Damage control tops the agenda for state-aided banks

While rating agencies are beginning to show first signs of positive sentiment towards European banks, the shifting regulatory landscape continues to complicate M&A processes, making it challenging to find committed buyers. Against this backdrop, high levels of financial sponsor interest in stressed and distressed assets are a welcome source of new capital. Recovery is certainly possible, but not without significant uncertainty.

Our 2018 M&A forecast

State-aided banks

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High levels of M&A as stability funds across Europe seek to offload 'good banks'. Pressure from ECB on Southern and Central European market players boosts NPL disposals and dealmaking.

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As pressure from local and supranational regulators mounts, state-aided banks seek to repair their balance sheets. Failure to act could result in a tailspin into financial distress

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Four key questions highlight the challenges and opportunities for M&A involving state-aided banks.

Q There appears to be a steady flow of M&A involving state-aided banks. Why are these deals coming to market now?

A Governments are eager to offload stakes in banks bailed out during and following the financial crisis, which have since recovered. Local prudential regulators appear supportive of this policy and are facilitating opportunities to ready assets for sale and address potential buyer concerns. The EC, for example, has approved Portugal's restructuring plan for Novo Banco and a €5.4 billion state bailout of Monte dei Paschi. By offering this kind of support, regulators seek to provide certainty over various long-running issues that have dogged state-backed banks until now. This should facilitate exits.

Q Why are auction processes being dragged out in the first place?

A An uncertain regulatory environment is one reason. For example, the UK government is consulting on tougher measures related to bank mergers, while the EC has issued a new discussion paper stating that 19 foreign banks will need to improve regulatory oversight. Some buyers are reluctant to take the plunge until there is more certainty around these key regulatory issues. Other buyers, financial sponsors in particular, are demanding seller protections that governments are reluctant to offer.

Q Given the fact that regulators are displaying more support, are M&A processes likely to be relatively straightforward from here on in?

A Not quite. Some government exit strategies are coming under pressure, despite tacit regulatory backing. Government stability funds that have supported troubled banks have been stretched themselves and are focused on achieving a "clean break" from such assets.

Q Where is the most deal activity taking place?

A A number of state-backed banks, including ABN AMRO, UniCredit and Intesa Sanpaolo, are among many that have been able to strengthen their balance sheets by selling off large portfolios of NPLs. Others, like National Bank of Greece, which has made no fewer than six disposals this year, have exited non-core operations. There have also been several state-backed bank mergers, such as the tie-ups between Bankia and Banco Mare Nostrum in Spain.

State-aided banks (continued)

2018 outlook

A constant high level of M&A activity as stability funds seek to offload 'good banks', and the European Central Bank exerts pressure on market participants, especially across Italy, Greece, Spain, Portugal and Austria.

Current market

Upward, significant

We are seeing

- NPL management and disposals
- Continuing non-core disposals
- Market consolidation, especially across the retail banking sector
- M&A activity involving government stability funds
- Continuing high level of financial sponsor interest in stressed and distressed assets

Challenges

- Government stability funds' exit strategies are under pressure. Temporary financing measures are necessary to allow breathing space as auction processes are becoming increasingly challenging
- Rising borrowing costs for struggling banks
- Few committed buyers and tough deal-financing market conditions
- 'Shifting sands' of regulatory landscapes making it tricky to find committed buyers
- Stringent and complex auction process rules
- Private equity buyers seeking to extract buyer-friendly deal protection from sellers/governments/stability funds
- Heightened litigation risk: 'private' litigation from market participants' reaction to government action, as well as 'public' litigation from inconsistency from application of new Member State regulatory reforms
- Damage to buyer sentiment by inconsistent implementation of supranational legislation across the EU

Trends to watch

- There is a perception that local prudential regulators are being lenient on sellers. But it is still unclear whether direct supervision of Significant Institutions by the European Central Bank will result in strict compliance with resolution ability
- Rating agencies showing early signs of positive sentiment towards European banks
- Inconsistency between antitrust and prudential regulatory imperatives continues to complicate processes

