

European Financial Services M&A Insight

February 2010

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Welcome

to the first edition of European Financial Services M&A Insight for 2010

This quarterly report aims to provide perspectives on the recent trends and future developments in the M&A market, including analysis of the latest transactions and insights into emerging investment opportunities.

Front cover image: The Pont Alexandre III, Paris.



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M&A activity continued to be relatively light in the second half of 2009, though a number of interesting themes are emerging, which are likely to set the scene for 2010. As we anticipated in the previous edition of Insight, divestment of asset management and consumer finance subsidiaries by universal banks continues to gather pace. We are also seeing the increasing use of joint ventures as institutions look for less costly and strategically less risky alternatives to acquisition. (See [‘Data Analysis – restructuring is well underway’](#).)

We believe that British banking is likely to be a key focus of activity, particularly for foreign financial services institutions and especially now that a number of leading groups are to be required to divest a significant proportion of their operations to meet EU competition rules. (See [‘British Banks – back in the sights of foreign investors?’](#).)

The move to Solvency II will force many insurers to re-assess capital efficiency, risk diversification and organisational

structures, the results of which will provide a powerful spur for both divestment and consolidation. (See [‘Waking up to new realities – The impact of Solvency II on strategy and M&A activity in the insurance industry’](#).)

PricewaterhouseCoopers¹ has just completed an online survey of the prospects for M&A, which attracted responses from more than 200 participants from financial services institutions across Europe. The results point to a pick up in the number of major transactions, with nearly three-quarters of respondents expecting large deal activity to increase over the coming year. However, when asked whether M&A can return to the same levels seen in 2006 and 2007 over the next three years, just over half (52%) said no, although a significant proportion (40%) said yes. (See [‘Looking Ahead – we predict increasing private sector activity’](#).)

We hope that you enjoy this edition of Insight. Please do not hesitate to contact either of us or any of the article authors if you have any comments or queries.



¹ ‘PricewaterhouseCoopers’ refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

Data Analysis

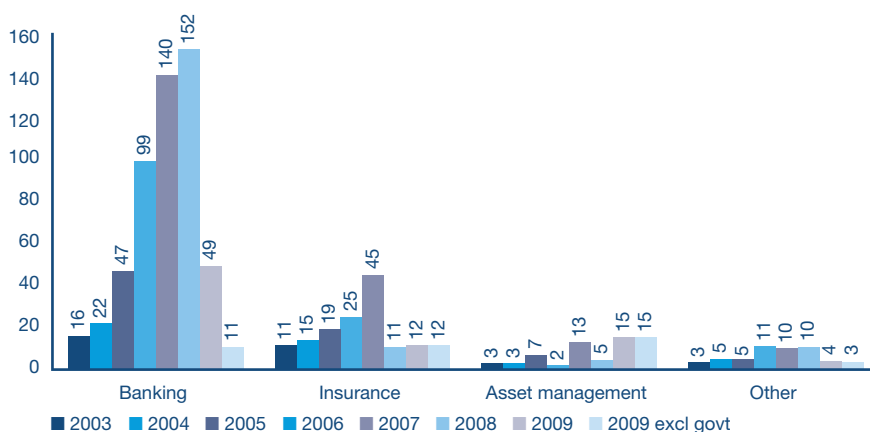
Restructuring is well underway



Following on from the October 2009 edition of this paper, which analysed deal activity during the first half of 2009, this edition was intended to focus on the second half of the year. However, a considerable amount of further transaction data for the first half has become public since the October edition. This analysis therefore reviews deal activity for the whole of 2009.²

Overall, 2009 saw a steep decline in financial services deal-making. Deals involving banking targets declined particularly quickly and, excluding government activity, fell to the lowest level seen in the seven years of this publication (see Figure 1a and 1b). Insurance deals remained at a comparable level to 2008, while asset management deal values received a strong boost from one very large transaction.

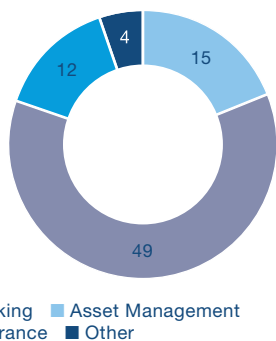
Figure 1a: Trend of European FS deal value by sector (€ billion)



Source: PricewaterhouseCoopers analysis of mergermarket, Reuters and Dealogic data

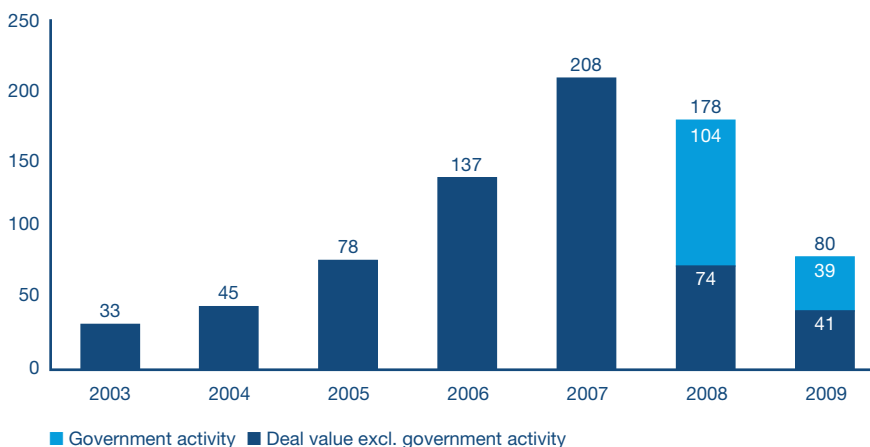
In total, financial services deals for which values were disclosed amounted to €80bn, compared to €178bn in 2008 and €208bn in 2007. With government activity excluded however, 2009's total deal value was only €41bn, lower than the €45bn reported in 2004 (see Figure 2). The slowdown accelerated in the second half, with total deal value falling to €26bn from €54bn in the first half of the year.

