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Investor appetite continues to grow

European Investor Insights 2012

European Portfolio Advisory Group

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PwC European Investor Insights 2012 – introduction

Richard Thompson
Chairman, European Portfolio Advisory Group

The enormity of the deleveraging task facing the European banks has been widely discussed. In the past year the banking sector has shown greater openness towards their deleveraging strategies. We estimate that identified non-core loan portfolios in the European banking sector now exceed €2.5 trillion, representing 6% of European banking assets.

The run-off or sale of these loan assets will continue for many years and will make up a significant proportion of future M&A activity. There has already been increasing activity in loan portfolio transactions, although it is still small compared to the overall size of non-core assets. We saw illiquid loan portfolios with a face value of over €30 billion trade in 2011. Based on our market knowledge and discussions with investors, we expect portfolios with a face value of €50 billion to trade in 2012 and €500 billion to trade in the next 5 to 10 years. Indeed, in Europe our pipeline of potential transactions is the longest it has ever been.

Investors have already accumulated c.€60 billion to invest in non-core European loan assets and are undergoing further fundraising. In 2011, as credit for leveraged transactions tightened, the bid-ask spread widened further in many sale processes. As a result, a number of transactions were completed using vendor financing, which helped increase the bid price.

We surveyed over 50 major investors active in the European loan portfolio market. Those surveyed ranged from investment banks and hedge funds to private equity groups. This is one of the most comprehensive surveys that has been carried out and seeks to understand the perspectives of those looking to acquire non-core loan portfolios from financial institutions.

In this document we set out the results of the survey, covering investors' perspectives on a range of topics including pricing expectations for 2012, investment plans by geography and asset class.

Highlights

100% *of respondents plan to make an investment in 2012*

1

Last year we estimated it would take up to 10 years for the European deleveraging process to be completed. Investors are now beginning to realise the scale of the task facing European banks. Although the majority of investors still think the deleveraging process will take up to 5 years to complete, twice as many respondents compared to last year think it will take more than 10 years.

2

Investors expect European portfolio sales to peak in 2013. The injection of liquidity into the market by the European Central Bank (ECB) in 2011 and early 2012 will provide a temporary reprieve for European banks. However, portfolio sales are expected to increase in the following year as banks begin to plan their refinancing of the ECB liquidity injection. This is consistent with what we are seeing in our pipeline.

3

The UK, Germany and Spain continue to dominate the market for loan portfolio sales. However, investor interest in Ireland and Portugal is increasing, arising from the active steps taken by regulators in these countries to restructure the banking system.

4

Investors are showing the greatest level of interest in commercial real estate (CRE) portfolios. This asset class is expected to see the highest level of investment activity in 2012 as real estate prices continue to decline, resulting in higher provisioning levels.

Over 60% of respondents plan to use funding for investments in 2012

5

While the volume of identified non-core loans has increased, we are also seeing a significant increase in investor appetite. Every single respondent in our survey planned to make an investment in 2012.

6

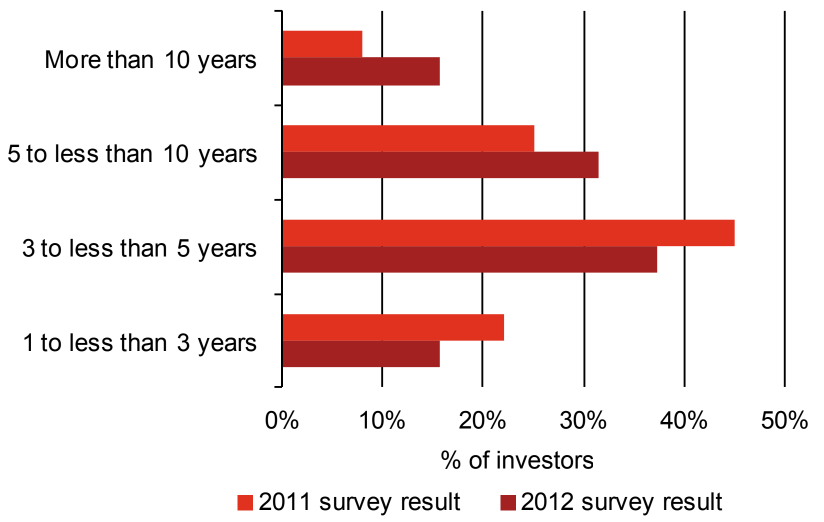
Out of the €2.5 trillion of identified non-core loans in the European banking market, €1.7 trillion are performing assets. Our survey shows that there is an increase in investor appetite for performing loan portfolios. New categories of investor are entering the market, such as insurance companies, pension funds and sovereign wealth funds. These investors demand more stable returns from longer maturity assets and therefore are more suited to performing portfolio investments.