State-aided banks – Key deals and situations

NPL management and disposals	□ Banca Mediocredito del Friuli Venezia Giulia's disposal of €385 million of NPLs (*August 2017*) □ Liberbank's disposal of €169 million of NPLs (*July 2017*) □ Banco Ibercaja's disposal of €489 million of NPLs (*July 2017*) □ Caixa Geral de Depósitos' disposal of €476 million of NPLs (*July 2017*) □ UniCredit's disposal of €450 million of NPLs (*June 2017*) □ Intesa Sanpaolo's disposal of €2.1 billion of NPLs (*June 2017*) □ ABN AMRO's disposal of €200 million of real estate NPLs (*July 2017*) □ Banca Carige's disposal of €940 million of NPLs (*May 2017*) □ Banca Sella's disposal of €125.5 million of NPLs (*May 2017*)
Non-core disposals	□ RBS's disposal of 4% of Euroclear *(October 2017)* and 33.3% of Hua Ying Securities (*July 2017*) □ NL Financial's disposal of 7% of ABN AMRO (*September 2017*) □ Novo Banco's disposal of 90% of Banco Internacional de Cabo Verde *(August 2017)* and 75% of its Macau-based operation (*May 2017*) □ NBG's disposal of 99.8% of South African Bank of Athens Ltd. *(August 2017)*, Vojvodanska banka a.d. Novi Sad (*August 2017*), NBG Leasing (*August 2017*), United Bulgarian Bank (*June 2017*), Interlease (*June 2017*) and 75% of Calamos-Exin (*June 2017*) □ NordLB's disposal of Deutsche Hypothekenbank (*July 2017*) □ BES Venetie's disposal of Benfica (*June 2017*) □ Alpha Bank's disposal of Alpha Bank Srbija (*April 2017*)
Consolidations	□ Santander's acquisition of Banco Popular Español (*July 2017*) □ Intesa Sanpaolo's acquisition of good assets of Banca Popolare di Vicenza and Veneto Banca (*June 2017*) □ Bankia–Banco Mare Nostrum merger (*June 2017*)
Exit strategies under pressure	□ Eurogroup Chairman, Jeroen Dijsselbloem, stated Greece must wrap-up an upcoming bailout review quickly to effect a 'clean' bailout exit in mid-2018 (*September 2017*) □ Single Resolution Board Chairman, Elke König, called on the EU to implement tighter restrictions on winding down lenders (*August 2017*) □ Taxpayer bail-out of Veneto Banca and Banca Popolare di Vicenza amidst controversial Single Resolution Board support on grounds that formal resolution under the EU Bank Recovery and Resolution Directive was 'not warranted in the public interest' (*June 2017*)
'Shifting sands' of regulatory landscapes	□ UK Financial Reporting Council will require banks to disclose expected effects of IFRS 9 loss accounting rules (*October 2017*) □ UK government has begun its consultation on proposed amendment of policies related to UK bank mergers (*October 2017*) □ European Commission could have power to block Chinese and other foreign takeovers under a new EU screening framework (*September 2017*) □ EU discussion paper stated that 19 foreign banks in the EU (including BAML, J.P. Morgan, Morgan Stanley and Mitsubishi UFJ) will need to set up new holding companies to improve regulatory oversight (*September 2017*)
Stringent/complicated auction processes	□ Auction sale of Novo Banco took nearly 3 years to complete (*October 2017*) □ Banco Popular's shares plummeted 17% to record lows over concerns that no buyers would be found (*June 2017*) □ NBG struggled to find buyers for Ethniki Hellenic General Insurance, finally selling to Exin Partners (*June 2017*) □ RBS's proposed sale of its stake in Alawwal Bank (previously Saudi Hollandi) was abandoned (*April 2017*)
PE seeking to extract buyer-friendly deal terms	□ Lone Star secured back-stop guarantees from Fundo de Resolução (for a Tier 2 capital raise and capital shortfalls resulting from legacy portfolios) in connection with its acquisition of 75% of Novo Banco (*October 2017*) □ Blackstone reportedly secured favourable terms for its 49% stake in real estate management JV with Banco Popular (*August 2017*)
Heightened risk of 'private' and 'public' litigation	□ Private: – Northern Rock's shareholders renewed their legal campaign for compensation (*September 2017*) – Santander has provisioned €7 billion for potential Banco Popular lawsuits (*September 2017*) – Banco Popular's investors are seeking annulments of Single Resolution Board and European Commission decisions which led to Santander's acquisition (*August 2017*) □ Public: – US Federal Deposit Insurance Corp launched a UK High Court claim against 9 banks for alleged LIBOR-rigging (*August 2017*)
Perception of lenient regulators	□ European Commission approved Portuguese restructuring plan of Novo Banco (*October 2017*), □ European Commission approved RBS's abandonment of Williams & Glyn disposal (*September 2017*) □ European Commission approved €5.4 billion state bailout of Monte dei Paschi (*July 2017*) □ European Commission approved aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law (*June 2017*)