Figure 1b: 2009 European FS deal value by sector (€ billion)



Source: PricewaterhouseCoopers analysis of mergermarket, Reuters and Dealogic data

Figure 2: European FS deals by value (€ billion)



Source: PricewaterhouseCoopers analysis of mergermarket, Reuters and Dealogic data

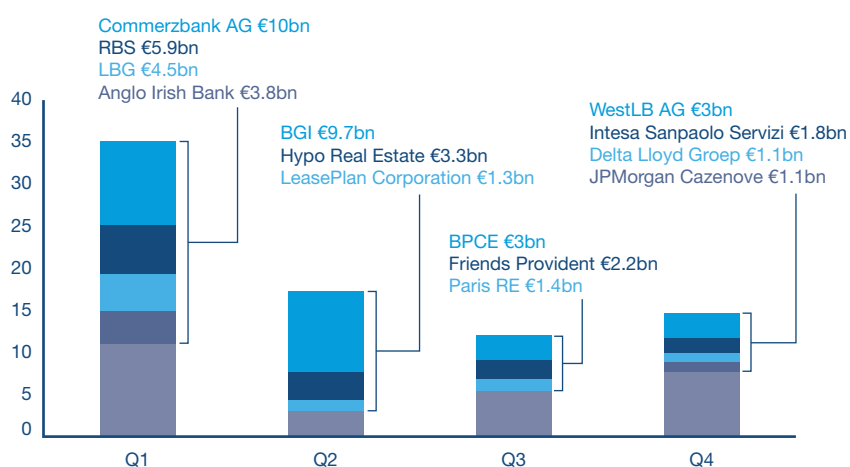
² The source data on the deals analysed in this publication come from mergermarket, Reuters and Dealogic, unless otherwise specified.

Data Analysis

continued...



Figure 3a: 2009 European FS deals by value (€ billion)



Source: PricewaterhouseCoopers analysis of mergermarket, Reuters and Dealogic data

Despite the absolute decline in the value of transactions, private sector deals accounted for a growing proportion of the total. Government-led transactions declined to 24% of total deal value in the second half of the year, compared with 58% for the first half, and cross-border activity as a proportion of private sector deals increased to 65% from 41% in 2008.

The largest deals of 2009 were driven by a number of factors

The varied drivers of financial services transactions in 2009 mean that it is worth reviewing the year's major deals on a quarterly basis (see Figure 3a and 3b):

- Government activity overshadowed the first quarter. Key transactions were the recapitalisations of Commerzbank for €10bn, Royal Bank of Scotland (RBS) for €5.9bn and Lloyds Banking Group for €4.5bn; the nationalisation of Anglo Irish Bank for €3.8bn; and a €3bn capital injection into HSH Nordbank.
- The second quarter was dominated by Barclays' sale of Barclays Global Investors (BGI) to BlackRock for

€9.7bn. As discussed in the last edition of Insight, this deal was one of the largest asset management transactions in history and was the largest private sector deal of 2009. Separately, the German government took control of Hypo Real Estate at a cost of €3.3bn.

- The third quarter saw Resolution buy Friends Provident for €2.2bn, 2009's largest insurance transaction. This interesting deal sees a large, established financial institution acquired by an explicitly consolidation-focused company. In July, the French state took a 20% stake in mutual banking giant Banque Populaire Caisse d'Epargne for €3bn, formed in June 2009, to strengthen the group's capital position.
- A variety of deals were announced in the final quarter. Germany took a 49% stake in WestLB for €3bn; State Street acquired Intesa Sanpaolo's securities services units for €1.8bn; Aviva floated 38% of Delta Lloyd on the Amsterdam Stock Exchange, raising €1.1bn; and JP Morgan bought out its joint venture with UK broker Cazenove for €1.1bn.

Figure 3b: Top 20 Deals 2009

Month	Target company	Target country	Bidder company	Bidder country	Deal value (€m)
Jan	Commerzbank AG (25.0001%)	Germany	Government of Germany	Germany	9,970
Jun	Barclays Global Investors	United Kingdom	BlackRock Inc	USA	9,678
Jan	Royal Bank of Scotland Group Plc (29.79% stake)	United Kingdom	HM Treasury	United Kingdom	5,884
Mar	Lloyds Banking Group Plc (21.60% stake)	United Kingdom	HM Treasury	United Kingdom	4,455
Jan	Anglo Irish Bank Corporation Limited	Ireland (Republic)	Irish Ministry of Finance	Ireland (Republic)	3,827
Apr	Hypo Real Estate Holding AG (91.35% stake)	Germany	Government of Germany	Germany	3,302
Feb	HSH Nordbank AG (25.99%)	Germany	Government of Germany	Germany	3,000
Jul	BPCE SA (20%)	France	Government of France	France	3,000
Nov	WestLB AG (49%)	Germany	Government of Germany	Germany	3,000
Aug	Friends Provident Plc	United Kingdom	Resolution Limited	United Kingdom	2,164
Jan	KBC Group NV (Undisclosed economic interest)	Belgium	Government of the Flemish Region	Belgium	2,000
Feb	Alleanza Assicurazioni SpA (49.60% stake)	Italy	Assicurazioni Generali SpA	Italy	1,805
Dec	Intesa Sanpaolo Servizi Transazionali SpA Sanpaolo Bank SA	Italy	State Street Corporation	USA	1,750
Jan	Societe Generale asset management business	France	CAAM	France	1,620
Jul	Paris RE	Switzerland	PartnerRe Ltd	Bermuda	1,435
May	LeasePlan Corporation NV (50.00% stake)	Netherlands	Fleet Investments BV	Netherlands	1,300
Nov	Delta Lloyd Groep (38.4%)	Netherlands			1,120
Nov	JPMorgan Cazenove (49.99% stake)	United Kingdom	JPMorgan Chase & Co	USA	1,119
Oct	Sal. Oppenheim jr & Cie SCA	Luxembourg	Deutsche Bank AG	Germany	1,000
Sept	Genesis Lease Limited	Bermuda*	AerCap Holdings N.V.	Netherlands	890
Sub-total					62,320
Other					17,761
Grand total					80,081

Source: PricewaterhouseCoopers analysis of mergermarket, Thomsons and Dealogic information

* GLS is headquartered in Republic of Ireland.

