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Craving fee income, more banks pursue nonbank acquisitions

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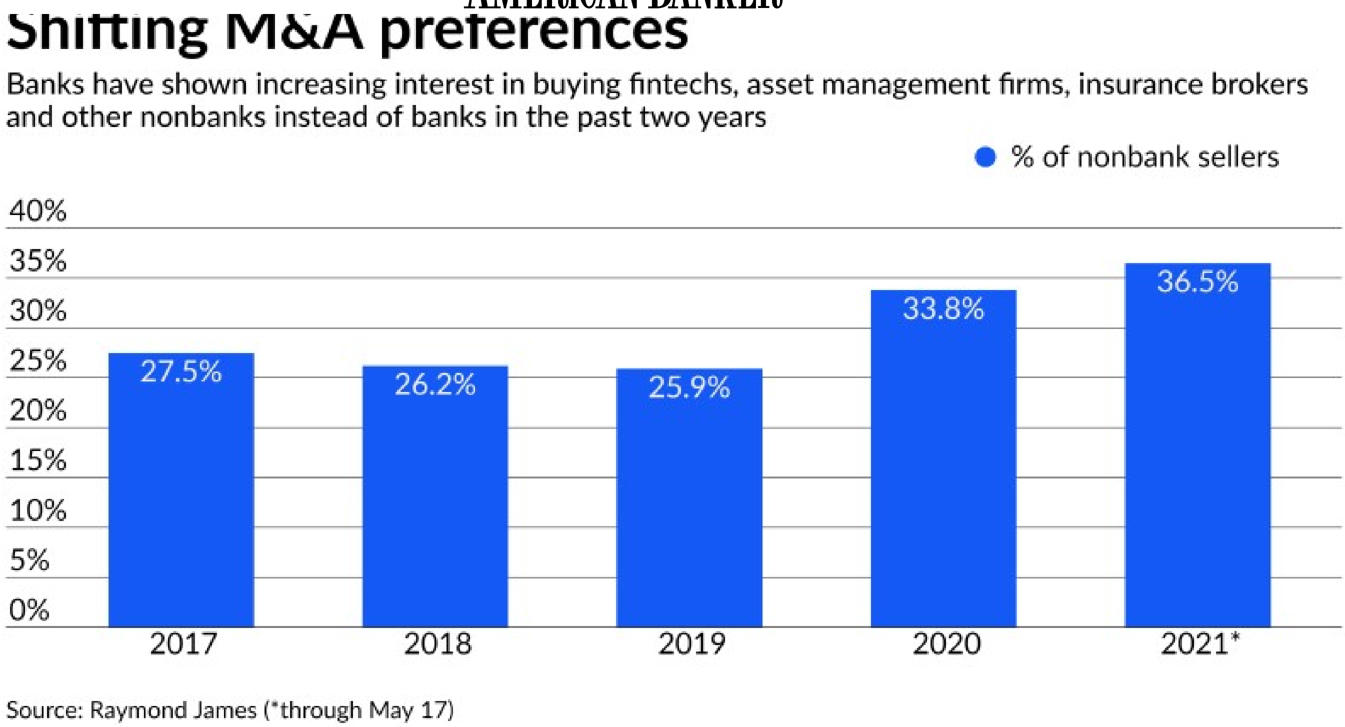
More banks are pursuing nonbank acquisitions as they hunt for new sources of income at a time when rock-bottom interest rates are suppressing revenue from lending.

Though traditional merger-and-acquisition activity has picked up of late, some banks are steering clear of buying other banks, instead eyeing deals for asset managers, insurance firms and other businesses that generate the bulk of their income from fees. United Community Banks in Blairsville, Georgia, for example, this month agreed to buy FinTrust Capital Partners, an investment advisor in Greenville, South Carolina, in a deal that will more than double its assets under management.

These types of acquisitions are not new, but banks are clearly interested in doing more of them in an effort to boost profits.

"Coming out of this pandemic, banks need income diversity," said Michael Jameson, a principal at Jameson Associates in Scottsville, N.Y. "Banks are looking hard at all ways to generate earnings, certainly including non-bank deals."



The yields that banks generate on loans have remained stubbornly low since the Federal Reserve drove its benchmark rate to near zero to help steady the economy at the onset of the coronavirus pandemic last year. With the Fed expected to keep rates low into next year, more banks are looking to build up fee-based businesses to offset the rate headwinds. Acquisitions are becoming an ever more important route to that end, notes Raymond James analyst David Feaster.

"The challenging rate backdrop…has significantly impacted spread revenues, leaving fee income lines as increasingly important," Feaster said.

When it comes to M&A, banks traditionally focus on buying out other banks. A Raymond James analysis showed that, in 2019, just 26% of acquisitions made by banks were of insurers, wealth firms, financial technology companies and other nonbanks. Last year, though, that figure climbed to 34%, and so far this year, nearly 37% of banks' announced acquisitions were for nonbank firms.

The $18.6 billion-asset United Community has been methodically building its investment advisory business and its deal for FinTrust will accelerate the unit's growth by adding $2 billion of new assets under management.

The $5.9 billion-asset Triumph Bancorp in Dallas said in April it would pay $97 million in cashfor HubTran, which offers automation software for back-office functions. The deal, expected to close in the second quarter, continues Triumph's efforts to create a fully integrated payments network for the transportation sector, one that could open a steady stream of fee income.

Also in April, Axos Financial in Las Vegas said it would buy E-Trade Advisor Services from Morgan Stanley. The parent of the $14.4 billion-asset Axos Bank is paying $55 million in cash for the registered investment adviser custody business. The deal, expected to close in the third quarter, would give the buyer

"Adding a flexible technology platform and an experienced relationship management and operations team dramatically accelerates our time to scale and credibility in this business," Greg Garrabrants, Axos Financial's president and CEO, said during a call with analysts after announcing the deal in late April.

Axos plans to add cryptocurrency trading and other fee-based services to further broaden its revenue streams.

"By operating a diversified set of lending, funding and fee-based businesses across our consumer bank, commercial bank, securities and investment subsidiaries…we are better positioned than most to maintain consistent profitable growth, irrespective of economic, regulatory and competitive changes," Garrabrants said.

Laurie Stewart, the president and CEO of the $937 million-asset Sound Financial Bancorp in Seattle, said investors should expect banks, including potentially hers, to pursue nonbank deals.

"We're awash in deposits and loan demand is still pretty modest," Stewart said. "It's hard to put those deposits to work. With rates still so low, that makes it pretty tough on margins."

She said that nonbank deals would not supplant traditional M&A but rather become an increasingly important complement to what is expected to be an active year for consolidation.

In fact, U.S. bank M&A jumped in April, with 19 announced deals, according to S&P Global. That marked the highest number of announced deals in a month since January 2020.

From the start of the year through mid-May, there were at least 54 announced deals involving banks buying out other banks or thrifts in 2021. In the same stretch, meanwhile, there were at least 31 nonbank deals announced.

While total deal volume remains light relative to before the pandemic, as a share of the total bank M&A pie, Raymond James said nonbank targets are on pace in 2021 to account for a greater percentage than in any other year in the past decade.

"We're all looking for new sources of revenue, looking under every rock for new earning assets," Stewart said. "This is a reflection of that."

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