Financial Services

European Financial Services M&A Insight

September 2010

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Welcome

Welcome to the third edition of European Financial Services M&A Insight for 2010.

The quarterly report provides 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: Houses of Parliament, London

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Although the overall value of deals in the European financial services sector grew in the second quarter of 2010, M&A activity has yet to reach the levels that many, including us, had anticipated at the beginning of the year. Analysis of recent transactions shows that the impetus for restructuring within banking and consolidation within insurance is still strong, though smaller and mid-level deals predominate. (See 'Data Analysis'). The sales by Royal Bank of Scotland of more than 300 branches to Santander for a reported £1.65bn[1] and of its Global Merchant Services business to a US private equity consortium for a reported enterprise value of up to £2bn[2] took place after the quarter end, but will be explored in more detail in the next edition of Insight.

The regulatory shake-up in the European asset management industry presents important commercial opportunities and threats for all parts of the value chain. Crucial considerations include group structures, operating locations and the viability of product, distribution and service propositions. M&A is likely to play an important part in the resulting strategic realignment and restructuring. (See 'Regulatory overhaul in asset management set to drive M&A').

UK building societies are struggling to sustain growth in the face of increasing funding costs, decreasing net lending and very low base rates. Securing sufficient funding looks set to remain a key challenge for the sector. Developments in the societies' search for new capital therefore hold out the possibility of further M&A activity in the sector. (See 'All change? Developments in the outlook for UK building societies').

Industry restructuring will continue to drive deal activity in the second half of the year. We also see the potential for a gradual recovery in growth-oriented transactions, albeit to some extent with a different focus to the boom years. This includes cross-border deals aimed at developing and strengthening a commercial presence in rapidly growing financial services markets such as Turkey, the Middle East and North Africa. Emerging market businesses may also seek to acquire European expertise – especially in wealth management or investment banking – and leverage this across their home or emerging markets. (See 'Looking Ahead').

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

1 'RBS agrees to sell its RBS England and Wales and NatWest Scotland branch based business to Santander UK plc', Royal Bank of Scotland website, 04.08.10

2 'RBS agrees to sell 80.01% interest in Global Merchant Services to a consortium of Advent International and Bain Capital', Royal Bank of Scotland website, 06.08.10

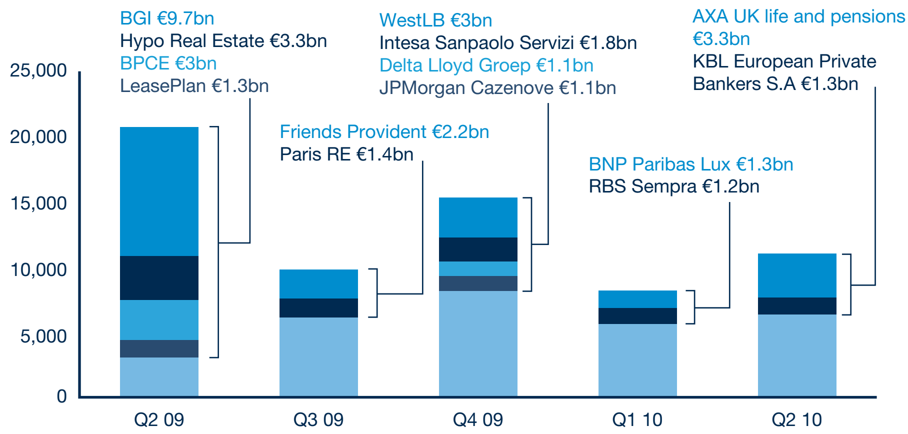
Data Analysis

European financial services M&A remains relatively subdued, although it has grown from the low levels of the first quarter. Banking restructuring, consolidation in insurance, private equity-led deals and scale-building in other areas of the industry continue to generate deal activity, particularly in the mid-market.

The value of European financial services M&A grew during the second quarter of 2010, increasing to €10.9bn from €7.8bn in the first quarter of the year.[3] However, most of this growth was attributable to the year's largest announced deal to date, Resolution's €3.3bn acquisition of AXA's UK life and pensions business, and only one other transaction was valued at more than €1bn. Total deal values for the quarter were 46% lower than the €20.3bn recorded during the same period of 2009, although that quarter was arguably distorted by BlackRock's purchase of Barclays Global Investors for €9.7bn (see Figure 1).

