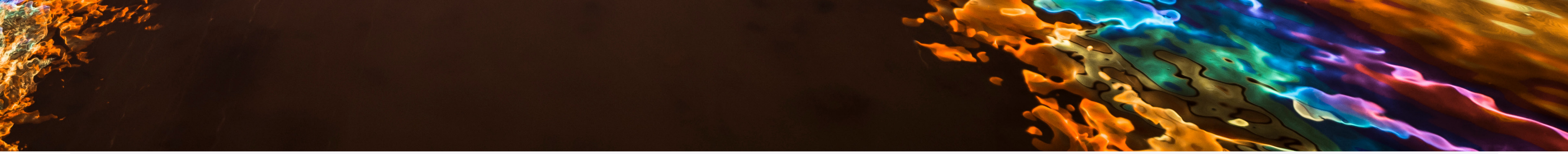
# The Navigator: perspectives on financial services M&A

Issue 3

EY

Building a better working world



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# Financial institutions are building competitive advantage through M&A.

## In brief

- The market continues to be challenging for financial services M&A, but there are reasons to be optimistic about 2024.
- Generative AI (GenAI) is here, and financial institutions recognize that they must act today to avoid giving competitors a strategic advantage.
- Private equity (PE) will become more active in the M&A market in 2024 as the outlook for monetary policy becomes clearer.

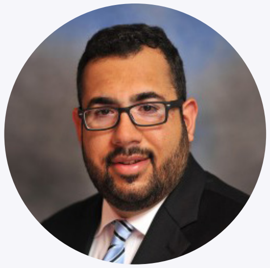
The financial services M&A market is still choppy, and opinions diverge on whether the US economy will experience a soft or hard landing. But for every challenge facing financial institutions (FIs), there is a corresponding opportunity. The market disruption stemming from the banking crisis this spring resulted in a few large tactical transactions, boosting M&A activity in 2023. However, this should not be seen as a signal that the financial services M&A market has rebounded.

For many FIs, their short-term attention has focused on navigating economic uncertainties and implementing strategies to preserve capital. More recently, conversations I've had with forward-thinking FIs have centered on where they need to invest today to be one step ahead of their competitors tomorrow. From an M&A perspective, this means translating their roadmap into tactical and strategic opportunities on the buy-side and the sell-side to drive long-term value creation.

As FIs become more adept at coping with macroeconomic uncertainty, the outlook and sentiment for financial services M&A is starting to improve. Here are some deal trends that we expect to see in 2024:

- FIs returning to M&A. According to the most recent CEO Outlook Pulse Survey, 90% of financial services CEOs are planning to engage in M&A over the coming year, and 72% intend to increase their investments in acquisitions.
- PE firms, sitting on significant capital, have started to come off the sidelines and are looking at more deals. High-quality assets that have come to market have sold quickly in competitive processes, and through 2024 we should start seeing PE lean more into the M&A market.
- GenAI is reaching a level of maturity where it can be leveraged at scale. The CEO Outlook Pulse Survey found 69% of financial services CEOs believe their organizations must act today on GenAI to avoid giving competitors a strategic advantage. FIs have an opportunity to harness the power of GenAI across their business. GenAI is only as smart as the data it has access to, so while FIs will partner with large tech for their GenAI infrastructure, there is an opportunity to use M&A to add, and enhance, their existing data.
- Divestments have a dual purpose. On the one hand, they can be used as a short-term tactical measure to support capital preservation. On the other hand, they can usher in transformational change. The CEO Outlook Pulse Survey found 51% of financial services CEOs were looking to actively pursue divestments over the next 12 months. FIs across banking, insurance, and wealth and asset management are facing fundamental shifts in their business models. This will drive another round of robust divestment activity, potentially including large, transformational carve-out deals.

In this issue, we take a closer look at what to expect with GenAI in retail banking and whether PE firms can achieve the ultimate prize in the wealth management advice space, offering white-glove services at scale.



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# GenAI: reimagining retail banking

## Banks must seek innovative use cases and overcome challenges posed by GenAI.

Of all the financial services M&A trends that we predicted in our first issue of *The Navigator*, the one that is most relevant to retail banks in this quickly evolving GenAI era is partnering.

In the EY-Parthenon Q2 2023 Generative AI in Retail and Commercial Banking Survey, decision-makers said they believe GenAI will enhance profitability and efficiency, with benefits including higher levels of tailored products and services and improved operational speed. But they are also worried about:

- Lack of internal expertise
- Regulatory ambiguity and volatility
- Cost and budget constraints
- Data privacy and security
- Accuracy and reliability

To stay relevant, banks will need to overcome these challenges and reimagine their future with GenAI.