Data Analysis continued...

A review of smaller deals reveals some interesting trends

Looking beyond 2009's headline transactions, analysis of the year's smaller and medium-sized deals reveals some interesting observations. In particular, we highlight the following themes, several of which were discussed in previous editions of Insight.

Use of joint ventures and other alliances. Joint ventures flourished during the year, particularly in France (see box below).

Acquisitions in asset management and private banking. As predicted in the last edition of Insight, M&A activity in asset management increased during the

second half of 2009. Several institutions made bolt-on acquisitions, often as a result of universal banks' disposals. Notable deals announced during the second half of the year included the acquisition of Sal. Oppenheim by Deutsche Bank for €1bn, Julius Baer's purchase of ING Bank Switzerland for €344m and BNY Mellon's acquisition of Insight Investment Management from Lloyds Banking Group for €273m.

Divestment of non-core banking subsidiaries. European banking saw several divestments outside the wealth management arena. The largest was Deutsche Bank's acquisition of ABN AMRO's former commercial banking businesses for €700m, after a protracted sale process that began when RBS and

Joint Ventures: Isolated transactions or the start of a trend?

2009 saw the formation of several large joint ventures (JVs) between banking groups, most noticeably in the French market:

- Consumer credit JV between La Banque Postale and Société Générale
- Asset management JV between Crédit Agricole and Société Générale
- Online banking JV between Société Générale and La Caixa

These JVs reflect different strategies:

- Banks keeping control over activities seen as important to customers, while benefiting from economies of scale and wider distribution networks;
- An alternative exit route to potentially lower realisation values, achieved in the financial services market during 2009.

Despite the creation of large pan-European retail banking groups in recent years, JVs are typically set up on a domestic basis, due to national differences in regulation, taxation and customer behaviour.

The Société Générale/La Caixa JV is an example of a less common cross-border JV. We believe partnerships across national borders may become increasingly common in certain segments of the financial services industry.

Fortis received government support in 2008. There were several consumer finance deals: BNP Paribas acquired 25% in Findomestic from Intesa Sanpaolo, with an option for a further 25%; Barclays bought Citigroup's Portuguese consumer credit units; and Santander purchased AIG Bank's Polish consumer business.

Consolidation in insurance. In addition to Resolution's acquisition of Friends Provident, Criteria CaixaCorp of Spain acquired health insurer Compania de Seguros Adeslas in two tranches, for a total consideration of €1.2bn. Danish insurer TrygVesta pursued its Nordic consolidation strategy, buying Moderna Forsakringar's non-life businesses for €109m. In Portugal, Rentipar acquired

two local insurance firms from CNP Assurances, and Spanish insurer CASER purchased 50% of Caixanova Vida from its parent bank. (See ['Waking up to new realities – The impact of Solvency II on strategy and M&A activity in the insurance industry'](#)).

Mutual savings bank mergers.

Two large French mutual banks merged to form Banque Populaire Caisse d'Epargne. No value was disclosed, but a €3bn capital injection by the French state implied a combined value of €15bn. Other deals with undisclosed values included the merger of mutual Yorkshire Building Society with rival Chelsea Building Society, the acquisition of Britannia Building Society by Cooperative Financial Services, the

merger of Spanish savings banks Caixa Sabadell, Caixa Terrassa and Caixa Manlleu and the acquisition of Swedish Sparbanken Finn by domestic rival Sparbanken Gripen.



British Banks

Back in the sights of foreign investors?

With Britain's banking sector stabilising, its growth prospects improving and EU competition rulings set to bring more acquisition targets onto the market, should now be the time for foreign players to take a fresh look at the UK?

'The UK is at the heart of Santander's success,' said executives at the Spanish group in a presentation to analysts in September 2009.³ Since acquiring Abbey in 2004 and then Alliance & Leicester and the savings arm of Bradford & Bingley in the wake of the financial crisis,⁴ Santander has provided a model for incoming institutions looking to establish a strong presence in the UK. Santander UK is now the country's second largest mortgage provider (market share 13%) and third largest deposit taker (market share 10%).³ A combination of strategic clarity, strict cost management and determined operational rationalisation has enabled Santander UK to sustain profitability in the face of the earnings pressures seen elsewhere in Britain's retail banking sector.

begun to turn the corner, following the turmoil and ensuing recession precipitated by the financial crisis. In December 2009, the Bank of England reported that the financial system has become 'significantly more stable over the past six months'.⁵ The UK government's injection of liquidity and takeover of some troubled institutions clearly played a crucial role in pulling the sector back from the brink of collapse. However, the past year has also been marked by steadily improving risk profiles as banks focus on secured lending and more effective credit control.