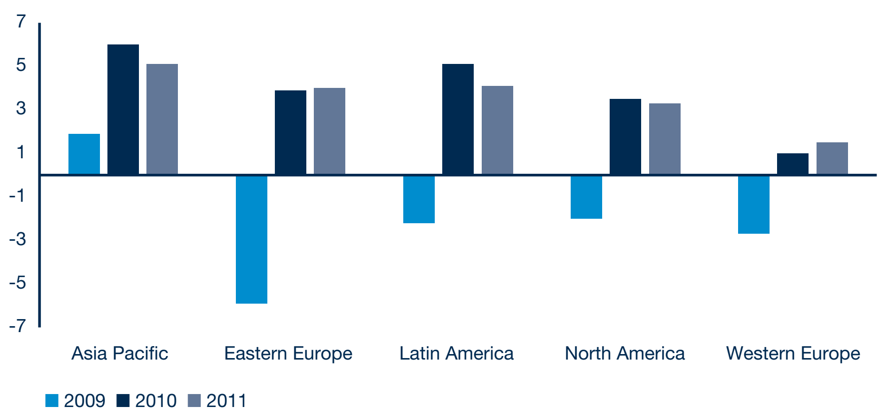
The relatively slow recovery of the developed economies (see Figure 2) and their need for fiscal rebalancing continue to make strategic planning a challenge for European financial services companies. Concerns over levels of European sovereign debt and European banking solvency are also casting a shadow over the capital markets,[4] contributing to the relatively subdued level of M&A activity.

Figure 1: Quarterly European FS deals by value (€m)



Source: Mergermarket, Reuters, Dealogic and PwC analysis

Figure 2: GDP growth prospects by world region (%)



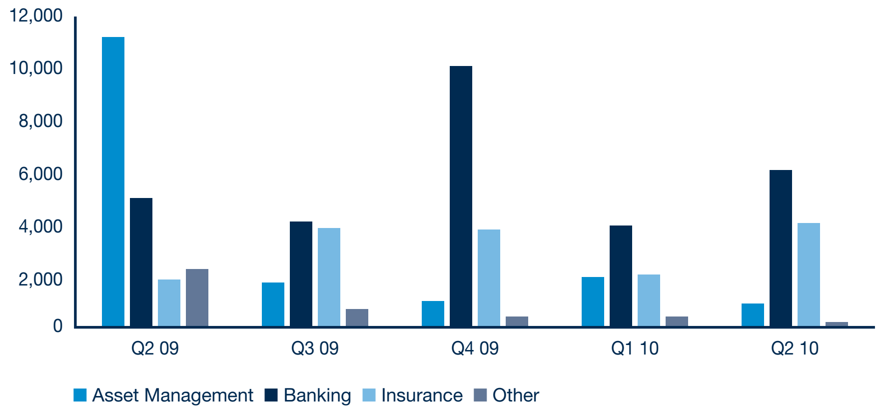
Source: PwC UK Economic Outlook, July 2010

3 The source data on the deals analysed in this publication come from mergermarket, Reuters and Dealogic, unless otherwise specified. Our analysis methodology is summarised on P14

4 'Volatility dulls appetite for big M&A activity', Financial Times, 29.06.10

Data analysis
continued...

Figure 3: Quarterly European FS deals by value – subsector analysis (€m)



Source: Mergermarket, Reuters, Dealogic and PwC analysis

Even so, it is worth noting that the quarter-on-quarter increase in total financial services deal values was not just the result of one large transaction. Mid-market activity increased, with the aggregate worth of deals valued at less than €1bn increasing to €6.2bn from €5.3bn in the previous quarter and €3bn in the comparable period of 2009. The increase in banking deal values reflected a range of transactions across Europe, while the pick-up in insurance activity was largely due to the Resolution/AXA UK deal (see Figure 3).

A review of all deals announced during April, May and June shows that restructuring in Western Europe was the central theme of the quarter. Domestic

Figure 4: Top 5 Deals Q2 2010

Month	Target company	Target country	Bidder company	Bidder country	Deal value (€m)
Jun	AXA SA (UK life and pensions)	United Kingdom	Resolution Limited	United Kingdom	3,330
May	KBL European Private Bankers SA	Luxembourg	The Hinduja Group	India	1,350
Jun	Societe Marseillaise de Credit SA	France	Societe Generale	France	872
Jun	Banco Guipuzcoano	Spain	Banco de Sabadell SA	Spain	807
Apr	Citibank International plc (Swedish operations)	Sweden	Marginalen AB	Sweden	640
				Subtotal	6,999
				Other	3,879
				Grand total	**10,878**

Source: PricewaterhouseCoopers analysis of mergermarket, Thomsons Reuters and Dealogic data transactions accounted for 70% of total deal value and five countries dominated deal-making, namely the UK (39% by value), Spain (14%), France (13%), Luxembourg (12%) and Sweden (9%). Government led activity was insignificant, representing just 0.5% of total deal value compared with 4% during the first quarter of this year and 24% during the second half of 2009.