## What to watch for

**Identifying optimal GenAI applications amid case noise**

Most decision-makers reported approaching GenAI in the same way as legacy automation capabilities, which will lead to missed opportunities. Survey respondents expressed apprehension about the viability of GenAI in the front office, and 67% said they are waiting for further developments and testing before prioritizing front-office use cases. Instead, enhancements are concentrated in the back office, with risk and operations projected to capture the largest efficiencies. By focusing on back-office priorities, banks risk losing out on strategic opportunities for new products, new markets and market differentiation.

To help identify optimal GenAI applications, banks should review the lessons learned from blockchain, where many wound up funding poor use cases. Given the high costs and challenges of GenAI, banks need to assess whether GenAI, legacy technology or a combination is the right solution.

### Establishing infrastructure and tech talent

Only 32% of survey respondents reported having a team focused solely on GenAI. Thirty-seven percent do not have confidence in their institution's technological infrastructure – which in banking tends to be outdated and heavily customized – or in their tech staff's capabilities to implement GenAI use cases. Banks will have to make investing in infrastructure and talent a top priority or risk getting left behind.

### Leveraging acquisitions, partnerships and ecosystems

Given the novelty of GenAI and in-house technology limits, 51% of respondents surveyed preferred partnerships as their go-to-market approach. To deliver new capabilities to market and transform their business models, banks should explore pursuing acquisitions or building partnerships and ecosystems with GenAI technology providers. Developing an ecosystem has the added benefit of outside-in perspectives that can uncover lagging practices, guide investments and facilitate successful implementation.

### Novel risks and challenges of GenAI

When exploring investment opportunities (i.e., targets) in the GenAI space or to bolster GenAI capabilities internally, more parallels can be drawn from blockchain, such as how the absence of regulatory clarity and risk management became the culprit for investment losses. Evolving technology can lead to additional risks. For GenAI, this includes, but is not limited to:

- Intellectual property (IP) (ownership of IP rights, potential infringements and ongoing litigation)
- Data quality, privacy and security (scrutinizing data acquisition methods, privacy compliance and security measures)
- Regulatory environment (compliance with fast-evolving regulatory requirements)

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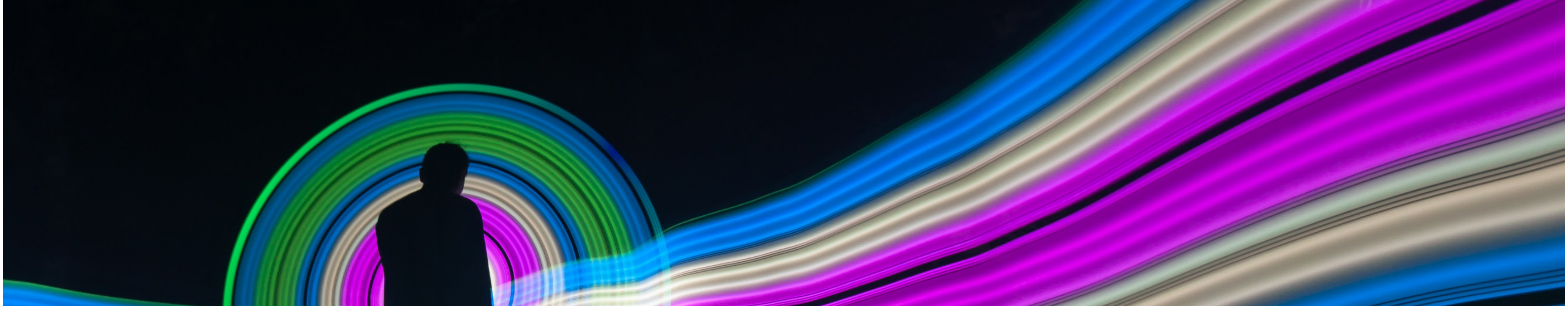

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# Wealth management: opportunity for disruption

## How PE could transform wealth management

In the wealth management advice space, we continue to hear about two goals:

- Expanding white-glove services
- Scaling to cater to the masses

At face value, these two goals are in conflict. By offering key white-glove services, the scale element remains elusive. On the other hand, scaling an offering makes it difficult to bolt on adjacent catered services. For the innovator who can square this circle, the upside is enormous, given the looming transfer of wealth from boomers to their Gen X and millennial children. But disrupting this space is no easy task.

