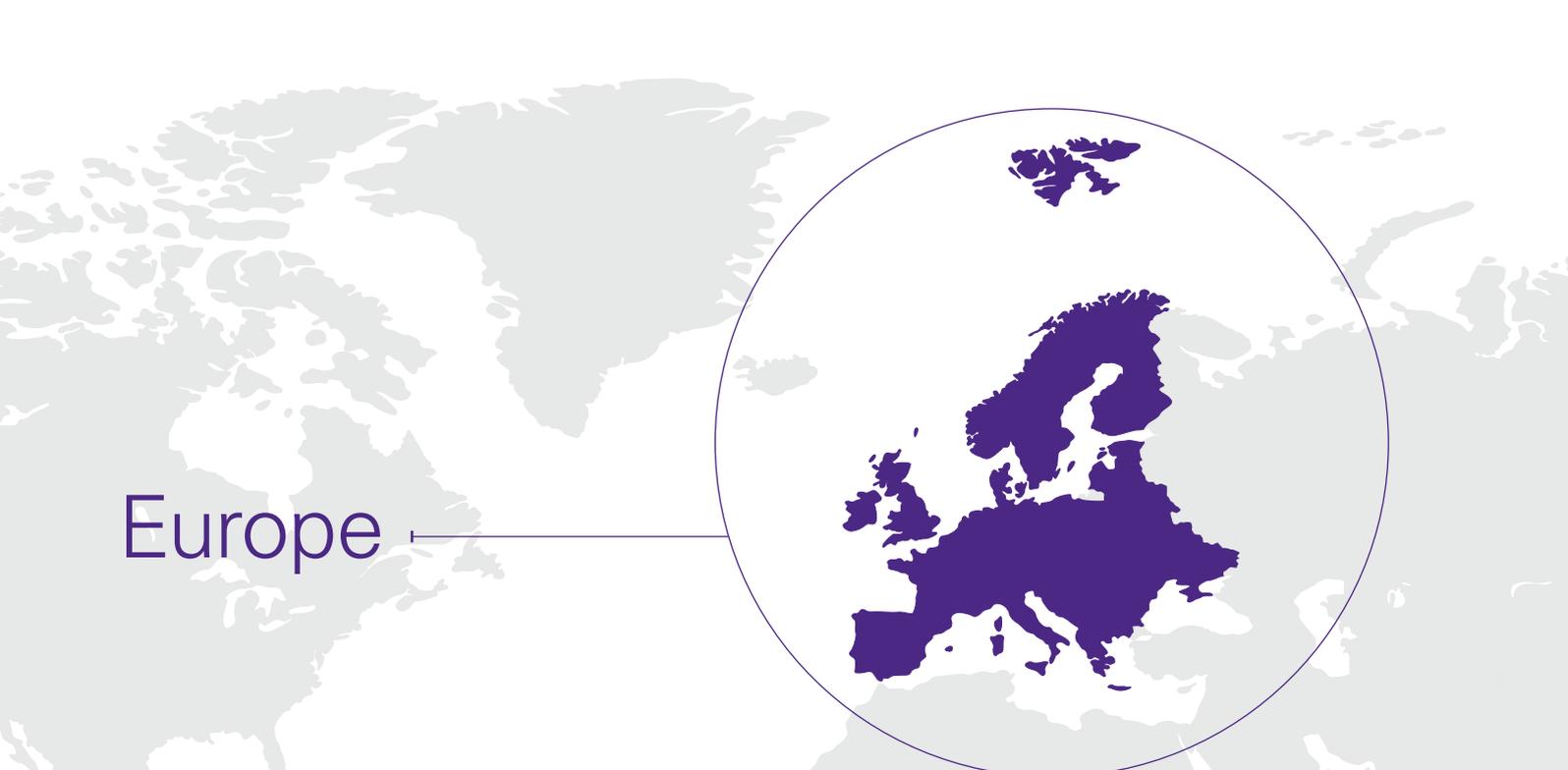
Stephen Bates
Partner, Deal Advisory Financial Services
KPMG in Singapore