Our analysis of the quarter's largest deals (see Figure 4), along with mid-market and smaller transactions, points to several key themes. In particular we draw attention to:

- **Consolidation in insurance.** In terms of individual transactions, the quarter's largest announced deal was the €3.3bn acquisition by the insurance consolidation vehicle Resolution of AXA's annuity, protection and group pensions businesses in the UK. The deal is to be part-funded by a rights issue, and will enable Resolution to combine the target with Friends Provident, the UK life insurer it acquired in 2009. From AXA's perspective, the sale supports its goal of withdrawing from capital intensive operations in mature markets in order to focus on opportunities in Asia.

  Other significant deals involving insurance targets included the acquisition of Standard Life Healthcare by South African insurance group Discovery Holdings for €200m, and – following its purchase of 50% of Caixa Catalunya's insurance businesses during the first quarter – Mapfre's acquisition of 50% of the insurance activities of Catalunya's merger partners, Caixa Tarragona and Caixa Manresa, for €86m.

  One interesting transaction was the acquisition of Turkish insurance company Fiba Sigorta by Sompo Japan Insurance for €253m. There have not been many recent examples of inward bids for European growth targets, but we believe there is further scope for deals of this nature (see 'Looking ahead').

- **Continued restructuring in banking.** The process of banking restructuring in Europe continues, with divestment of non-core activities still a key driver of M&A activity. The largest such deal was the Hinduja Group's acquisition of KBL European Private Bankers for €1.35bn from KBC, which had agreed to sell the unit after receiving state aid. The transaction marks a rare European banking acquisition by a private Indian company, which plans to give the business an emerging markets focus. In connection with KBC, we also note the announcement since the quarter end of an anticipated management buy-out of its UK brokerage, KBC Peel Hunt.

  Other deals involving the divestment of non-core businesses included Citibank's sale of its Swedish retail business to local firm Marginalen for €640m and Libyan Arab Foreign Bank's purchase of a majority stake in British Arab Commercial Bank from HSBC for €68m.

  There were also several notable scale-building banking transactions in Western Europe. The largest of these was Societe Generale's acquisition of Societe Marseillaise de Credit for €872m, but other in-market deals included Banco de Sabadell's purchase of Banco Guipuzcoano for €807m and Veneto Banca's acquisition of a 45% stake in Banca Intermobiliare di Investimenti e Gestioni (€299m).

  Lastly, the quarter saw a number of sales of branch networks, in whole or in part. In addition to Marginalen's acquisition of Citibank's Swedish operations, we noted Credit Mutuel's purchase of 123 of Banco Popular Espanol's branches for €313m, the acquisition of 50 of Banca Monte dei Paschi di Siena's branches by Instesa SanPaolo subsidiary Banca CR Firenze, and Societe Generale's acquisition of SEB's French branches for an undisclosed consideration.

- **Ongoing private equity investments.** Private equity activity continued the resurgence seen during the first quarter. Secondary buyouts included AXA Private Equity's acquisition of holdings from Natixis Private Equity for €534m and Vision Capital Partners' acquisition of a stake in Swedish lender Nordax Finans from Palamon Capital Partners for €105m. Direct investments included deals focused on speciality finance targets, such as Duke Street's acquisition of a 58% stake in debt recovery firm Marlin Financial Services for €57m.

In addition to these themes, we note signs of continuing scale-building activity among asset managers, asset servicers and mutual savings banks. On the asset management side, notable deals included Swedish investment manager Investment AB Oresund's acquisition of local rival HQ Fonder AB from its parent bank for €89m and F&C Asset Management's purchase of alternative investment manager Thames River Capital for €62m. Although outside our dataset since it involves a US target, we also note Man Group's $1.6bn acquisition of GLG.[5] This is a significant deal for the hedge fund sector, as Man Group continues to build scale and extend its geographic coverage.

In the asset servicing area, two deals saw specialised asset servicing businesses acquired by larger, global players hoping to develop their niche capabilities. Credit Suisse acquired Fortis Prime Fund Solutions for a minimum consideration of €150m, and JP Morgan Worldwide Securities Services purchased Schroders Private Equity Administration Services for an undisclosed amount.

There was also a further round of merger activity involving mutual savings banks in the UK, and as anticipated in the previous edition of Insight, Germany and Spain. In the UK, the process of building society consolidation continued with the merger of the Skipton and Chesham Building Societies (see 'All change? Developments in the outlook for UK building societies'); in Germany Sparkasse Karlsruhe merged with Sparkasse Ettlingen, and in Spain there were a large number of mergers involving Cajas and rural Cajas, with Cajamar and Caja Rural de Toledo among the most active merger partners. (Please see May edition of Insight for a M&A assessment of the German and Spanish banking markets).

5 'Man agrees to $1.6bn takeover of rival GLG', Financial Times, 17.05.10

Regulatory overhaul

in European asset management set to drive M&A

The European asset management industry is facing a wave of new regulations in the wake of the global financial crisis, aimed at improving choice, strengthening investor protection and extending the single market in the EU. These developments will have important strategic implications for the industry, spurring many companies to consolidate, relocate or shift the focus of their operations.