7

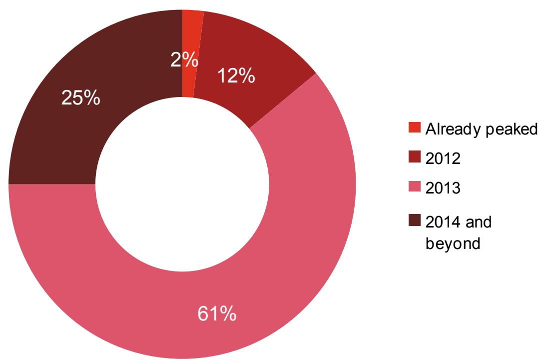
Leverage continues to be an important factor in enabling transactions to complete. Over 60% of respondents plan to use funding for investments in 2012. Following the injection of ECB liquidity into the market, investors remain confident that funding will be available for transactions in 2012 and beyond. Only 18% of respondents thought it would be more difficult to raise debt this year compared to last.

The scale of the deleveraging task facing European banks is beginning to emerge

Expected time for European banks to deleverage



Expected peak of European portfolio sales (% of investors)



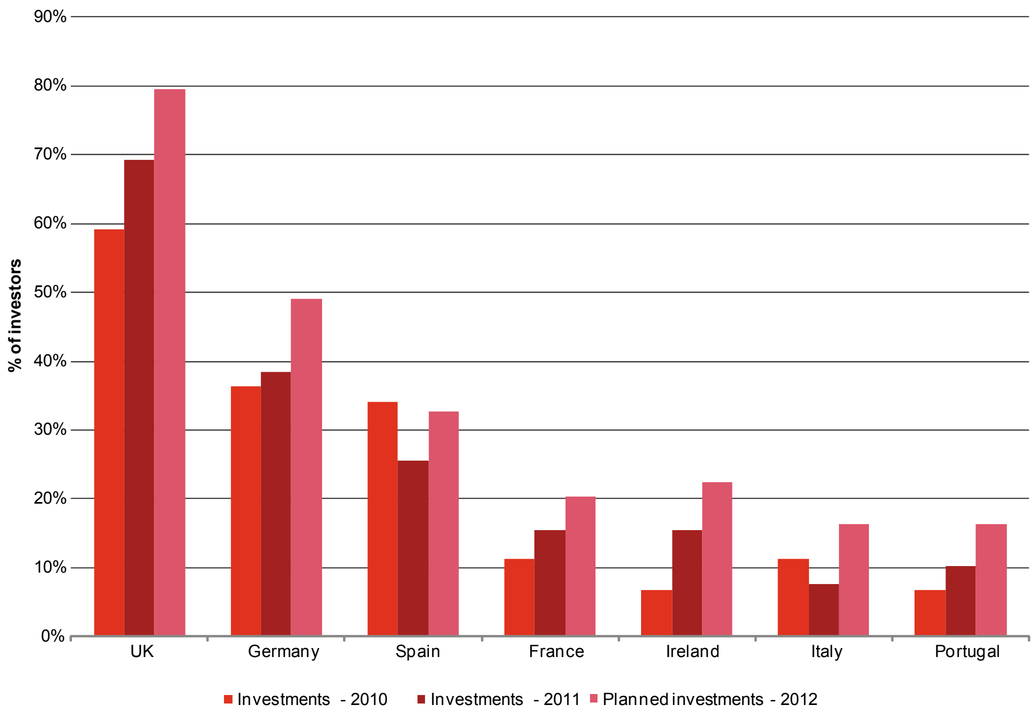
We estimate there to be €2.5 trillion of non-core loan assets in the European banking sector, up from €1.3 trillion a year ago as banks have become more transparent about which assets are classified as non-core. We also believe that the deleveraging process will take up to 10 years to complete.

