Four Reasons CFIs Are Acquiring Nonbanks

by Steve Brown cross-sell fintechs digital banking

Summary: Community financial institutions are buying nonbanks more than ever. With the global fintech market growing to $143B this year and several financial advisors looking to sell, there is a rich field to choose from. We explore some of the reasons your peers are purchasing nonbanks and what to look out for, if you consider going down this path as well.

Itching can be caused by many things, including rashes, bug bites, and food or medication allergies. The Mayo Clinic says if the itching lasts longer than six weeks, it is considered chronic and can lead to infection, scarring, and affect your quality of life. Remember to keep calamine lotion handy!

Luckily for community financial institutions (CFIs), many nonbanks are itching to sell these days, including fintechs and wealth management firms. It is a hot market right now. M&A activity between financial institutions and fintechs is expected to escalate, as the number of fintechs continues to skyrocket. The entire global fintech market is projected to grow from $143B in 2021 to $188B in 2024, according to Credit Suisse, Deloitte, and Mordor Intelligence.

What's more, it's not just fintechs willing to sell. The number of financial advisors now wanting to exit the firms they founded because of the pandemic has risen fivefold from pre-pandemic days. As one consultant said, "*This is not going to slow down – it is only going to accelerate from here.*"

Four reasons CFIs are buying nonbanks, for your consideration, as you plan for your institution's future growth.

1. **Diversification of fee income.** Just as CFIs need to diversify their loan portfolios, fee income should be diversified too. If certain business lines become less profitable as fees decrease (such as overdraft fees), fee income from nonbank products and services can fill those gaps. Not only that, but there may also be some fees that customers are more willing to pay than others. Having a wider variety of fees allows you the flexibility to manage that more easily. As one attorney noted, "*With net interest margins so low, most community banks are looking for other avenues to increase profits.*"
2. **Taking control of innovation.** A $1B-asset Midwestern CFI acquired a fintech, not only for its automated savings tool, but also to boost the CFI's technology capabilities to launch its own cutting-edge products and services. "*We had done as much as we could with our current vendor set of technology and realized that we needed some fintech help if we wanted to take our technology to the next level,*" the CIO says. "*The acquisition of the fintech puts us in control of our own destiny technology-wise and moves us closer to our goal of technological autonomy.*" With banking customers more digital-savvy than ever, this could be a good way to stay ahead of the technology curve for the long term.
3. **Greater cross-sell opportunities.** To appeal to a larger customer base, having a larger number of offerings can help. Financial institutions have leveraged various complementary offerings of nonbanks to satisfy more diverse customer needs. A regional financial institution recently bought several nonbanks, including two boutique investment banks and an online student lender. The CEO says that the institution will continue acquiring niche businesses that can enhance the product and service menu the institution can offer its targeted client bases. In June 2021, a larger $13B-asset

CFI based in NJ, acquired a data and risk analytics fintech to help further broaden its products and services. With a mission to innovate, this acquisition allows the CFI to now offer end-to-end Software-as-a-Service to its customers.

4. **Greater ROE.** Generating fee income from a nonbank subsidiary is ROE-friendly. If the acquisition is in line with the CFI's strategic plan, it may increase the holding company's access to capital markets, broaden its investment base, and create positive interest for current shareholders. These are all strategic considerations prompting management to seek out the right acquisition opportunity with nonbanks.

Still, careful consideration must be taken with these acquisitions. CFIs should make sure they fully understand the products and services they acquire and that they mesh well with the CFI's business model. As one attorney has said, "This is the biggest mistake I see: forcing an acquisition when a bank really shouldn't be in the business because it doesn't understand it well enough."

Furthermore, additional regulations will likely need to be met. For example, when considering the acquisition of a wealth management firm to operate as a subsidiary of the institution or its holding company, CFIs will need to register as an investment advisor with the SEC or the state, depending on the amount of assets under management.

Several CFIs are finding nonbank acquisition opportunities worthwhile. If you notice yourself considering this as well, ensure that it is in alignment with your strategic goals and do your due diligence. Whether you join your peers in nonbank M&A or not, you now have more information to make this decision.

ECONOMY & RATES

Rates As Of: 08/17/2021 06:10AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.06	0.00	-0.03
6M	0.05	0.00	-0.04
1Y	0.07	0.00	-0.04
2Y	0.22	0.03	0.10
5Y	0.76	0.07	0.40
10Y	1.25	0.02	0.33
30Y	1.91	0.02	0.27

FF Market	FF Disc	IOER (Interest on Excess Reserves)
0.10	0.25	0.15

SOFR	Prime	OBFR (Overnight Bank Funding Rate)
0.05	3.25	0.08