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The current European regulatory shake-up includes a far-reaching update of the Undertakings for Collective Investments in Transferable Securities (UCITS IV) and the controversial Alternative Investment Fund Managers Directive (AIFMD). Also on the horizon is the Retail Distribution Review (RDR), which while specific to the UK market has echoes in other parts of Europe as regulators strive to improve value, transparency and fairness for investors.

These developments present important commercial opportunities and threats for all parts of the value chain, including asset managers, distributors, service companies and other intermediaries. Firms will need to look beyond the immediate compliance implications at how the regulations will affect their strategies, business models and tactical decisions. Crucial considerations include group structures, operating locations and the viability of their product, distribution and service propositions. We believe M&A will form an important element of the resulting strategic realignment and restructuring.

UCITS IV

UCITS IV is the latest stage of the EU drive to create a single market for investment funds. It is due to come into force in July 2011 and introduces five key provisions: a new management company (ManCo) passport; new rules for fund mergers; new rules for master-feeder fund structures; key information documents (KID) for investors and more efficient notification procedures (for further information and analysis, please see the PricewaterhouseCoopers' 'UCITS IV: Time for Change' series – www.pwc.com/gx/en/asset-management).

The ManCo passport will enable asset managers to market funds anywhere in the EU without maintaining a physical presence. Many firms are likely to use the ManCo passport as an opportunity to concentrate their operations in a strategic or tax efficient jurisdiction and use the fund merger and master-feeder arrangements to develop larger and more cost efficient cross-border funds. The potential benefits include fund rationalisation, tax savings and lower costs (which should also lower the costs of the funds and therefore to the investor). However, it is important to bear in mind the challenges in managing a fully centralised operation. These include managing the complexity of different market dynamics and regulatory frameworks and dealing with operational change and new compliance requirements (mainly the KID).

UCITS IV's impact on M&A

To maximise the benefits of restructuring and rationalisation, asset managers may divest some of the entities that provided a physical presence in a particular market. The buyers are likely to be companies seeking to establish or strengthen operations in target markets or non-EU asset managers looking to gain a foothold inside the EU.

As asset management operations could be consolidated in fewer locations, service providers will need to position themselves to be able to service clients effectively both where their operations are based and where their products are sold. Furthermore, depositories will need to be physically present in the locations where their clients' products are sold. This means that many service providers may have to increase their geographical footprint. M&A can play an important role in achieving this as service providers may view acquisitions of local entities as a speedier alternative to proprietary start-up strategies. Among the sellers will be firms that no longer wish or are unable to operate on a pan-European level.

AIFMD

The AIFMD, which was born out of the G20 meeting in London in 2009, aims to provide more transparency, robust governance and improved solvency within the alternative investment sectors. While it is mainly directed towards hedge funds and private equity, the scope may extend to mainstream managers and funds by covering virtually all investment vehicles outside the UCITS framework. The AIFMD has been the subject of considerable political wrangling, which has resulted in rival European Parliament and Council of Ministers drafts. However, a deal is believed to be imminent and the directive could be in place by 2012 (please see PricewaterhouseCoopers' 'AIFMD News' for further information on the AIFMD and regular updates on the latest developments in the directive – www.pwc.com/gx/en/asset-management).

AIFMD's impact on M&A

As the draft directive currently stands, the AIFMD would make it difficult for non-European asset managers in countries that do not apply the main provisions of the directive, most notably the US, to distribute their funds within the EU. As a result, some of these 'third country' asset managers might wish to acquire EU regulated businesses to continue to be able to distribute products within the EU. Alternatively, they may choose to dispose of their EU operations, creating attractive acquisition opportunities. Furthermore, the tighter controls on delegation in areas such as risk and depository management may encourage some service companies to withdraw from the EU, creating further openings for potential buyers.

RDR

The RDR aims to increase transparency for investors, improve the quality of advice through increased professional standards for advisors and ensure that advisor remuneration does not influence the advice to investors by disallowing commissions. The RDR is due to come into force on 1 January 2013 (PricewaterhouseCoopers' 'Distribution Post-2012' series examines the impact of the RDR and underlying changes in consumer expectations – www.pwc.co.uk/eng/issues/the_ retail _ distribution_review.html).

RDR's impact on M&A

As advisor remuneration moves to a fee basis, it will become transparent to investors how much they pay for particular advice and services. As a result, most investors are only going to want to pay for advice and services they perceive as adding value, rather than information they could themselves freely obtain from publicly available sources.

Regulatory overhaul
continued...

Editorial eye

The new regulatory initiatives may provide a catalyst for a wider competitive shake-up in the asset management industry. For some companies, the priority will be basic compliance. Others are already looking at how these developments will affect their business models, what they will need to do to respond to the implications and how they can turn the changes to their advantage. This needs to include assessing the role of M&A.