Investors are beginning to come round to our view. Although the majority of investors think the deleveraging process will take up to 5 years to complete, double the number of respondents this year believe it will take more than 10 years to complete.

Deleverage will be achieved in a number of ways: aggressive run down of portfolios, disposals and asset swaps. We are aware of a large number of portfolios coming to market over the next 12 months, especially in the UK, Ireland and Spain. We expect the face value of transactions involving illiquid loan portfolios to reach €50 billion in 2012, making it by far the largest area of financial services deal activity.

Most investors expect the number of portfolios taken to market to peak in 2013. The injection of liquidity into the market by the ECB will provide a temporary reprieve for European banks in 2012. However, investors expect portfolio sales activity to increase again in the following year as banks are required to refinance. We believe that high levels of transaction activity will continue for many years.

Investors expect the UK, Germany and Spain will continue to see the highest volumes of transaction activity



The UK, Germany and Spain are expected to experience the highest levels of transaction activity by volume in 2012 - a similar picture to both 2010 and 2011.

Transaction levels in Germany and the UK have remained strong as these are the largest and most sophisticated financial markets in Europe. In addition, the economic climate and asset quality in these countries have remained relatively stable year on year.

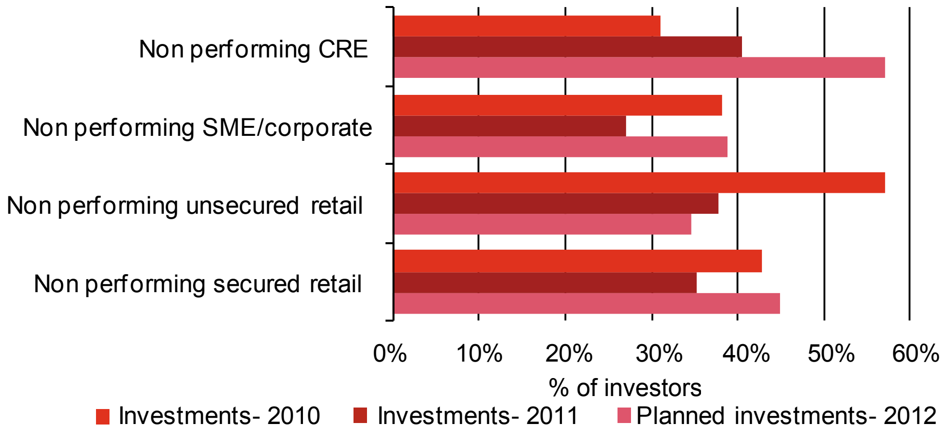
The anticipated high transaction volume in Spain is a result of continued consolidation in the banking sector as well as the increased provisioning requirements imposed on the banking system by regulators.

As we predicted in our 2011 survey, Ireland has seen a marked increase in transaction activity, driven by the active steps taken by regulators to restructure the banking system. Investor demand remains strong, as Irish financial institutions continue their €73 billion asset disposal process as part of the Financial Measures Programme.