Japan

Several factors have come together to further accelerate the number of bank deals, delayed but widened by COVID-19. These include challenged regional banks, partnerships with fintech players, historically low sector valuations and support from Japan's Financial Services Agency (FSA). The immediate impact of COVID-19 on the banking sector is an increasing need for liquidity to support both the corporate and retail sectors, possibly resulting in temporary softening of FSA stances, while accumulated damages to bank sectors' balance sheets would deepen and widen consolidation moves in the medium term. Outbound investments may continue, mainly into Asian banks and non-banks together with strong interest in the US regional banks by major Japanese players, seeking US dollar funding capability, although intervened or delayed to some extent by COVID-19. A key priority for the banking sector is to develop a sustainable business model.

Southeast Asia

Though dependent on foreign ownership restrictions, several regional Asian banks are looking to grow their presence by helping consolidate Indonesia's banks and injecting new capital into Vietnam and Myanmar. Some international banks continue to exit minority and strategic stakes in banks across the region, offering opportunities for deals. The Monetary Authority of Singapore (MAS) plans to issue up to five virtual banking licenses to Singapore-headquartered companies, which could spur collaboration/joint ventures to meet capital requirements and further boost interest in regional challenger-banking. Thai banks, which have been increasingly active in regional deals, are increasingly cautious in the wake of uncertainties in the export, tourism and real estate markets. Investments in fintech and digitization are being prioritized and are expected to accelerate and may be supplemented with opportunistic purchases in consumer finance. Given the heavy reliance on the hospitality sector in Indonesia, stress in some banks could emerge later in 2020. Domestic banking consolidation remains key in Indonesia with in-country transactions dominating the deal landscape due to a large number of smaller regional banks. In Malaysia, further medium-term industry consolidation is expected as the number of local banks have reduced from the current 10 players. COVID-19 has delayed the digital banking license process in Malaysia. However, the competitive landscape is still expected to expand.



Europe

Western European deal volume is likely to suffer reflecting a fall in confidence and economic activity associated with COVID-19. M&A activity in Central & Eastern Europe may experience a slowdown as regulators appear reluctant to approve transactions.

The UK

In the UK, economic uncertainty associated with the fallout of COVID-19 will replace election uncertainty and Brexit uncertainty as key factors dampening deal volume. There will, however, be opportunities for deals, in particular amongst fintech and non-bank lenders where the market may see distressed assets. In the fintech market, reduction in valuations for recent entrants may increase the level of interest from incumbent banks, who see an opportunity to acquire technology and customer bases to enhance their proposition. Meanwhile, the pressures that have pushed towards consolidation within the mid-tier banks — in particular reduced profitability in mortgage lending — as a result of the combination of ring-fencing rules creating excess liquidity and low swap rates will not disappear. Once COVID-19-related uncertainty dissipates, sector consolidation opportunities will return.

Central & Eastern Europe

The CEE banking sector outlook has turned negative due to COVID-19. Banks' profitability may be impacted while liquidity is unlikely to come under pressure as buffers are substantial. Large banks in the region are less vulnerable as compared to small lenders and microfinance companies. A slowdown in new lending, higher-risk costs, margin pressure from lower interest rates and exchange rate fluctuations (in some jurisdictions) is expected to adversely impact the profitability of traditional incumbents. Several large banks are also likely to record a slowdown in their progress in resolving legacy asset quality issues. The deal environment will likely be subdued during the next six months and a decline in volume of transactions is expected across all countries in the region. Reputable players with a non-strategic position planning exit are expected to temporarily pause their plans.

Currently, prospective buyers have great difficulties pricing assets; hence deals are halted as long as the impact of COVID-19 becomes clearer. The completion of already signed deals has become a challenge as buyers are focusing more on capital preservation and regulators are appearing reluctant to approve transactions in the current climate. Fintechs are likely to face funding issues, too, yet players in non-lending areas such as payments, e-commerce and compliance are expected to see a surge in product demand as clients go deep on digital.