The expected lower fee margins for asset managers in the post-RDR environment mean that for many asset managers, continuing 'as is' will put significant pressure on profitability. To sustain current margins, asset managers may need to offer more of this value-adding advice and service than is generally the case today. We expect some of the required capabilities to be acquired through M&A.

Furthermore, the increasing cost of providing such advice and services will make it more important to generate economies of scale through increasing volumes. This is likely to accelerate the current trend towards consolidation. For non-UK asset managers, the expected lower fee margins and the cost and complexity of RDR compliance may make the market unattractive and some may wish to exit as a result.

In the advisor sector, higher professional standards will put significant pressure on both individual advisors and firms and may spur many to exit as a result. The level of investment required by mass market advisory firms to comply with the competency standards of the RDR and scale needed to provide cost-competitive advice may prove especially prohibitive. We believe there will be consolidation as a consequence. Consolidators that act decisively will have significant opportunities for growth, horizontally or vertically.

Finally, the outlook for platforms and their role within the value chain are still unclear, with the RDR not finalised in this regard. If the platforms' business models continue to be challenged in the final directive, some firms may prefer to withdraw from this area of product distribution and servicing.

Capitalising on the opportunities

This latest round of regulation forms part of a wider European drive for increased transparency, comparability and choice, with the impetus coming from both regulators and investors. It is important to recognise their areas of overlap and dynamics – individually and between them as well as with other regulatory initiatives – as many participants in the European asset management industry will be impacted by more than one of these regulatory initiatives. The result is likely to be a growing overhaul of strategy, product design, distribution and pricing.

Asset managers, distributors and service companies will need to act quickly if they want to take advantage of the potential opportunities opened up by these regulatory changes. This includes: assessing the impact of these developments on their operations; deciding how and where they intend to compete; and addressing the potential gap between product and service offering and investor needs. M&A is likely to play an important part, whether transformational or bolt-on in nature, in helping them to capitalise on the opportunities and defend against the threats. Naturally there will be a number of firms with similar goals and the most attractive firms are likely to be targeted early. Divesting companies also need to assess their options and move speedily as once the full implications of the regulations are understood, there could be a glut of operations coming on to the market and hence lower prices/greater difficulties in securing a deal.

All change?

Developments in the outlook for UK building societies

Building societies are typically renowned for their dependability, but the last two years have been anything but predictable. Developments in the societies' search for new capital hold out the possibility of further M&A activity in the sector.

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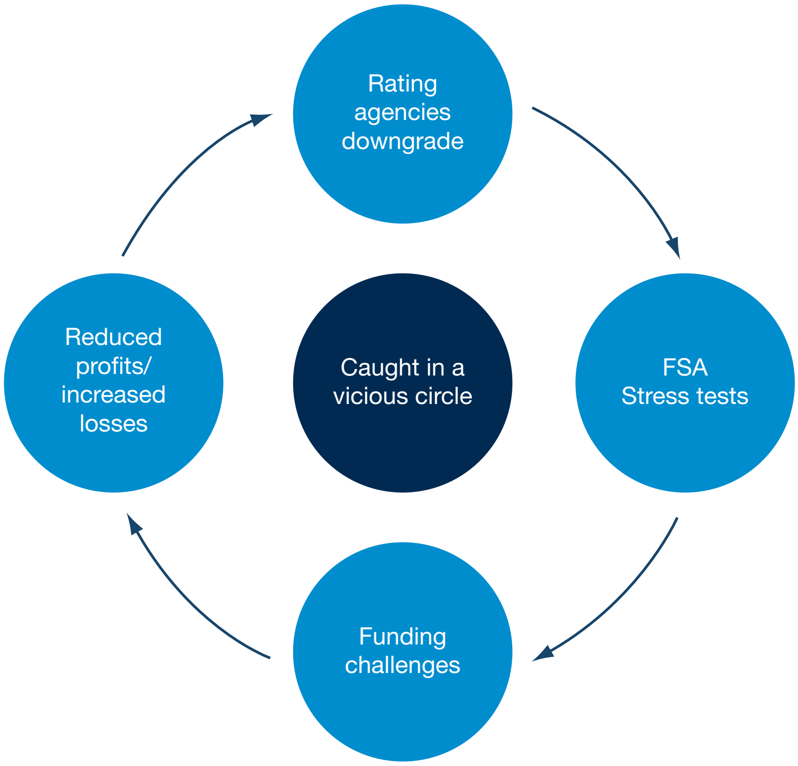
UK building societies have had a rough ride since 2008, symbolised by the downgrades of nine societies' ratings by Moody's in April 2009. The UK Financial Services Authority (FSA) responded with a round of capital stress testing to try and counteract market uncertainty over the sector's solvency, its funding problems and pressures on profitability. The challenges of stress tests, solvency, funding and profitability reinforced each other, creating a vicious circle (see Figure 1).