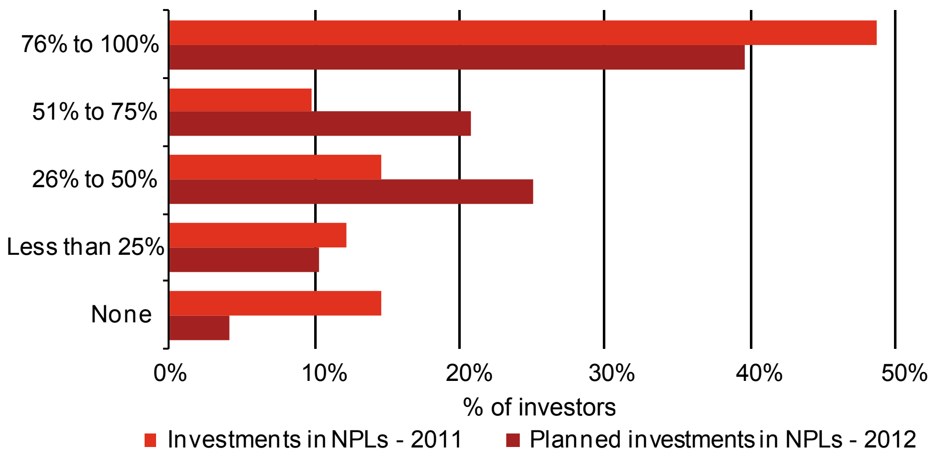
There has been an increase in the percentage of respondents planning to make an investment in Portugal this year. We believe that the loan to deposit ratio targets set by the banking authorities will raise expectations for transaction activity in this market.

Investor appetite continues to grow

Investor activity in non performing loans



% of investments in non performing loans (NPLs)



85% of our respondents made an investment in 2011. This represents an increase in activity from 2010, where 81% invested.

Interestingly, our survey shows that 100% of our respondents plan to make an investment in 2012.

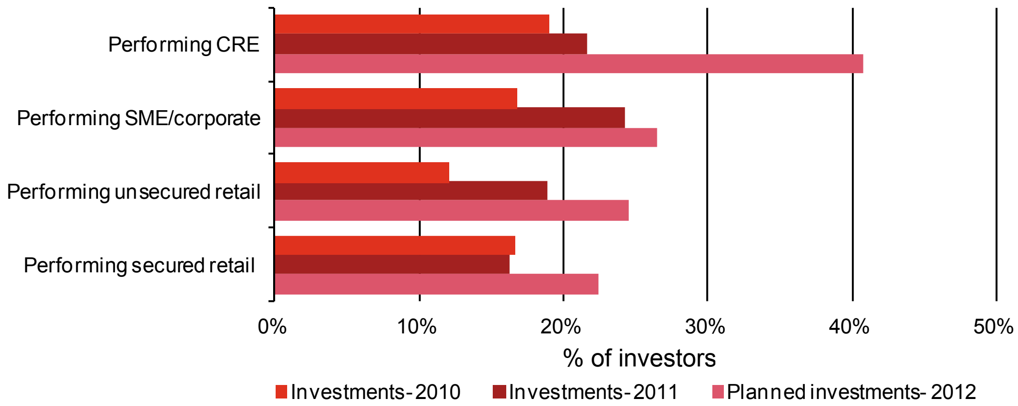
Investors are showing the greatest level of interest in commercial real estate (CRE) portfolios. This asset class is expected to see the highest level of investment activity in 2012 as real estate prices continue to decline, resulting in higher provisioning levels. 57% of investors plan to make a non performing CRE portfolio investment in 2012, rising from 41% in 2011.

The market for unsecured retail portfolios continues to be very active, where sellers' provisioning levels are higher and specialist servicing capabilities exist. In Spain, for example, unsecured portfolios accounted for over 50% of the debt sold in 2011.

Non performing loans continue to dominate the loan portfolio sale market. Close to half our sample invested over 75% of their funds in non performing loan portfolios in 2011.

Investor demand for non performing loans remains strong, and appetite for performing loans is increasing

Investor activity in performing loans



Of the €2.5 trillion of identified non-core loan assets in Europe, we estimate €1.7 trillion are performing.

