



CANADA'S BANKS PREPARE TO DEAL

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Bankers have long considered the Great White North a wasteland for financial services deals. Under its regulatory law, Canadian deals have been frozen out for fear they would eliminate competition.

That was until June when the Canadian parliament passed C-8, their version of the financial services reform the U.S. Congress passed in 1999. Though the bill was hailed as a counterpart to the U.S. model, its immediate impact may be the establishment of a regulatory framework for big banking deals.

Now, once-dead Canadian transactions may soon come to life. And bankers both north and south of the border are salivating at the prospect.

"It's going to be a springboard for joint ventures, spin-offs and deals that weren't possible in the prior regulatory climate," said Philip A. Panaro, Global Managing Director of the M&A integration consulting practice of IM2 in New York. "Every one of [banks] has planned moves in anticipation of the change."

As Panaro explains, it wasn't so much that the laws were set against the mergers, rather, Canadian law didn't provide for a regulatory review process which formally recognized mergers as a legitimate part of a firm's strategic plans — a oversight that C-8 seeks to improve to allow Canadian Banks a more equal footing with their North American peers.

What's driving the consolidation push? For one, Canadian banks have been shunning certain regulatory doom in Canada and venturing further outside of their own borders to drive profits. PricewaterhouseCoopers estimates that 48% of the profits at the "big six" banks came from subsidiaries outside of Canada. The tightly controlled Canadian market also has kept interest margins on loans low, about half of their U.S counterparts.

As a result, Canadian bank valuations have suffered under the do-nothing regulatory approach. The combined market value for the big six was about \$120 billion before C-8 passed, or about the same as the biggest foreign bank operating in Canada, ING Group NV.

"Not all these service providers are subject to the same degree of regulation as Canada's bank financial groups," the Canadian Bankers Association argued in a report to parliament in March. "The North American financial services market is increasingly converging into one."

Of course, the new regs also open the door to foreign buyers. In June, in anticipation of C-8, Swiss giant UBS AG bought asset manager RT Capital from Royal Bank for \$220 million.

But Panaro, whose clients include four of the big six, cautions that foreign deals will likely take a back seat to the home grown.

"I don't see an explosion. The market culture is very nationalistic and proud," he said.



After all, 50% of working Canadians hold stock in nationally based banks. And the industry itself employs 220,000. Still, U.S. investment banks are likely to have a leading role in shaping Canada's merger scene. Last year, Merrill Lynch & Co., Morgan Stanley, Lazard and Goldman, Sachs & Co. each advised on \$40 billion in mergers or more — nearly double the value of mergers involving RBC Dominion Securities Inc., Canada's leading M&A investment bank, according to Dealogic.

"There's been a huge change, and these banks are chomping at the bit," Panaro said. "They've had active plans for six months to a year before this happened ... now, it's a matter of time."