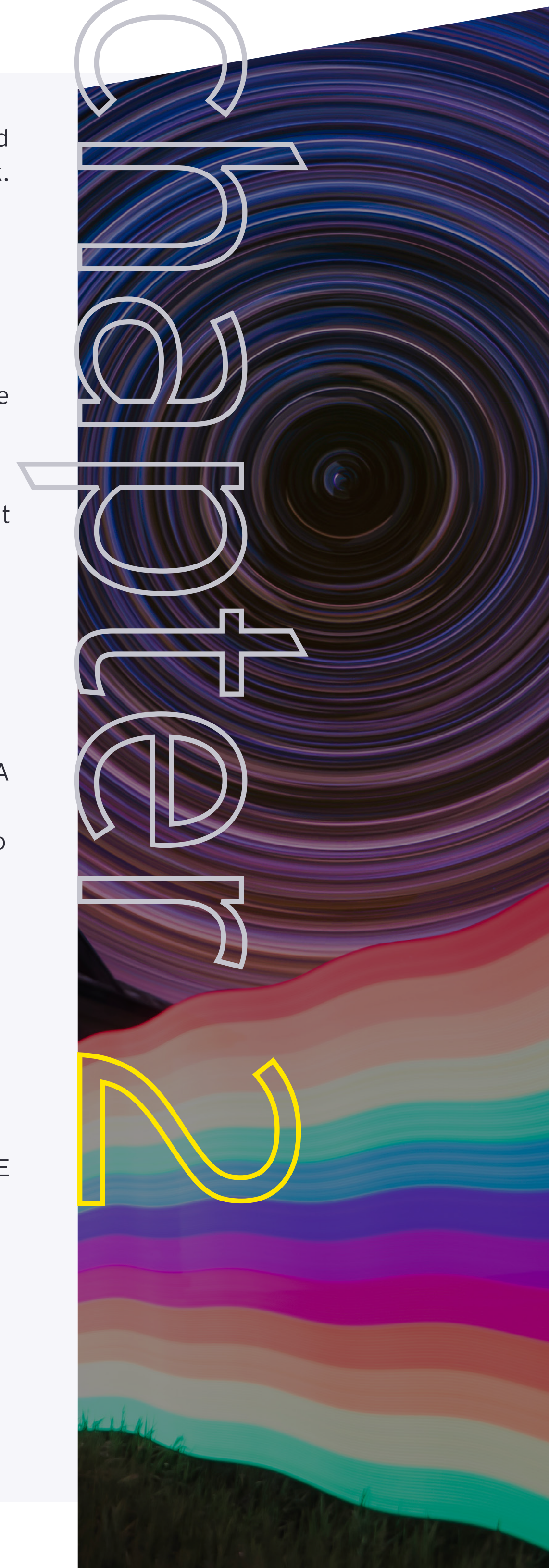
Five years ago, registered investment advisors (RIAs) worried that robo-advisors would be a game changer, only to discover that most clients prefer to entrust their financial assets to a human advisor. Clients continue to look for the personal connection that no robo-advisor can currently provide. While robo-advisory offered up one of the aspirational goals – scale – it wasn't enough to disrupt.

So who can actually provide white-glove service at scale? We believe PE firms, with their existing M&A and investment model, are in the best position to reach this apex.

Their M&A and investment model allow PE firms to invest in several RIAs at once, in a range of areas that include tax planning, estate planning and GenAI. This creates an attractive package of advisors, distribution channels and key white-glove services, all in the same portfolio. Over the last five years, more than 150 PE firms have invested in RIA portfolio companies, according to EY analysis. Of these, 33 have crossover in at least five other wealth service portfolio companies.

For independent RIAs, PE portcos have the advantage of value creation. They can help RIAs improve their pricing and upscale their distribution channels. And they can recommend bolt-on M&A and partnership opportunities to further expand into white-glove services. Meanwhile, many independent RIAs are feeling the burden of overhead costs in technology, human resources and strategic planning, leading them to seek out investments and guidance from PE firms.

We have yet to see a PE firm pursue white-glove service at scale as a holistic wealth management strategy. But we predict the one that does will upend legacy advisory services and will be poised to take full advantage of the coming generational wealth transfer.



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# Summary

***The Navigator:*** *perspectives on financial services M&A* is a series providing insights on trends in the deal environment and how they are impacting business.