In September 2009, the quarterly PwC/CBI financial services survey revealed the first upswing in banking business volumes and confidence for nearly two years,⁶ with this positive sentiment sustained in the December survey⁷ (see Figure 1). With the availability of both corporate and consumer credit still restricted,

Banks or other financial services institutions looking to follow Santander's lead in the UK will find a market that has

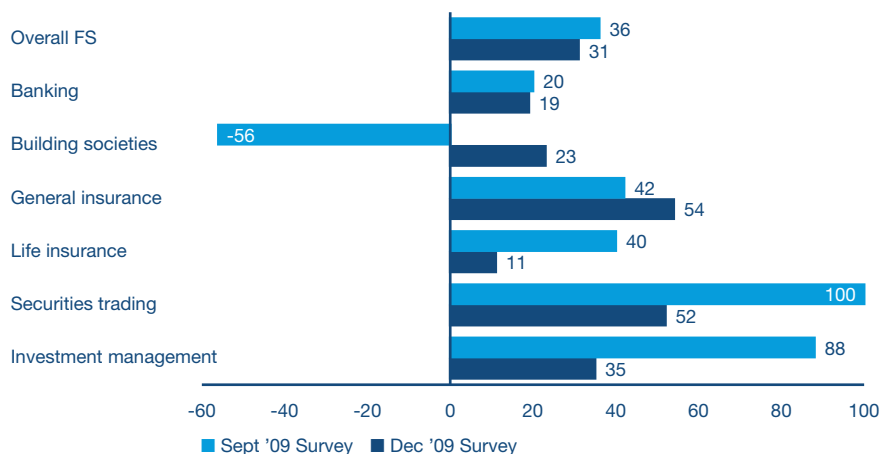


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Figure 1: Optimism about overall business situation – Key sectors



Source: CBI/PricewaterhouseCoopers Financial Services survey, December 2009

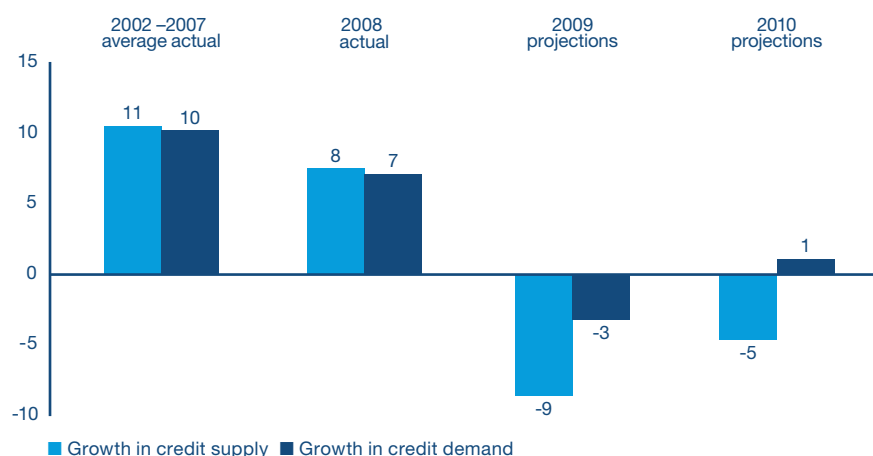
3 Grupo Santander presentation to analysts in Madrid, 17.09.09

4 Abbey, Alliance & Leicester and Bradford & Bingley are to be fully integrated into the Santander brand over the course of 2010 (www.santander.co.uk)

5 Bank of England Financial Stability Report, December 2009

6 PricewaterhouseCoopers/Confederation of British Industry quarterly financial services survey, September 2009 (www.pwc.com/financialservices)

7 PricewaterhouseCoopers/Confederation of British Industry quarterly financial services survey, December 2009 (www.pwc.com/financialservices)

Figure 2: Bank lending capacity and credit demand growth (%)

Source: IMF, PricewaterhouseCoopers analysis

institutions have benefited from the opportunity to charge higher fees and be more selective in their lending. Looking ahead, data from the International Monetary Fund indicates that demand for credit from consumers is likely to return faster than lending capacity (see Figure 2). With banks no longer able to rely on wholesale funding, they will need to increase their deposit base to meet credit demand.

The increasing optimism within the banking sector also reflects the gradual upturn in business output and demand. Although the UK took longer to climb out of recession than Germany or France, and the recovery remains fragile, PricewaterhouseCoopers' economics unit predicts that real GDP growth in the UK will come back to more than 2% per annum by 2012, ahead of its main continental counterparts (France 1.8% in 2012 and Germany 1.5% in 2012).⁸

The good news is tempered by the increasing weight of regulation and government scrutiny, which may intensify still further as the management of the economy and financial system

take centre stage in this year's election. The UK's banking sector also faces continuing impairment charges and lingering uncertainty over the extent of the losses still to come, the risks of which will need to be factored into any acquisition assessment. It may take several years of deleveraging before debt ratios within the banking sector come down to sustainable levels. Despite greater consumer caution, personal debt also remains especially high by international standards (an average of around £60,000 per household).⁹ On the corporate side, repayment difficulties have led to extensive demand for independent business reviews* and debt workout arrangements, though the proportion of corporate loans being written off (less than 1% in 2009) is some way below the 2% or more experienced during the UK recession of the early 1990s.¹⁰

Weakness creates openings

While these difficulties will clearly be an important consideration for potential buyers, they could work to the

advantage of incoming investors. As UK institutions concentrate on repairing their weakened balance sheets, they will have limited appetite for acquisition, leaving some of the potentially most favourable opportunities to be picked up by better capitalised foreign players. In turn, many British banks would welcome the chance to strengthen their capital position through the sale of non-core assets. Commenting on the sale of Barclays Global Investors (BGI) to BlackRock, which was announced in June 2009 and completed in December of that year, Marcus Agius, Chairman of Barclays, said that the deal 'will reinforce our capital position at a time when additional capital resources are highly valued by the market'.¹¹ Despite the share price rally in 2009, the banking sector's legacy issues also mean that equity values are still subdued in comparison to their pre-crisis highs. This may put pressure on the acquisition prices of banks, though the paucity of recent deals makes it difficult to judge pricing trends with any precision.

