Background to the RBS Consortium acquisition of ABN Amro

In April 2007, the European Commission ordered Dutch regulators to allow the takeover of ABN Amro (ABN). Soon after, ABN received a €66bn takeover bid from Barclays Bank. Two days later a consortium (the RBS Consortium), led by Royal Bank of Scotland (RBS) and including Fortis Bank and Banco Santander, made an even bigger offer of €72bn, €50bn of which would be cash and the remainder of which would be made up of shares in RBS.

Significance of the deal

The takeover is unrivalled in terms of size and complexity and is hugely significant as it is the world’s biggest banking transaction to date and the first cross-border takeover of a European bank. For example, the €13.4bn rights issue that Fortis needed to fund its contribution of the €70bn was the biggest ever in Europe. No European bank had ever succumbed to a cross-border hostile bid and it is interesting that the acquisition was for a perfectly solvent conglomerate. It is commonplace for acquisitions like that of ABN to happen in circumstances where there is a disparity between two organisations or where one organisation is in financial crises. An example of this is the Virgin Group’s proposed acquisition of Northern Rock following the effect of the credit crunch, where share prices tumbled to an all-time low.

In the case of ABN, you have a bank with a significant presence in the European banking market and its performance certainly did not suggest that it was in any financial difficulties. Although takeovers are often triggered by the weakness of the target, ABN is a huge organisation with offices in 53 countries and its reputation was never that of a desperate operation. To give you an idea of the size of ABN Amro’s operation, here are a few facts provided by fsteurope.com:
• Founded in 1824
• Total operating income €22.658bn
• Ranked as the eighth largest bank in Europe
• Headquartered in Amsterdam, with more than 4,500 branches in 53 countries
• Employed more than 105,000 people before the takeover

With the exception of HSBC, American banks such Citigroup, Bank of America and JP Morgan dwarf all of the European banks and tend to top most of the league tables in terms of size and revenue. As the eighth largest bank in Europe, a combined force of ABN and RBS, or even Barclays, would allow the new owners of ABN to move up into the league of some of their American counterparts.

One of the significant factors had been ABN’s sale of LaSalle, its US banking division, to Bank of America for a total of about €12bn in cash.

The offers: RBS Consortium versus Barclays

The takeover is described as hostile because the board of ABN Amro did not recommend either the offer from Barclays or the RBS Consortium. It was therefore the shareholders (owners of the company) who were instrumental in voting. Shareholders will typically support the offer that delivers them the biggest gains. Among ABN’s largest shareholders were pension and fund managers, and because they own such a large proportion of the shares their votes were crucial.

The RBS Consortium was competing against Barclays Bank, which outlined plans for a €65bn takeover of ABN in March 2007. Market forces including the credit crunch (for more information see ‘The Ultimate Law Guide to the Credit Crunch and the implications for corporate law firms’) and the subsequent support offered by the Bank of England, which pushed down Barclays’ share price, meaning it was unable to match the €70bn proposed by the RBS Consortium. The RBS Consortium’s offer was cash rich and looked more generous to the ABN shareholders than the equity-heavy offer from Barclays, which was lessened by the fall in its share price.

The shareholders struggled to choose between the larger offer from the RBS Consortium, which would split ABN, and the lower offer from Barclays, which was decreasing daily due to the fall in share price but which would ultimately keep the entire ABN organisation together. In Britain or the US it will be no surprise that the higher offer was preferred. Barclays was seeking to create a new global bank which would become one of the world’s biggest financial institutions. The RBS
Consortium responded by launching a charm offensive to persuade the authorities that its plan to break up ABN was not such a terrible option.

ABN bosses preferred the Barclays offer because this would have kept the institution intact and the headquarters would have remained in the Netherlands. One aspect worthy of note is the cultural difference between the Dutch shareholders and British or US shareholders. The complexity and potential for conflict in the RBS Consortium's proposal was immense. The plan was to split the bank into three parts, and each of the RBS Consortium members would take control of the parts of the banks they were best placed to deal with. In practice, this would mean that RBS would take over ABN’s wholesale operation and its Asian business; Santander would take control of the retail banking franchises in Italy and Brazil; and Fortis would take over the Dutch retail operation, and the asset management and private banking arms.

On 8 October 2007, the RBS Consortium announced that it had secured the bid for ABN after eight months of negotiation. The reason why the Barclays offer fell through was ultimately because it did not meet its deadline for securing majority shareholder support. The RBS Consortium, however, stormed away and its bid was accepted by 86 per cent of ABN shareholders, higher than the 80 per cent threshold required to secure the deal.

The RBS Consortium

The most striking feature about the RBS Consortium was that the three banks each had different areas of specialism and decided to divide up ABN Amro’s assets accordingly. No takeover has ever attempted to split a bank the size of ABN Amro before; there is no precedent for this type of transaction. With its Continental European and South American expertise, Santander would continue to operate the retail banking operation in Brazil and France; Fortis Bank was well placed to take over ABN’s asset management and private banking arms; and finally RBS would be left to take over ABN’s wholesale business, including its Asian operations. This approach was massively opposed by the Dutch unions, which thought that this method would lead to mass lay-offs.