Figure 1: The challenges of stress tests, solvency, funding and profitability



Source: PricewaterhouseCoopers analysis

Move forward to 2010 and, despite a government guarantee for short-term debt, funding remains a key challenge for the sector. The origins of this problem lie in the societies' 13% average annual growth in mortgage loans between 2002 and 2007, at a time when remortgage volumes were at their highest (see Figure 2). This expansion was largely enabled by wholesale funding, which increased at an average annual rate of 23% over the period.[6] When wholesale funding began to be far less affordable, the consequences were severe. The societies tried to fall back on retail deposits, but these proved hard to attract and expensive to maintain. In 2009 net lending by the sector went into reverse for the first time since data began to be collected in 1982.[7]

6 Source: Building Societies Association statistics and PricewaterhouseCoopers analysis
7 Source: Council of Mortgage Lenders statistics

All change? Developments in the outlook for UK building societies

continued...

The combination of increasing funding costs, decreasing net lending and very low base rates squeezed building societies' net interest margins, and competition for retail deposits is maintaining that pressure. The societies are facing tough competition from established banks, which have funding challenges of their own, not to mention National Savings & Investments and new retail banks with deposit-led strategies. Foreign players are also active in the UK savings market. The Irish and Icelandic banks may have retired, but others – such as the Indian banks that currently feature in best buy tables – are resurgent.

Combined with the costs of the Financial Services Compensation scheme, this margin pressure is putting the sector's core profitability under strain. Potential responses include acquiring existing savings books from other deposit-takers, developing non-balance sheet business and making cost-focused adaptations such as back-office outsourcing.

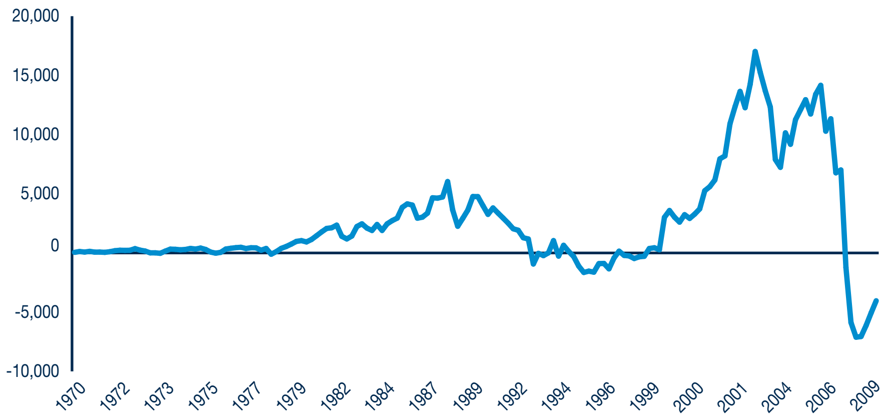
Unfortunately, all of these moves require capital investment, at a time when prudential regulation of the sector is tightening. In 2009, the FSA ruled that permanent interest bearing shares (PIBS), a form of subordinated capital unique to the sector, could not be counted towards Tier 1 capital. The societies' need for additional capital has consequently grown, and is only likely to increase further with the advent of Basel III, which is expected to place more stringent capital requirements on all European mutual banks.

A key question then is how to introduce new capital to the societies without compromising their mutual status?

8 'NBNK Investments starts trading as it eyes UK banking assets', Wall Street Journal, 21.08.10

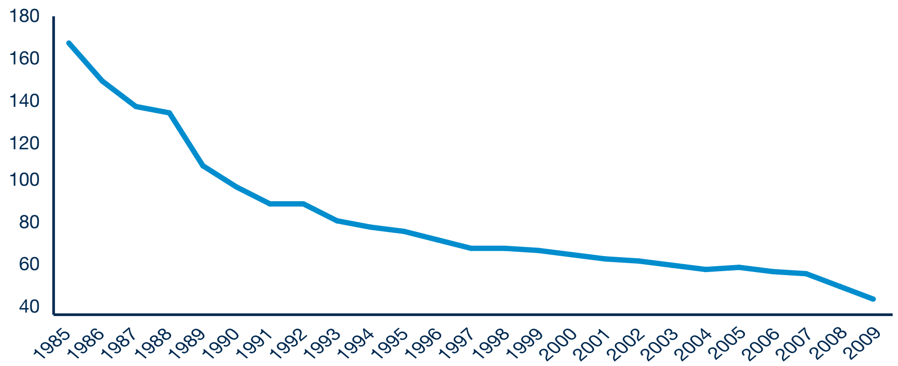
9 'Building society capital and related issues', HM Treasury, March 2010

Figure 2: Total net quarterly housing equity withdrawal by individuals (£m)



Source: CML, PricewaterhouseCoopers analysis

Figure 3: Number of UK building societies



Note: In 1910, there were 1,723 authorised building societies in Great Britain. This figure declined to 726 by 1960 and 273 by 1980.