The longer term prospects for British banking are positive. The UK is an open and sophisticated economy with a diverse population, considerable talent pool and substantial banking needs. Whether or not the financial crisis and the resulting changes in regulation and legislation weaken London's long-term position as a leading financial centre, banking profitability in the UK will be sustained by the strong underlying demand for mortgages, SME lending and other mainstays of traditional credit business.

⁸ PricewaterhouseCoopers Economics Unit projections, October 2009

⁹ 'Precious Plastic 2010', PricewaterhouseCoopers' report into the UK credit card market, published on 08.11.09 (www.pwc.com/financialservices)

¹⁰ 'Trends in Lending, December 2009', published by the Bank of England

¹¹ Chairman's Statement from Barclays PLC General Meeting, 06.08.09

British Banks continued...

Unprecedented choice

The other key attraction for foreign investors is the growing and, in many ways, unprecedented potential availability of acquisition opportunities within UK banking. Divestment has already been gathering pace as groups seek to bolster balance sheets and concentrate resources on the core business. Some of the non-core operations that may be put up for sale are likely to be insurers, asset managers and businesses on the fringes of the banking industry, creating opportunities for foreign players to gain a foothold or strengthen their presence in these areas.

The availability of potential takeover targets has been given further impetus by the announcements in November 2009, that some of the groups that have received significant government funding will be required to sell off certain assets, to fall into line with EU state aid and competition rules¹² (see Figure 3). This includes Northern Rock, which has been broken up to make way for the sale of its better performing assets¹³ and the Lloyds Banking Group (LBG), which has agreed to reduce its dominant shares of the UK mortgage and current account markets. LBG's divestment package will include the sale of part of its branch network and its UK mortgage book.¹⁴

The other affected group is Royal Bank of Scotland (RBS), whose agreement with the European Commission includes the sale of some branches and other banking assets, along with the divestment of its insurance division.¹⁵ RBS Insurance, which could constitute a FTSE 100 company in its own right if it was sold as a standalone business,

Figure 3: Coming on to the market

Following agreement with the European Commission, RBS, LBG and Northern Rock will be required to divest certain assets, which according to the Commission will 'facilitate the entry of a new competitor or the reinforcement of a smaller existing competitor'.

The key mainstream banking assets coming on to the market include:

Northern Rock plc – a new savings and mortgage bank that will hold and service all the group's customer savings accounts and some existing mortgage accounts;

RBS branch network in England and Wales, the NatWest branches in Scotland and Direct SME customers across the UK, which together represent around 5% of the SME and mid-tier corporate market;

Divestments from LBG will include the sale of at least 600 branches, representing just under 5% market share in the UK personal current account market and 19% of the group's mortgage book.

Source: European Commission media release – 18.11.09, Northern Rock media release – 10.11.09, LBG presentation to analysts – 03.11.09

presents a significant acquisition opportunity. Also being put up for sale are RBS' WorldPay division and the group's interest in RBS Sempra Commodities, both of which occupy leading positions in their respective markets.¹⁵

Further investment opportunities are likely to come from the scaling back of operations by some US consumer credit groups, along with a growing interest from private equity groups in the purchase of non-performing assets. Ultimately, the government will be looking for the right juncture to relinquish its considerable holdings in the banking sector, which include outright control or majority stakes in RBS, LBG and Northern Rock.

Enhanced competition

The openings for foreign groups will be augmented by the government's desire to increase what it sees as the limited choice in the retail banking market. Discussing the proposals for RBS, LBG and Northern Rock in an interview with the BBC in November 2009, Alistair Darling, the UK Chancellor of the Exchequer, said 'we want to ensure there is proper competition and choice in the high street as that is the best way to make sure you have a good supply of credit at affordable rates'.¹⁶

If it gained power, the Conservative opposition could go further by referring the impact on competition of recent consolidation within the banking sector to an enquiry by the UK Office of Fair

¹² European Commission media releases, 18.11.09 and 14.12.09

¹³ Treasury media release, 10.11.09, Northern Rock media release, 04.01.10

¹⁴ LBG presentation to analysts, 03.11.09

¹⁵ RBS media release, 03.11.09

¹⁶ BBC Politics Show, 01.11.09



Trading (key deals include the 2008 merger of the UK's leading mortgage providers LBG and HBOS). The results could lead to more enforced divestment and 'help to inform a Conservative government's strategy for disposing of its banking shares'.¹⁷

Whichever party wins the election will be keen to ensure that the divested assets go to new entrants, both from abroad and outside the mainstream banking sector, rather than the main existing players, as this would increase choice and avoid what the current Chancellor described, as an 'unacceptable situation' in which 'we end up with half a dozen big providers'.¹⁸ However, some UK groups that have not received direct state aid may be lobbying behind the scenes.

Window of opportunity

Foreign groups looking to establish and develop their presence in the UK banking sector are set to benefit from an auspicious combination of increasing market opportunity and growing target availability. While optimism is returning, the recovery is still tentative and it may therefore take several years before the banking industry reaches its full potential once again. However, the long-term prospects for this large and advanced sector will continue to be attractive. In one of the most open markets in the world, foreign acquirers are, in our opinion, likely to be welcomed by the government as a way to increase competition and inject fresh capital. In turn, the success of Santander highlights the opportunity to create significant shareholder value in a leading global financial market through effective acquisition and restructuring.

Editorial eye

Such is the financial, strategic and government pressures spurring divestment that a number of institutions could seek to sell subsidiaries at around the same time. What is unclear is whether an influx of takeover targets will drive up prices as investors vie to gain access to a recovering and, in the long-term, profitable market or whether concerns over regulation, the current fragility of the economy and the condition of British banks deter bidders and force prices down.