Western Europe

— **Luxembourg:** Banking groups with private bank subsidiaries whose assets under management fall below critical mass are accelerating their exit. The consolidation of Luxembourg private banking is therefore likely to continue in the foreseeable future. Regulations, digitalization and compliance have indeed escalated the cost to operate for banks with assets under management of less than 10 billion euros (EUR). Regulators and central banks from these groups' home countries have sometimes added further pressures on boards to dispose of activities unrelated



For the second time in 10 years European lenders will undergo a profound stress and, as before, this will create M&A opportunities for growth, consolidation and distress combined with the need for accelerated digital transformation and the necessary but market-distorting effects of government intention. //

Jeremy Welch

Partner, Deal Advisory Financial Services, KPMG in the UK

core retail banking operations. Luxembourg regulators also favor a higher concentration and merger of smaller private banking operations into larger competitors. More generally, private banks are refocusing their own businesses to serve high/ultra-high net worth individuals, which imply a restructuring of traditional relationship management models to more sophisticated/higher value-added platforms where teamwork with estate planners, asset allocators, tax specialists and private bankers offer higher value-added solutions to demanding clients. Among fund administration and custody banks, there has not been a wave of M&A yet, however these banks currently seek to reinforce their competitive advantage depending on their operating model.

- **Italy:** COVID-19 and a potential economic recession may make banks take strengthened capital positions to face a potential second wave of NPEs and associated risk costs. Within this context, the consolidation of mid-size ‘Popolari’ banks, especially in the center/south of the country, is expected. In June 2020, the European Commission has given its green light to the EUR1.6 billion capital increase for Banca Popolare di Bari, which was put under extraordinary administration by the Italian regulatory authority at the end of 2019. The capital increase, expected to be finalized in mid-2020, will be financed by state-owned Banca del Mezzogiorno-Mediocredito Centrale (MCC) and by the Italian Deposit Guarantee Fund. When looking at large-sized players, in late February 2020, Intesa Sanpaolo, the largest Italian banking group by market capitalization, made an unsolicited EUR4.9 billion public exchange offer for its smaller peer (i.e., the third largest group in Italy), approved by the ECB in June 2020, triggering expectation for further consolidation. Specialty finance challenger-banks are the new model, with a strong potential for superior performance. This new banking model may have the opportunity to acquire market share in the lending space given the new social and economic environment.
- **France:** The consolidation seems to be in its final stages with French banks showing little sign of significant deal activity (apart from HSBC France announcing plans to execute a massive restructure, which is now threatened by the post COVID-19 environment). Despite the stable capital solvency ratio, banks need strong capital positions (especially as they would have to cope with increasing cost of risk post COVID-19), necessitating an exit from some unprofitable businesses, along with cost cutting — particularly branch reduction, all of which may offer some M&A opportunities. As banks strive to become more ‘asset light’, they may need to sell non-core businesses.
- **Germany:** Early measures adopted by the German government to deal with the virus might have lessened the overall impact, yet banks still face performance pressures, specifically around profitability. In recent months, a large number of German banks have been charging negative interest rates to large deposit accounts above EUR100,000 and new customers. Additionally due to increasing liquidity constraints in the corporate sector, banks are able to request higher margins for their loans while simultaneously demand for state-guaranteed loans among SMEs is also increasing. German banks are therefore being challenged to complete quick loans assessments of these companies to meet demand. Moreover, German banks still participate with 20–30 percent on these loan exposures, putting pressure on them to expedite loan applications and inject necessary liquidity into the economy. Banks therefore are being forced to safeguard reputational and future credit risk at the same time. In terms of deal activity, it’s too early to evaluate the full impact of COVID-19. Some activities by financial institutions may focus on restructuring, cost-cutting and efficiency improvements through digitization. Disposals would be dependent on whether low-priced assets match sellers’ expectations and how hard the financial sector will be hit by rising loan losses in the second half of 2020 and early 2021. Distressed situations could force existing shareholders into mergers or dispose financial assets despite lower prices. On the buy side, interest from financial sponsors is increasing for asset-light financial service businesses, but also for initial distressed situations. However, the number of attractive assets is still limited.
- **Spain:** The consolidation of former savings banks is expected while capital-generating transactions could be an initial step toward bank mergers.
- **Switzerland:** There is a continued need for consolidation, as several private banks are performing below par and struggling to significantly improve. This may be accelerated by COVID-19. The retail banking sector looks stable, however negative interest rates and shrinking margins in the mortgage business could have an adverse impact on long-term performance, opening up deal opportunities. The impact of COVID-19 on the real estate market and on SMEs may still lead to credit losses in some retail banks. Any impact however is expected to be minimal.