Source: Building Societies Association

In the past, PIBS might have been seen as the solution, but the loss of their Tier 1 status and the fact that institutional holders were arguably hurt by the conversion of West Bromwich's PIBS into profit-participating deferred shares (PPDS) means that these instruments have lost their appeal for issuers and investors alike.

The UK coalition government has stated its hope that a revived building society sector – in combination with new retail banking entrants such as Metro Bank, Virgin Money and the NBNK Investments PLC[8] among others – will strengthen competition in consumer banking. Indeed, a March 2010 discussion paper from HM Treasury called on societies to develop a new form of instrument that would combine bond-like attributes with equity-like loss absorption.[9] There is little doubt that both the FSA and the societies would be delighted by such a development, and for a time the Building Societies Association had hoped to

agree a new category of 'mutual ordinary deferred shares' with the FSA. However, this has proved a difficult square to circle, not least because investors remain wary of the risks of regulatory-driven restructuring.

The obvious alternative to introducing new capital to the sector is to use existing resources more efficiently – in other words, to merge. The rationale for building society consolidation is straightforward: Deals offer the chance to realise cost synergies, improve diversification and access cheaper wholesale funding. The financial crisis has certainly proved a catalyst for consolidation among building societies, which has accelerated since 2007 (see Figure 3).

Mergers announced during the last two years include Yorkshire's merger with the Barnsley, and then with the Chelsea; Skipton's mergers with the Scarborough and the Chesham; Nationwide's absorption of the Derbyshire, the Cheshire and much of the Dunfermline; and the merger of Co-op Financial Services and the Britannia. The effect has been to reinforce Nationwide's leading position, with Co-op/Britannia and Yorkshire/Chelsea the only other societies coming close to a national branch network.

Furthermore, July 2010 saw the appearance of a potential new avenue for societies seeking to access external capital. The announcement that the Kent Reliance was in talks with US private equity house J.C. Flowers over a new joint venture came as a surprise to many in the sector.

According to the published terms of the transaction, Kent Reliance will convert into an 'industrial and provident' society, the same legal structure as Co-op Financial Services.[10] In exchange for a £50m injection of capital, the society will give J.C. Flowers part-ownership of a new banking subsidiary into which it will place its main activities. Comments reported in the media at the time of the initial announcement suggested that J.C. Flowers was ready to recapitalise a number of societies in this way, and that the new entity could serve as a consolidation vehicle to create a 'mini super-mutual'[11].

This deal clearly opens the possibility of other foreign investors or new entrants to the UK banking market becoming involved in the mutual sector. Regulatory attitudes will be crucial, but the presence of former FSA chairman Sir Callum McCarthy on J.C. Flowers' UK board is unlikely to harm the proposed deal.

In conclusion, there is no doubt that building societies' models are under significant pressure and that many societies would benefit from injections of fresh capital. However, until the legal, regulatory and competition frameworks within which the societies operate are clarified, the sector will struggle to raise Tier 1 capital on the open markets.

Even so, the societies are not without options. Mutual mergers will continue to attract societies seeking greater financial stability, and the potential involvement of private equity or other investors raises further possibilities for strategic transformation. Societies wishing to survive and prosper in the future must resist the temptations of inertia. Instead they should make a clear-headed assessment of the challenges facing their business and, if they have not already done so, begin to explore their strategic choices.

Editorial eye

We have written about the challenges of the UK building society sector in earlier editions of Insight and the drivers for M&A activity and restructuring in the sector have, if anything, increased over the last 12 months. We believe a number of building societies have an unsustainable business model on a stand-alone basis and we expect the strategic conversations and transactions to continue over the forthcoming quarters.

10 'New Business Structure and Capital Investment', Kent Reliance Building Society, 03.08.10

11 'Building societies tackle merger issues', Financial News, 19.07.10

Looking Ahead

Financial services M&A in the first half of 2010 may not have lived up to expectations, but we expect industry restructuring to continue to drive deal activity in the second half of the year. We also see the potential for a slow recovery in growth-oriented transactions, albeit in a rather different form to those seen during the boom years.