Finding the right partners for a deal like this is difficult work. Unless you have the right combination it will be very difficult to agree on how to divide up the assets, and moreover there is massive risk inherent in restructuring and dismantling an organisation the size of ABN. On this transaction, Merrill Lynch was the sole adviser to all the RBS Consortium members and this obviously helped the RBS
Consortium decide how to divide up the assets. You can imagine that it would have been very difficult if each RBS Consortium member had its own advisor looking out for individual interests.

Successful mergers often come from good cultural synergies. The fact that Belgium’s Fortis Bank would take over part of ABN’s Dutch operations was viewed by many commentators to be positive because middle management had similar outlooks and characteristics, so they would share a similar cultural approach.

**Advantages of this type of merger**

In a typical acquisition of any kind, the acquirer will look for synergies (a fashionable word to denote any type of gain that is greater than the gain by each single organisation when two businesses are joined) between itself and its target. A synergy is about creating value. As early as October 2007, ABN’s clients had already expressed an interest in using the increased number of capital markets services available from the combined bank, including private placings and treasury products.

Buying a rival business is often the fastest way to achieve high growth. When RBS took over NatWest in 2000, NatWest had long been seen as vulnerable to a takeover because of its poor track-record, and the fact that NatWest was forced to accept the offer from a smaller rival was a result of poor performance. The argument was that NatWest was badly managed, and the merger would save billions a year through branch closings and more efficient use of the acquirer’s information systems. In a series of events – which started with NatWest making a bid for Legal & General (the insurance firm), a move that was badly received by investors – NatWest stock fell by close to 26 per cent, and as a result the bank became the target of a hostile takeover bid.

Successful mergers result in economies of scale and for that reason they can result in huge cost savings. For example, during the RBS Consortium’s due diligence process (a process in which a potential acquirer instructs specialists to analyse the assets of the target organisation and investigate further areas if required), the RBS Consortium forecast a massive cost saving and revenue benefits of €1.8bn if they successfully took over ABN.

In addition to cost saving, ABN’s business would allow the RBS Consortium to access a whole new group of clients, particularly in fields where ABN held strong positions, for example in debt and risk management products. The member of the
RBS Consortium who took over this aspect would have a list of ready-made contacts and the goodwill that comes from having built business relationships over the years. The new owners would also have a new host of services to offer their existing clients. Barclays had similar ideas: if it had been successful in merging with RBS, its plan was to eliminate costs of €2.8bn.

Each bank spent a significant amount of time analysing the value that could be recovered through assets sales and reduction in the number of staff. Typically, in bidding wars valuation and bidding strategies play a huge part in the battle; a bidder will always fear bidding over the odds but will be aware of the risk of losing as a result of not bidding highly enough.

**Disadvantages of this type of merger**

All stock market companies have to grow to satisfy their shareholders, who want bigger profits and a higher share price. In order to make a takeover successful, the acquirer needs to think of ways in which it can extract profits from its new business. When Barclays set out its plan for ABN, it contemplated getting rid of around 12,800 jobs from a workforce well in excess of 200,000 and moving over 10,000 jobs offshore.

In fact, both rival banks had planned to trim jobs in order to generate cost savings. The RBS Consortium issued a statement saying that it would keep half of the bank’s current management and half of its supervisory board members, and take full responsibility for ABN until the deal was complete. But it would appear that the RBS Consortium only made this offer to appease Dutch authorities, which were concerned about a lack of stability in ABN during the course of the acquisition.

Individual organisations will not always complement each other entirely and an acquirer may need to assess which parts of a target it will keep. It may be that the acquisition is structured around the takeover of the target’s main business but the acquirer is not interested in the target’s other assets and wishes to sell these off. The disastrous takeover of Donaldson, Lufkin & Jeanette by Credit Suisse First Boston in the 1990s is an example of an acquisition where the institutions were not complementary. There were massive disagreements within the management and little communication between the merged organisations. The bankers fought ruthlessly to determine who would survive on a division-by-division and group-by-group basis.
Other problems include difficulty in dealing with personnel and information technology, and the possibility of a decrease in share price, which may tumble if there is market apprehension due to the thought that the acquirer has overpaid for the target or that the businesses will be too difficult to integrate. The RBS Consortium would do well to follow the approach it took when integrating NatWest, which it acquired following a hostile takeover. Although the share price dropped initially, the merger was a success as a result of RBS’s operations, which improved cash flows and performance (although some of this success was due to the low interest rates during the years that followed the merger and the rising property market in the UK). If investors are not confident about the prospects for the newly merged company, the resulting fall in share price could be disastrous.

The role of the European Commission

The role of the European Commission is to enforce EU competition policy, and the European Commission has the power to block mergers in certain circumstances. In making a decision about a potential merger, the European Commission will evaluate the impact of the merger largely in terms of the following:

- The market position of the merged firm (considering whether the market position means that competition in the relevant field will be reduced significantly)
- The commercial strength of the remaining competitors (if the merger means that competitors are completely overshadowed)
- Customers’ buying power
- Potential competition (is there still a competitive market?)