Americas

The US domestic market is likely to see continued near-term M&A activity. Canadian banks could be expected to focus on loan management and capital preservation although targeted complementary acquisitions (including further tech-proofing their operations) remain a possibility. In Latin America, the impact of COVID-19 is still unclear, and capital market reduction will likely delay anticipated transactions.

The US

COVID-19 market disruption will likely create distress among many financial services players — particularly those with exposure to the energy, travel and hospitality, and commercial real estate sectors. These conditions might create opportunities for well-capitalized institutions looking to increase scale or move into new markets. The November 2020 election might create additional market uncertainty and a decrease in M&A in banking as players wait to see in which direction the regulatory wind will be blowing. On balance, payment processors, data providers, and wealth management firms that have been catalysts for inter-industry consolidation and have sparked increased interest from PE firms, which could continue to see at or above market deal activity for the rest of the year after the COVID-19 market shutdown ends.

Canada

Organic growth would be hard to come by during 2020. Banks are focused on supporting clients in a, so far, concerted manner, and on loan management and capital preservation. COVID-19 in certain instances, caused a review and tech-proofing of their operations (which is expected to continue). These dynamics could lead to investments in tech (whether internally or through external fintech investments) that would position banks to face the future, compounding the pressures to be exercised as open banking is being focused by the government. Furthermore, banks could be expected to continue their review of existing operations, leading to sustained pruning of divisions/assets, if deemed non-core or sub-optimal in terms of scale, profitability or growth prospects. That said, selective buy-side M&A is anticipated, albeit with challenges, especially for assets that complement existing lines of businesses. Canadian banks are likely to first consider relevant acquisition targets that reinforce their domestic presence,



COVID-19 has significantly slowed down current banking deal activity. When the market is able to emerge from the lockdown, we expect there will be distressed deal opportunities for highly capitalized players. Other sectors (fintech and wealth management) will likely stay strong until September or October at which point, they may slow down as well. //

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primarily focusing on domestic (and, as relevant, international) wealth and asset management, building up existing operations in non-Canadian core markets (US and certain Latin American countries).

Latin America

The main economy in the region, Brazil, experienced record M&A activity in 2019. Banks continue to pursue acquisitions of fintechs and digital offerings, while PE and VC investors remain active in the region. International banks are looking to invest in asset management, investment banking and other high-net-worth-focused products. In Argentina, following the 2018–19 crisis, a significant slowdown of economic activity is expected in 2020; nonetheless, some activity in fintech investment and digital banking is anticipated. Chile's social unrest has impacted activity, which, unlike last year, is set to be lower. The overall regional impact of COVID-19 is still unclear, with some analysts predicting a slowdown in some countries. Banks and PE are still well-capitalized and looking for M&A opportunities, yet the timing of these transactions remains unclear. Capital market reduction could impact the timing of some of the anticipated transactions, delaying activities until 2021.

Key deal drivers under the lens

Impact of key drivers on global banking transactions in H2 2020

Top 3 picks for H2 2020:



Fintech to roar

- Fifty-six percent of key markets expect fintech startups to have either a steady or strong impact: fintech the most prominent driver in H2 2020.
- India, Indonesia, South Africa and Chile are markets to watch.

Regulators eyeing deals

- Forty-eight percent of key markets expect either a steady or strong impact by regulatory agencies/bodies.
- China, India, Australia, Indonesia, Italy, and Luxembourg are markets to watch.