¹⁷ 'From crisis to confidence: Plan for sound banking', Conservative Party policy white paper, published on 08.07.09

¹⁸ BBC Politics Show, 01.11.09

Waking up to new realities

The impact of Solvency II on strategy and M&A activity in the insurance industry

While most insurers are primarily focusing on the technical aspects of Solvency II, a number of companies are now beginning to assess the far-reaching strategic implications. With these implications set to provide a strong spur for M&A, what will be driving M&A strategies and how will the industry be able to turn the directive to their competitive advantage?



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With many insurers still mired in the minutiae of model development, documentation and other aspects of Solvency II Pillar 1 implementation, it is easy to lose sight of the bigger strategic picture.

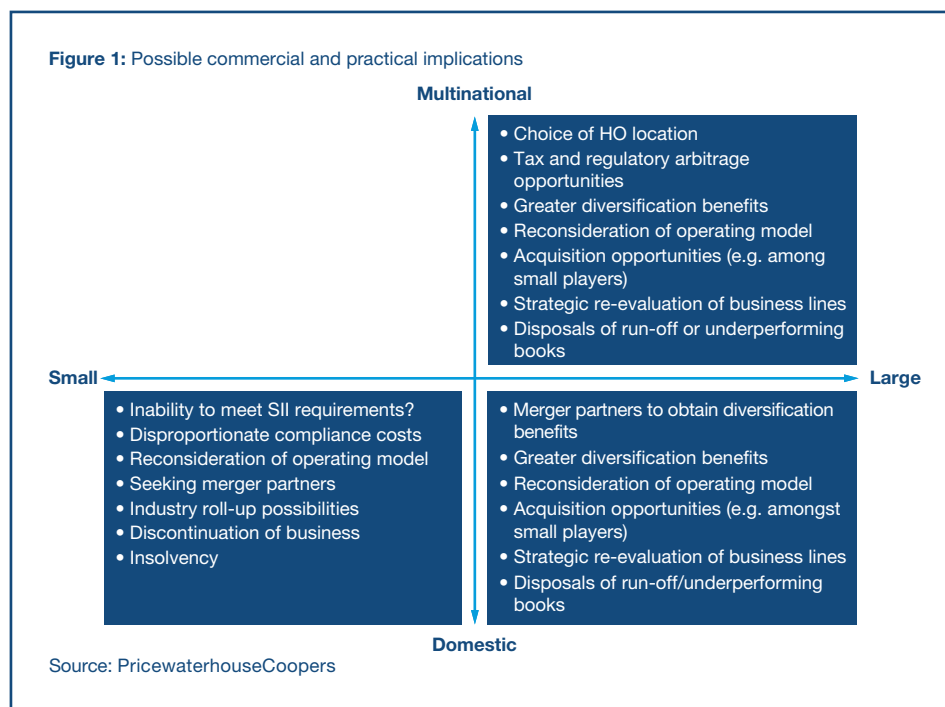
Strategically, the key driver for change will be the demand for more effective enterprise risk management (ERM), its closer integration into business decision-making and opening up to far greater stakeholder scrutiny. This will have a profound affect on the way risks are evaluated, how capital efficiency is judged and, ultimately, how and where insurers choose to compete – the ‘new realities’. Specific ramifications include potentially higher capital charges for policies with volatile or uncertain risk profiles such as guaranteed life products, long tail casualty business and low frequency/high severity lines. The directive will also highlight the capital tied up in discontinued business. For non-life insurers, in particular, there is the challenge of being required to take investment risks fully into account, which will make it more difficult for

companies to compensate for poor underwriting performance by running high investment risks.

More broadly, the concept of ‘diversification’ will need to be re-examined and refined in the light of Solvency II as companies look at size, geographical reach, multi-line operations, non-correlation of assets and liabilities, non-contagion, etc. As a result, larger and genuinely diversified businesses will be able to develop balanced portfolios and resulting capital advantages that will not be open to smaller and mono-line entities. On the flip side, the difficulties of oversight and control created by managing complex group structures, conducting business in multiple territories and divergent legal environments will increase operational risk and associated capital charges – a challenge that many insurers have yet to consider fully.

The cumulative impact of these changes will force insurers to review their strategies, existing structures and product mix, as they look at how to





optimise capital efficiencies and develop a clear articulation of their business objectives and the trade off between risk and reward (see Figure 1).

Impact on M&A

M&A in the insurance industry has been relatively restrained in the wake of the financial crisis. The number of sales that have eventually been abandoned over the past 18 months highlights the particular challenge of how to generate buyer appetite for acquisition of an insurer's non-core assets. However, we believe that the re-think of strategic options emanating from Solvency II will lead to a pick-up in deal activity. The broad spectrum of transactions is likely to include transformational deals through to diversification, cost-efficiency plays and highly structured arrangements for closed books of business.

Articulating a robust strategic rationale for how divestment or acquisition will improve capital efficiency and

competitive relevance in the post-Solvency II environment will clearly be critical in securing shareholder and stakeholder support. The underlying consideration is what business model is likely to be most appropriate for a particular company in this new environment and what part M&A will play in the resulting reshaping of the enterprise.

We expect to see the emergence of two distinctive paths for M&A, one which is seeking out benefits from a horizontal strategy and one which is seeking to capitalise on vertical integration:

Redefining diversification

One model will be the true consolidators. Companies that are already reasonably diversified and will therefore realise capital advantages under Solvency II will be able to look at how M&A could further enhance the balance of their portfolio. These acquirers will be highly selective in seeking out targets that will enable them to bridge diversification gaps in their product line or geographical spread. One of the key

value metrics for their choice of which company to buy will be the enhanced level of capital efficiency the deal will generate.

At the other end of the spectrum will be the true specialists. Some companies will not be able to secure effective diversification and could face additional capital charges because of a narrow product or regional focus. These firms will want to look at the adequacy of risk-adjusted return on capital from each element of their portfolio and judge which operations are therefore worth retaining within a specialised entity. Underperforming lines will either be sold to the true consolidators or discontinued.