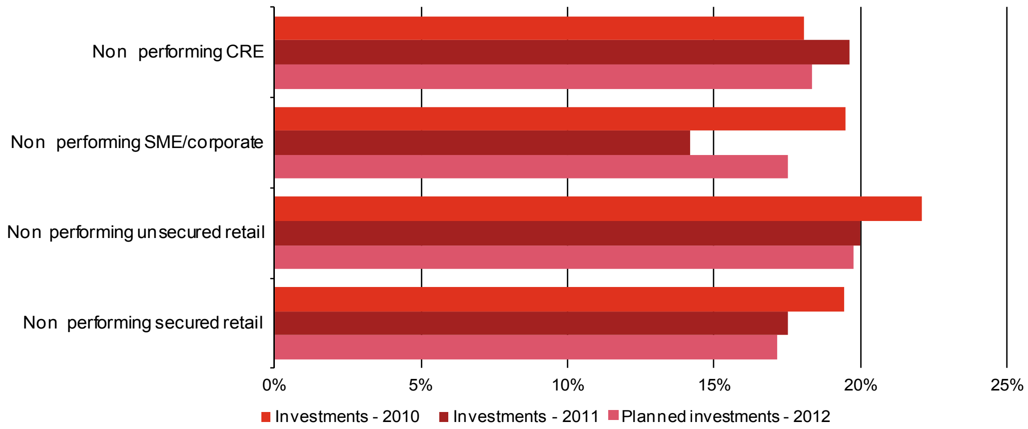
While there has only been a modest increase in performing loan sale activity from 2010 to 2011, our survey shows that there is a significant increase in investor demand for this asset class in 2012.

We are seeing new categories of investor entering the market, such as insurance companies, pension funds and sovereign wealth funds. These investors demand more stable returns from longer maturity assets and therefore are more suited to performing portfolio investments.

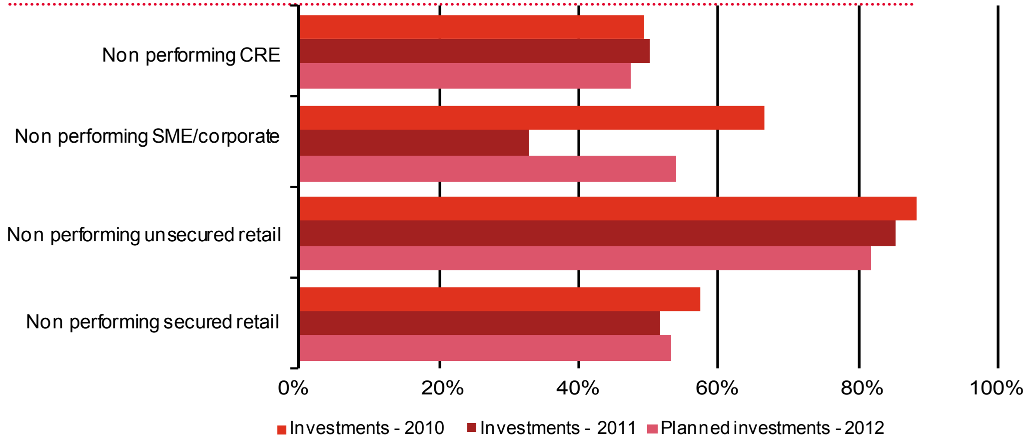
Understanding how to derive value from a performing loan portfolio requires a very different skill set from that required to manage a non performing loan portfolio. In addition, in our experience, driving value from a sale process for a performing portfolio is also likely to be more complex than for a non performing portfolio.

Non performing loans - leverage is pivotal to increase price

Average expected unlevered IRR



Average discount on unpaid principal balance



Despite the significant increase in supply of non-core loan assets year on year, our survey shows that there is a corresponding increase in demand. Internal rates of return (IRR) and portfolio discounts are both receding. This demonstrates that the market for non-core loan assets is growing, creating opportunities for buyers and sellers.