NPL markets in full swing

- Non-performing loan portfolio sales to foster in H2 2020. Thirty-six percent of key markets expect either a steady or strong impact by NPLs.
- China, Japan, India, Singapore, Thailand, Italy and Chile are markets to watch.

Key drivers analysis

Region	Country	PE impact	Fintech impact	NPL impact	Regulatory impact
ASPAC	Australia	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	China	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	India	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Indonesia	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Japan	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Malaysia	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Singapore	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Thailand	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
Europe	CEE	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	France	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Germany	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Italy	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Luxembourg	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Netherlands	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Poland	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Russia	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Spain	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Switzerland	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	UK	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
Africa	South Africa	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
Americas	Argentina	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Brazil	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Canada	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	Chile	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
	US	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■



Source: KPMG analysis

Key deal drivers under the lens



Fintech

COVID-19 has become an accelerator for all business models focusing on digitalization, therefore, it can be assumed that fintechs with a proven and sustainable business model and strong capital levels will survive COVID-19 or even emerge from it stronger. On the other hand, fintechs with high burn-rates who have yet to achieve reasonable levels of revenue could be severely challenged, depending on the duration of COVID-19 and investor patience. At an aggregate level, while we are likely to see a reduction in overall investment as a result of COVID-19, larger M&A deals could take place as incumbents and investors recognize the need to accelerate digital transformation. Some high-end M&A transactions are taking place, instigated by incumbent banks and scaled fintech (which are aiming at expanding into other markets). Furthermore, technology companies are seizing opportunities that have emerged during COVID-19.



Regulations

Before COVID-19, the regulatory attitude had softened toward bank M&A. For instance, in Asia Pacific, new policies and incentives sped up consolidation with governments actively promoting the entry of tech-based firms and fintechs which introduced greater innovation and competition. In Europe, some policymakers are favoring consolidation to establish regionally dominant players and accelerate the Eurozone banking union. However, divisions remained between local regulators, politicians and the ECB's Single Supervisory Mechanism. In America and specifically with US revisions to Dodd-Frank — through the Economic Growth, Regulatory Relief and Consumer Protection Act (aka the Crapo Bill) — attempts were made to ease compliance burdens faced by the US financial institutions. For financial regulators, however, the early part of 2020 has been overshadowed by COVID-19. Work plans and timelines required reprioritization as regulators reacted to the extraordinary pressures confronting markets, firms and consumers. Some regulatory bodies have suspended or decelerated approval processes and have even adjusted timelines for merger review procedures. Moreover, the resulting backlog of transactions may cause delays in obtaining regulatory clearances for new proposals. Banks with strong levels of capitalization and liquidity may see loosening, rather than tightening, of regulatory requirements. In addition, asset quality deterioration is expected, however government stimulus and regulatory relaxations may help banks to manage NPLs and credit costs.



COVID-19 will be a catalyst for greater digitization of the banking and finance industry as we expect a permanent shift from customers to digital services and channels. We predict M&A activity to rise as incumbents make larger strategic investments and pursue bolder M&A deals to accelerate their transformation efforts. //

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Private equity

In Asia Pacific, PE and sovereign wealth funds are taking predominantly minority stakes in banks, largely due to foreign direct investment restrictions. These investments seek to recapitalize banks to support continued lending growth (+20 percent a year), driven by growing middle-class consumers, real estate lending and infrastructure development. As funds assess the immediate impacts of COVID-19 on their portfolio companies and with significant dry powder to deploy as the situation stabilizes, PE players are expected to continue to target growth banks, platform-driven digital banks, non-banking financial institutions and insurance brokerages.

In Europe, PE continues to show significant interest and has surplus dry powder and expertise to invest across the financial services spectrum. There is continued interest across a range of sectors including digital lending platforms, capital markets infrastructure, insurance distribution, and wealth management. As the economic cycle turns, PE attention is likely to refocus on the NPL markets, and opportunities to purchase portfolios from both bank and non-bank lenders.