Unbundling the value chain

As Solvency II increases transparency and forces insurers to re-assess the capital dynamics of their operations, some companies may look at alternative business models. Rather than being a consolidator or specialist, the choice would be whether to focus on a particular aspect of a value chain that is likely to be increasingly segregated between distribution, manufacturing, service (IT, administration, etc.) and capital provision.

One of the potential benefits opened up by the unbundling of the value chain would be enabling capital providers to align investment more closely with their risk appetite and return expectations. There will continue to be investors who will want to assume direct exposure to insurance risk in return for the required level of reward. However, there would also be other investment opportunities that retain minimal insurance risk and operate with reduced regulatory requirements as they concentrate on areas such as distribution, insurance services or other non-manufacturing parts of the value chain. This is likely to attract fresh interest from a range

Waking up to new realities continued...

of capital providers including financial investors, who may previously have been deterred by the complex compliance requirements and the need to tie up significant capital to support risk within a conventional insurance business. Other investors could include new entrants from sectors such as IT or retail as they seek to tap into opportunities close to their respective expertise. The overall result would be clearer and more differentiated investment prospects within the insurance industry and hence the ability to attract more capital from a wider array of providers. Whether or not this is the intention of the architects of Solvency II is difficult to say, but it would certainly provide a valuable boost for investment in a sector that has been finding it difficult to compete for funds in a risk-averse and capital-constrained market environment.

Investing in run-off

One of the results of the two models set out on page 13 is that as an increasing number of life and non-life companies choose to exit capital intensive and non-core operations, there may be a glut of targets, which will put pressure on prices, but also provide fresh opportunities for buyers of run-off portfolios. A survey of more than 500 insurance executives carried out by PricewaterhouseCoopers in 2009 found that nearly three-quarters see the proactive management of their organisation's run-off as a priority for senior management, with Solvency II seen as one of the key factors driving this growing focus.¹⁹ The concept of consolidating and servicing closed books of business, which seeks to optimise capital, cost and regulatory synergies, is likely to become more accepted as a result, particularly in continental Europe where it is less developed than the UK. This will in turn attract new entrants to the market through acquisitions of closed insurance portfolios, which could include more financial investors.

Emerging stronger

With only two years to go before Solvency II comes into force, the need for boards to assess the impact on the economics of their businesses and how they should respond is becoming ever more urgent. Divestment and consolidation are set to play a key part in this strategic reappraisal and resulting restructuring, enabling companies to re-balance their portfolios, sharpen specialisation or focus on a particular aspect of the value chain, depending on their choice of business model.



Editorial eye

The focused business models that emerge as a result of the move to Solvency II could help to attract fresh investment into the industry. However, with deal appetite still constrained in the aftermath of the financial crisis, articulating a convincing acquisition or divestment rationale that supports the wider strategic objectives of the company in the post-Solvency II environment will be critical for success.

¹⁹ 'Unlocking value in run-off: A survey of discontinued insurance business in Europe', published by PricewaterhouseCoopers in March 2009

Looking Ahead

We predict increasing private sector activity



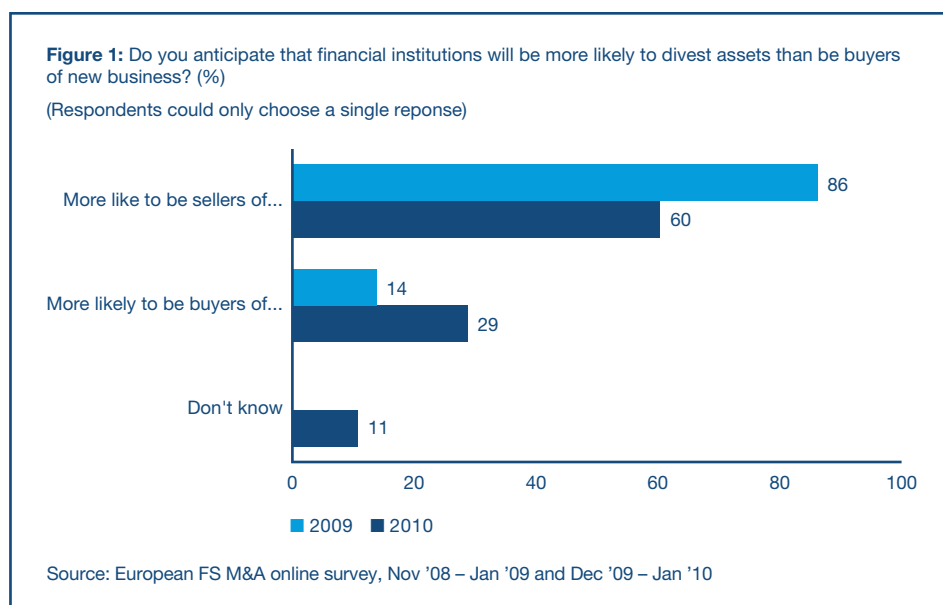
The second half of 2009 saw a marked slowdown in European government-led financial services transactions. Private sector deal activity also declined, but less rapidly.

We believe M&A activity will begin to recover during 2010 as industry restructuring gathers pace. Respondents to our online survey of deal professionals appear to agree, with 59% of those surveyed expecting other financial institutions to be the most prominent bidders for financial services targets during 2010 and 2011.²⁰ In contrast, only 14% now expect governments to take the most prominent role.

We believe that increasing stability in financial markets will help to reduce price expectation gaps during the year ahead, drawing more potential buyers into the marketplace. This will be crucial if the level of private sector transactions is to increase materially. Our survey suggests that there are still far more would-be sellers than potential buyers for financial services businesses (see Figure 1), although the 60% of respondents expecting to see divestments during 2010 is less than the 86% recorded in last year's survey.

