# Restructuring In The Banking & Financial Services Sector

## Pauline Renaud, June 2010

Banks and financial institutions around the world have been forced to take restructuring action to address deep-rooted issues. In the main, those actions have involved cutting jobs and locations to focus on vital and profitable units. The financial crisis has also forced institutions to scale back their operations abroad and concentrate on their home markets where they have local knowledge.

The banking & financial services sector is expected to see more consolidation going forward, with cash-rich players swallowing their struggling rivals. In particular, Western companies with units in the Far East are expected to continue divesting to local firms. However, many sellers are finding it difficult to offload units at reasonable valuations in the current market. Indeed, several restructuring and transactional challenges exist along the way, which need to be addressed effectively to make the most of current distressed opportunities and help companies emerge stronger from the uncertainty.

Restructuring in the banking sector is rarely a straightforward process. One deal that illustrates the challenges of integration during the consolidation process is the break-up of ABN AMRO between RBS, Fortis and Banco Santander, in the biggest banking takeover in history. Following the onset of the financial crisis, the Dutch government nationalised the divisions owned by Fortis, while the British government is now in control of the divisions allocated to RBS due to the financial bailout of the Scottish bank. The process of integrating some of ABN AMRO's divisions into the new owners, and divesting others, has not been achieved yet. "Dutch financial markets are still in the process of settling issues surrounding the split up and subsequent merger of Fortis and ABN," says Vincent Vroom, co-head of the restructuring group at Loyens & Loeff N.V. "Furthermore, other financial institutions, such as bank-insurance companies, like ING, have been forced to restructure by governmental authorities, such as the Dutch government or the European Commission, in order to improve their risk profile or the market structure in general." Under European rules, companies that received state support in the context of the financial crisis have been required to submit a restructuring plan to demonstrate their long-term viability. The main aspects of ING's plan, announced last year, included a complete separation of its banking and insurance units and the divestiture of some operations.

Governments and regulators in other countries have also pushed for restructuring efforts to be undertaken by financial institutions. The US administration introduced a series of regulatory proposals in June 2009 addressing consumer protection, executive pay, bank financial cushions or capital requirements and expanding regulation of the shadow banking system and derivatives. Last January, President Obama proposed additional regulations limiting the ability of banks to engage in proprietary trading. "But institutional lenders are in something of a double bind from federal policies in the US," points out Patrick Darby, a partner at Bradley Arant Boult Cummings LLP. "On the one hand, members of Congress and the administration criticise banks for hoarding capital and not making loans to individuals and small businesses. On the other hand, federal regulators are pushing underwriting standards that attempt to eliminate risk or reduce risk to levels that are impractical. Congress also is considering additional regulation to prevent another credit crisis." He adds that by preventing banks from taking risks when lending, federal regulation in this area threatens to choke the recovery. The US Senate is currently considering financial reform legislation which would create a new Bureau of Consumer Financial Protection and make sales of most derivatives take place through a public clearinghouse.

**Seizing distressed opportunities**

Due to potential regulatory hurdles, financial institutions are strongly advised to take cautious steps when restructuring their operations. "Depending on the kind of financial institutions, a contemplated restructuring or reorganisation may require the consent and cooperation of the competent supervisory authority," explains Mr Vroom. "Establishing a clear time-path for all parties involved, including the competent supervisory authority, is key. Involving professional advisers who not only know the rules but also the merits of the relevant supervisory authority and maintaining good contact can create advantages."

Despite potential difficulties, restructuring and consolidation efforts are essential to maximise recovery and opportunities that currently exist in the banking and financial services sector. As Mr Darby points out, some financial institutions have become more aggressive about selling their distressed loans to third-party investors. "The downside of this is that distressed loans sell at a discount. The upside is that a sale of distressed paper presents a quick exit strategy. The discount on principal is balanced in part by reduced costs of managing the loan through restructure or enforcement of legal remedies. Plus, the institution is able to streamline its procedures and clean up its balance sheet faster." Some lenders are also willing to bring litigation against obligors and guarantors, and to enter into settlements of loan debts at below par value in order to enhance their ability to recover from the financial crisis.

In the Dutch market, a main point of focus has been on the enforcement of share pledges by senior lenders. "Two key Dutch cases have dealt with this the past couple of years: the enforcement of the shares in JVH Gaming B.V. and subsequently the enforcement of the shares in Schoeller Arca Systems," says Mr Vroom. "JVH Gaming B.V. concerned an entity in the gaming industry and was the first loan market association-type share enforcement transaction in the Netherlands. This was a consensual deal, without court involvement. The senior lenders enforced their share pledge in Schoeller Arca through a court process," he adds. On 23 September 2009, the Dutch court gave its approval in respect of a private sale of the shares in the Dutch holding company Schoeller Arca Systems, by way of an enforcement of a Dutch law share pledge. It was the first Dutch court ruling in respect of a Dutch pre-pack whereby an enforcement sale of a Dutch holding company is pre-agreed between a buyer, the company and its senior lenders – its subordinated bridge lenders opposed to the proposed sale. The decision introduced the possibility for a secured lender either to wipe out subordinated mezzanine debt or to implement a loan-to-own strategy.

With several investors and firms now in a stronger position, some hotspots of distressed deal activity have emerged in recent months. The US market presents a significant number of potential opportunities in the banking, asset management and insurance sectors for investors that have the liquidity and capital strength to be acquisitive again. Recent large deals include the $51bn sale of foreign life insurance units relinquished by American International Group, as well as the $2.31bn sale of PNC Financial Services Group's investment servicing unit to Bank of New York Mellon. Consolidation is also increasing among independent, small to mid-sized asset managers in both traditional and alternative asset management sectors, as valuations improve. "Market participants and commentators have noted that cash-rich investors have sat on the sidelines through much of the financial crisis but in recent weeks and months, we have seen a great deal of money move into the market for distressed assets. Apparently, many investors have determined that the market has hit bottom and are eager to find bargains," says Mr Darby. He also believes that private equity investors and strategic purchasers with an interest in underlying assets will be well positioned to conduct distressed deal activity, as long as they have plenty of capital and the ability to wait for the expected rebound.

In Europe, with UK banking groups required to divest a large portion of their operations to meet EU competition rules, acquisitions by foreign financial institutions are expected to be a key source of activity. Some of the larger European firms benefiting from distressed opportunities include ING, which is expected to strengthen its position as the largest player in the Dutch market. Deutsche Bank may also play an improved role in the Dutch market following its acquisition of a stake in ABN Amro, which had to be divested as a result of the merger. Although restructuring efforts can sometimes be painful and complex, they are also necessary not only to comply with banking regulations but also to improve the long-term prospects of a financial institution. Divestiture requirements will create distressed acquisition opportunities for investors and firms. And with more financing now available, M&A in the financial sector is expected to dramatically increase in the months ahead.