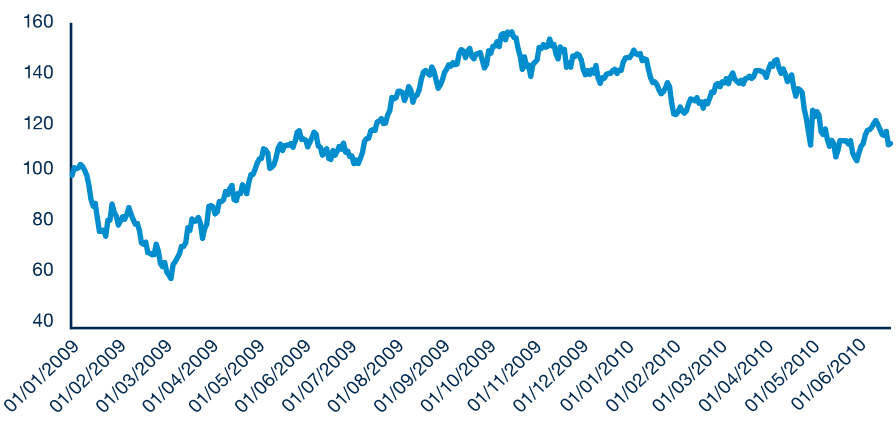
In common with many commentators, at the start of 2010 we felt that the scene was set for a recovery in M&A activity. In fact, debt finance has remained expensive, financial markets have become more volatile in recent months (see Figure 1) and it has been hard for buyers and sellers to agree on valuations. As discussed in 'Data analysis' (see pages 3–5) this has had a direct impact on levels of M&A activity, especially at the large end of the spectrum. Our perception is that the collapse of Prudential's ambitious bid to acquire the Asian assets of AIG may also have dented confidence among chief executives and deal-makers in European financial services.

Even so, we believe that the underlying drivers of European financial services M&A remain at work, and we expect the coming months to see a continuing flow of mid-market deals punctuated by the occasional €1bn-plus transaction. We have grouped the areas where we expect to see deal activity under two main headings.

Further industry-wide restructuring. Banking restructuring may not be the only game in town, but we expect banks to remain at the heart of European financial services deal activity, both as sellers and bidders. More specifically, we predict:

- Further consolidation in areas of European banking seen as being under particular stress, such as Greek private sector banks, Spanish Cajas, German Landesbanken and UK building societies;
- Additional disposals of non-core activities such as asset management (including wealth management), payment processing and asset servicing, especially, but not uniquely by, banks like Lloyds Banking Group, ING and Commerzbank, which need to satisfy European Commission state aid conditions;
- More sales of captive insurance subsidiaries by banking groups, especially in areas of Northern Europe where the bancassurance model has not always worked well; and
- Further disposals of bank branch networks, such as Royal Bank of Scotland's recently announced sale of its 318 former Williams & Glyn's branch network.[12]

Figure 1: European Financial Services Equities Index, January 2009 – June 2010



Source: Datastream

12 'Santander seals deal for 318 RBS branches', Financial Times, 04.08.10

Beyond banking-led activity, we also expect to see:

- Further consolidation among European insurers, as global groups look to trim their developed market businesses and re-focus on higher-growth markets in Asia; and
- Additional scale-building and restructuring deals among asset managers and asset servicers, encouraged by the wave of new regulation affecting the industry.

Investment in growth. We are not predicting a return to significant numbers of large cross-border deals aimed at acquiring growth or building instant scale in 'second home' markets. Nonetheless, we believe that coming quarters will see a slow recovery in transactions aimed at raising the growth profile of bidders, whether they are based in Europe, North America or Asia. These could include:

- Scale driven consolidation in the insurance industry. We have already seen transactions and bids for scale driven deals across Europe (particularly in the UK) and there are plenty of rumours of multi-billion euro bids in the short-term future.
- Deals aimed at acquiring positions in rapidly growing financial services markets such as Turkey, the Middle East or North Africa;
- Transactions focused on acquiring Europe-based expertise – especially in asset (including wealth) management or investment banking – and leveraging this across emerging market-based financial groups; and
- Deals involving targets in mature markets with potential for above-market rates of growth. Santander's acquisition of part of Royal Bank of Scotland's branch network, announced after the quarter end, is an example. The UK is now one of Santander's strongest units and this deal could give a boost to Santander's ambitious growth plans for UK business banking.

In addition, we expect the revival in private equity deal-making to continue. Secondary and even tertiary buyouts may become an increasing feature as funds look to drawdown on existing capital commitments. The acquisition by two US private equity firms of Royal Bank of Scotland's Global Merchant Services unit[13] (including its WorldPay brand), announced after the quarter end, suggest that direct investments will also remain firmly on the horizon.

13 'RBS to unveil £2bn sale of card processing arm', Financial Times, 05.08.10

Methodology

FS M&A deal activity analysis

This issue includes financial services deals:

- Reported by mergermarket, Thomson and Dealogic;
- Announced during the second quarter of 2010, and expected to complete;
- Involving the acquisition of a >30% stake (or significant stake giving effective control to the acquirer); and
- Acquisitions of European based financial services targets where a deal value has been publicly disclosed.

Since 2009, our data coverage has included Dealogic information. However, comparative figures for previous years have not been restated.

Our analysis also excludes deals that, in our view, are not 'pure' financial services deals involving corporate entities or entire operations, 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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