Nonetheless, it is encouraging to find that 73% of respondents expect appetite for large financial services deals to increase slightly or strongly during the year (see Figure 2 overleaf). This marks a considerable change from last year's survey, when only 42% expected this to be the case. Considering the recent slowdown in public sector transactions, we feel that this supports our prediction of increased private sector activity during 2010.

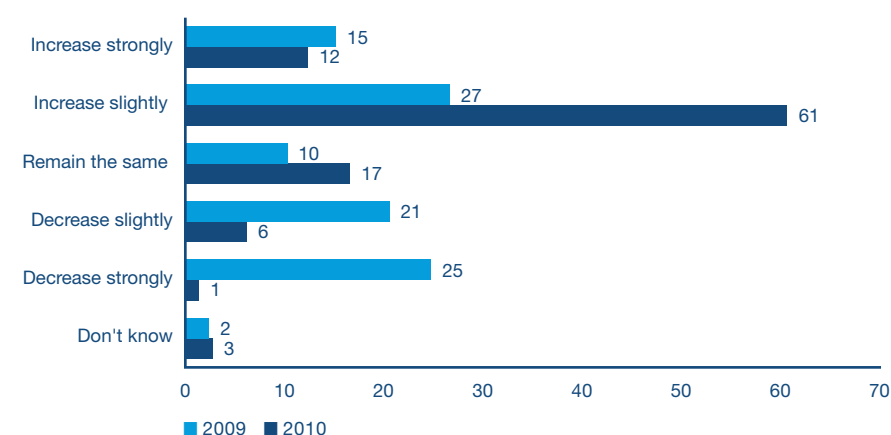
Indeed, most European governments have already switched their focus from the targeted support of certain financial institutions to planning their exits from bank shareholdings in the medium to long term. However, we believe it unlikely that large-scale exits by European governments will materialise during 2010.



Looking Ahead

continued...

Figure 2: How do you expect appetite for large deals to develop over the coming year? (%)
(Respondents could only choose a single response)



Source: European FS M&A online survey Nov '08 – Jan '09 and Dec '09 – Jan '10



Specific areas where we expect to see further deal activity in the near future include UK banking, as discussed in the main body of this edition (see [‘British Banks – Back in the sights of foreign investors?’](#)), and scale-building transactions among European insurers (see [‘Waking up to new realities – The impact of Solvency II on strategy and M&A activity in the insurance industry’](#)).

We also expect that non-core disposals by banks will continue to play a major role in deal activity. Again, this view is supported by the majority of respondents to our survey (62%). Asset management businesses will continue to change hands, and not just in response to disposals by banks. We also anticipate further consolidation among independent firms as asset managers seek to harness the potential benefits of scale.

Nor do we believe that non-core divestments be limited to asset management. We predict that universal banks will trim peripheral activities in areas such as consumer finance, general insurance, securities brokerage and securities services. In each case, joint ventures could remain an attractive option for parent groups not in need of a quick or outright sale.

In particular, a number of European banks now have significant divestment requirements to implement if they are to satisfy European Commission conditions relating to State Aid. For instance, Royal Bank of Scotland has already commenced large-scale disposals, which we expect will feature among some of the larger transactions of 2010.²¹ Restructuring activity at other large state-supported banking groups including Lloyds Banking Group in the UK, KBC in Belgium and ABN AMRO/Fortis Bank Nederland is also likely to contribute to deal activity during the year.

Looking further forward, we continue to believe – as discussed in the previous edition of Insight – that financial services in Central and Eastern Europe and the Commonwealth of Independent States is due for a round of restructuring. Although progress has been slower than expected, we still feel that parent groups from outside the CEE and CIS region would welcome the chance to sell, if they could do so without incurring material asset value write-downs.

Lastly, we expect private equity firms to continue to take part in financial services M&A, albeit in niches. Waterland’s purchase of Intertrust and AnaCap’s acquisitions of Ruffler Bank and Cattles Invoice Finance during 2009 suggest that private equity could play a role in banking carve-outs during 2010. For example, it is expected that private equity firms will feature as bidders in the sale of WorldPay by The Royal Bank of Scotland.

²¹ RBS media release, 03.11.09

Methodology

FS M&A Deal Activity analysis

This issue includes financial services deals:

- Over €25 million reported by mergermarket, Thompson and Dealogic;
- Announced in the calendar year 2009, and expected to complete;
- Involving the acquisition of a >30% stake (or significant stake giving effective control to the acquirer); and
- Acquisitions of Europe based financial services targets where a deal value has been publicly disclosed.

This year we enhanced our data coverage compared to prior years with the inclusion of Dealogic information. However, comparatives used in prior issues have not been restated.

Our analysis also excludes deals that, in our view, are not 'true' financial services deals, e.g. real estate deals and sales/purchases of asset portfolios where the disclosed deal value represents the value of assets sold.

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About this report

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About the survey conducted for this study

Between December 2009 and January 2010, PricewaterhouseCoopers (UK) conducted an online survey of a sample of its European Financial Services clients, gathering their responses to key questions about the development of M&A activity during 2010 and 2011. The survey was completed by 212 individuals (Nov 2008 – Jan 2009 online survey, 292 respondents) located throughout Europe. There was a spread of respondents from banking, insurance, asset management, private equity and other sub-sectors of financial services.

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For further information on the Global FS M&A Marketing programme or for additional copies please contact Maya Bhatti, Global FS Marketing, PricewaterhouseCoopers (UK) on +44 (0) 20 7213 2302 or at maya.bhatti@uk.pwc.com.

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Deal activity in the financial services industry is likely to increase in 2010 as markets stabilise and restructuring in the sector gathers pace.

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