The majority of cases that are referred to the European Commission are authorised; in the last 15 years less than 20 have been blocked. An example of a blocked merger is the proposed merger between Air Tours and First Choice Travel on the basis that it would create a dominant position in the market for short-haul foreign package holidays in the UK, as a result of which competition would be significantly impeded in the common market. After a similar analysis the European Commission gave the go ahead for the RBS Consortium to take over ABN.
Main economic arguments for approving/rejecting a merger

<table>
<thead>
<tr>
<th>Approval</th>
<th>Rejection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Static efficiency (cost saving)</td>
<td>Creation of monopolies and market dominance</td>
</tr>
<tr>
<td>Increased efficiency</td>
<td>Merger can deter actual or potential competition</td>
</tr>
<tr>
<td>Role of the capital markets (to sort out mergers which fail to deliver forecasted benefits)</td>
<td>Imperfections in the capital markets (unsuccessful managements may remain in place for some time)</td>
</tr>
<tr>
<td>Market contestability (free market to encourage competition)</td>
<td>Employment (loss of jobs)</td>
</tr>
<tr>
<td>Investment (higher level of capital investment)</td>
<td></td>
</tr>
<tr>
<td>Globalisation (improve competitive position of EU companies)</td>
<td></td>
</tr>
<tr>
<td>Enhanced economic integration within the EU</td>
<td></td>
</tr>
</tbody>
</table>

The RBS Consortium will not be able to begin integrating the businesses immediately. First, it will have to agree a strategy with the Dutch regulator, following which it will need to consult unions and employees in relation to its proposals. This may prove difficult and expensive.

**Will the ABN takeover lead to more merger activity between banks?**

The ABN merger with RBS was two years in the making. The chief executive of RBS first met Rijkman Groenink of ABN Amro in February 2005, and it was thought that they continued to correspond over the course of two years in relation to a possible merger of the banks.

*The Economist* explains that merger activity by consortia rather than single banks is the way forward. In this way, banks can share the costs and the risks associated with any merger. It also means that they will not be forced to sell off parts of the target’s business that do not fit in with their own model, as these can be hived off and distributed to the RBS Consortium member that is best placed to take control of those assets.
There may be more banking deals in Europe which take the form of hostile takeovers. Analysts are predicting the inevitability of Barclays pursuing a larger merger or itself become a bid target. Following the ABN takeover (and at the time of writing this article) there have been whisperings that Unicredit are holding talks with Société Générale in France regarding a possible takeover.

Technology is becoming more and more relevant, and banks are able to extract a massive amount of value through the use of technology. Ultimately, this means they can work across borders more easily. The merits of a merger if all the considerations are weighed up correctly can extract massive cost savings. Moreover, many banks are keen to diversify away from saturated home markets and explore new jurisdictions, and the role of technology makes this even easier. The credit crunch has proved that in a shaky economy it is important to have a diverse business, and a by-product of a merger is diversification; however, the outlook must be long term.

There have also been reports that private equity firms may start trying to get in on the act. They have previously avoided banks because they are highly leveraged and this goes against the principles of private equity firms, which make their money by buying companies cheaply and borrowing against the newly acquired company’s assets.

Finally, the regulatory environment is turning towards cross-borders deals. This transition is aided partly by the single currency and partly by changes in legislation. For example, the new European banking legislation, which (at the time of writing this article) will come into force in about eight months, will require that bids be assessed in a non-discriminator way and ‘do not distinguish between friendly and hostile takeovers. This means that if Unicredit did merge with Société Générale, the Trichet doctrine (which allows the French regulators to oppose hostile takeovers) could not be enforced. On this basis, it is inevitable, now that a precedent has been set, that we will see more cross-border mergers in the very near future.
Note to reader:
This article is intended for educational purposes only. The Ultimate Law Guide articles are pitched at practising lawyers, and are worth reading to build knowledge on specific aspects of mergers and acquisitions. The articles are somewhat advanced for the purposes of your training contract interview and you should not think that you have to master all of the issues discussed. However, if you are able to grasp some of the concepts, you will no doubt look even more impressive at your interview.

Further related reading:

‘How to structure an acquisition: Share purchase or asset purchase: tax issues’ [insert link to PLC article]

‘Acquisition finance: considers the commercial factors that influence the buyer’s choice offinance on an acquisition and analyses the most common forms of debt and equity finance.’ [insert link to PLC article]

References

Mahar, J & Polson, K, ‘The battle for Natwest’, , 26 November 2003,
Stewart, D, ‘RBS seal the ABN Amro deal’, Banking Times, 8 October 2007, online at <http://www.bankingtimes.co.uk/08102007-rbs-seal-the-abn-amro-deal/>.


‘European Merger Policy – merger policy’, online at <http://tutor2u.net/economics/content/topics/Europe>.

‘Triple play’, The Economist, 11 October 2007..

Larsen, TL, ‘RBS Consortium to take control of ABN with board nominations’, Financial Times.