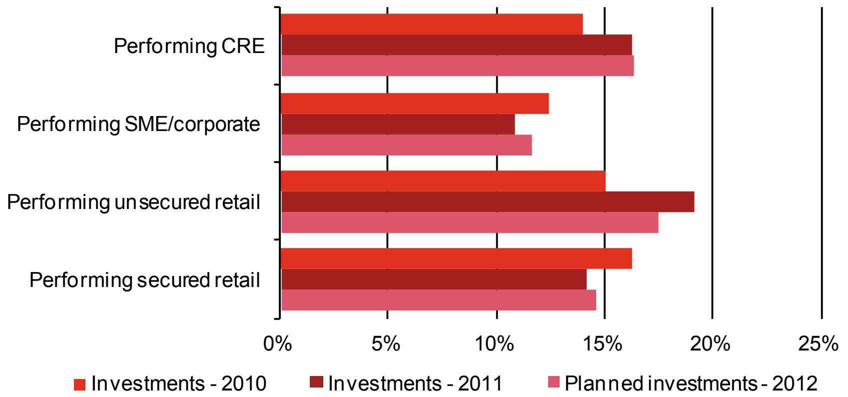
In our 2011 survey, we commented that leverage was an important factor in enabling transactions to complete. The availability of funding increases liquidity and enables a reduction in the bid/ask spread.

With the deepening of the Eurozone crisis during the second half of 2011, there was a reduction in the availability of funding. However, following the injection of ECB funding into the European banking system, investors remain confident that funding will be available for transactions in 2012 and beyond.

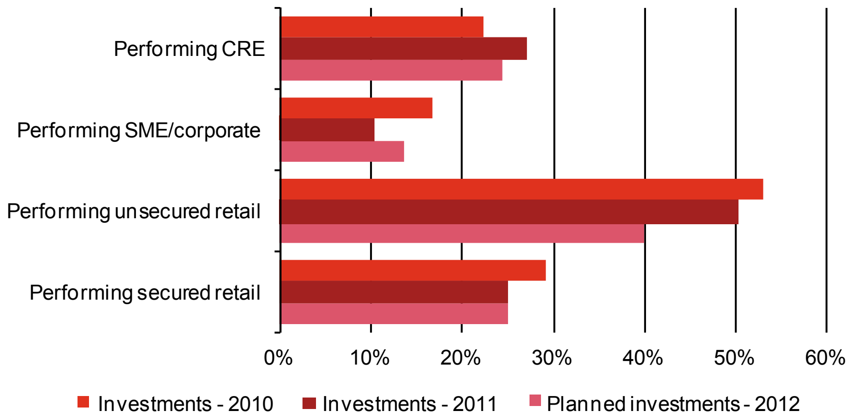
We estimate that investors have already accumulated €60 billion to invest in non-core banking assets and are undergoing further fundraising month on month.

Performing loans - leverage and economic recovery are key price determinants

Average expected unlevered IRR



Average discount on unpaid principal balance



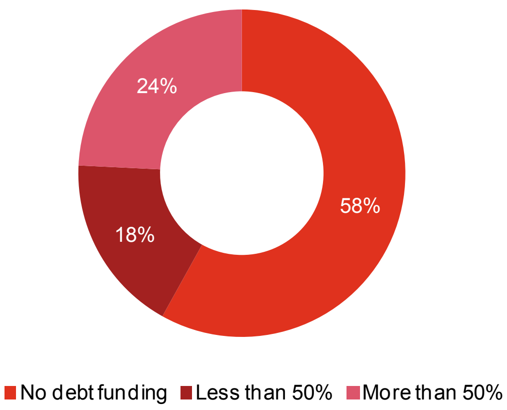
Return requirements for commercial real estate backed portfolios have increased, reflecting the continued erosion of real estate prices across many European countries including the UK and Spain.