Before COVID-19, PE's direct investment in North American banking remained at modest levels, focused on underserved niche areas like subprime and small business lending. Direct investment in depository institutions was negligible, amid benign credit market conditions. However, current market dislocation presents opportunities for private investors in liquidity constrained areas of the market, such as mortgage, small business and consumer lending. In the medium-term, the post-COVID-19 recession may present a need and opportunity to recapitalize medium-sized financial institutions most affected by the likely substantial resulting credit losses. Other areas of interest like wealth management and related wealth management technology; benefits and fund administration; and insurance distribution and services may see declining activity, notably as companies experience drops in revenue and profits and sellers would like to wait for more benign conditions before examining an exit.



Loan portfolio sales

In Europe, COVID-19 is slowing down non-performing loan portfolio sales. The first quarter of 2020 (with a total volume of loan sales of EUR3.8 billion) saw the least activity since 2015. Before the market stopped, some deals managed to close with the only activity in Spain, Italy and Cyprus. On paper, a large amount of portfolios (around EUR80 billion of loans) are still on the market. As consequence of COVID-19, the default rates are expected to increase in the coming years (with a time lag effect). The macroeconomic context could foster long-term non-performing loan portfolio sales in mature markets (Italy and Spain). In Italy, in the third quarter of 2020, a strong acceleration of NPLs disposals driven by the opportunity to convert the Deferred Tax Assets in tax credits could take place. In this context, it is possible to see increased emphasis on Southern Europe (in particular, Greece and Cyprus) and a low level of activity in the new jurisdictions (Turkey and Ukraine) due to high volatility. While the interest in unsecured portfolios, secured corporates/SMEs, RE (real estate) would remain, granular secured deals, real estate-owned (REO) rented portfolios, re-performing and unlikely-to-pay (UTP) loans are likely to capture more interest.

In Asia Pacific, NPL markets remain active in China and most Asian countries. Given the economic impacts of COVID-19, more liquidity and prudent risk management could lead to a rise in buy and sell transactions. Banks are disposing off both corporate and retail loans, and the region has many asset management companies (AMCs), corporate investors and distressed (special situations) funds to invest into. Recently, there have been cases where strategic investors from various industries acquired strategic assets from NPL pools. With COVID-19, an increase in NPLs and default situations is reasonably expected, especially from those vulnerable sectors such as aviation, hotel, retail and real estate across the whole region. Consequently, we expect that this would pave the way for distress investors looking to buy at deep discounts. Moreover, as a global scenario takes strides toward economic improvement, the recently released US-China trade agreement could give new hope, allowing more American investors to invest into China NPL markets and asset management companies.

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Methodology

Data

The information presented in the report is an analysis of announced deals in the banking sector in 2019, accessed in January 2020. The data has been sourced from Thomson, where the target company belongs to any of the following sectors: all forms of banking — commercial, private, investment, retail, corporate; payment services; credit institutions; brokerage firms/houses; diversified financials/conglomerates; business support services. There are certain adjustments made to the data to select only relevant data from the mentioned sub-sectors and exclude transactions of debt restructuring, buyback, repurchases and exchange offers. Certain sub-sectors such as accounting, auditing, bookkeeping services, and miscellaneous intermediation have been excluded. The analysis is conducted on M&A transactions including deal status of completed, pending and pending regulatory. Additionally, data is continuously updated and is therefore subject to change. It may not exactly replicate the last year numbers as there are continuous additions that have been made in the back end from database.

Survey

An internal KPMG survey was conducted with Deal Advisory (DA) banking leads of approximately 24 countries including CEE as a region. The survey covered three aspects — expected trends in banking deal environment, drivers' impact (PE, fintech, NPL and regulations) on deal activity and a quote highlighting the banking M&A outlook for H2 2020. The expected banking M&A growth rate (%) and the expected impact of key drivers (%) on banking deal environment for each country has been provided by the respective KPMG DA banking leads.

Country and regional information

All country and regional level analysis is based on the survey inputs. This has been well supported by deal analysis from Thomson and secondary research from multiple sources.

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