Discounts for performing loans have generally fallen. Systematic risk factors play an important role in pricing performing portfolios and although there is still significant economic volatility in Europe, we believe that the increase in prices shown is a symptom of an improved, albeit still volatile, European economy.

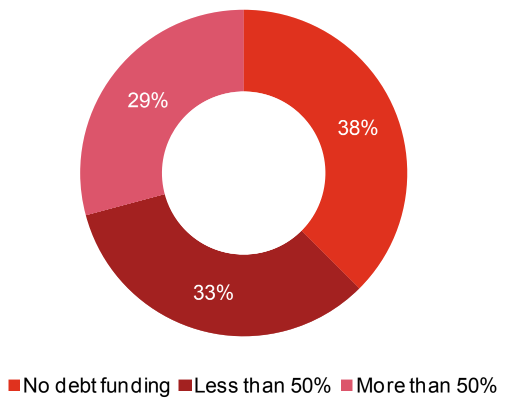
As with non performing loans, the use of funding will be key to increase price. As we explore later in this survey, investors appear to be optimistic about the availability of funding in 2012.

Investors remain optimistic about the availability of funding

Leverage used in transactions – 2011 (% of investors)



Planned leverage in transactions – 2012 (% of investors)



We discussed on the previous pages the importance of leverage to increase price and liquidity in the market. Investors views on their use and availability of funding are consistent with their price expectations.

We noted in our previous survey that 63% of investors planned to use leverage for their investments in 2011. This year our survey shows that only 42% of investors were able to do so.

Our 2012 survey shows that 62% of investors plan to use leverage for investments in 2012. There is clearly a disparity between the desire to use leverage and the availability of funds.

We specifically asked investors if they thought raising debt would be more difficult in 2012 compared to 2011. Only 18% of investors we sampled thought this was the case.

Clearly leverage will play an important role in increasing prices and liquidity in the European loan portfolio market. Investors remain optimistic about accessing further funding for transactions this year. However, whether this funding will be available to investors remains to be seen.

Investor insights into what would increase the completion rate of European loan portfolio sales

Increased provisions

"banks holding assets at realistic carrying values in their balance sheets and making adequate provisions"

"aggressive provisioning policy"

"increased ability/willingness of banks to recognise P&L losses"

"increased provisioning"

"forced accounting recognition of impaired assets -i.e. MTM rather than book value"

"greater willingness on the part of sellers to mark to the actual market"

Availability of funding

"access to funding"

"access to reasonably priced leverage in order to close the bid-ask gap"

"access to third party debt"

"increased funding availability"

"availability of financing"

"available financing"

Role of ECB and regulation

"regulation and legislation implemented for acquisition vehicles"

"transparency and rules for all tenders"

"reduction in ECB liquidity"

"increasing interest rates"

"stronger sanctions against banks who fail to mark-to-market their portfolios"

"reduction in ECB funding and the banks being forced to mark portfolios to market"

"long term funding for banks and lower capital targets"

Innovative structures and portfolio data

"on the buy-side, greater innovation and flexibility on structure"

"structures to accommodate negative swap marks"

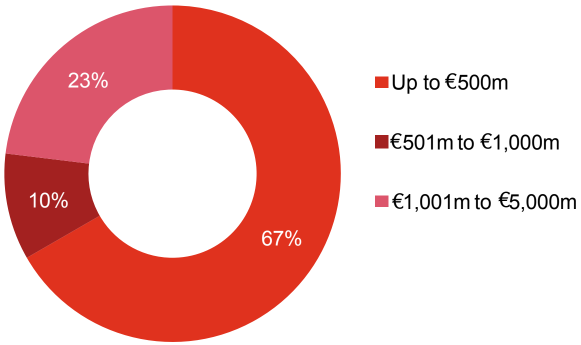
"more limited auctions with better data sharing upfront"

"appropriate loan portfolio composition"

"a better recognition of what buyers want in terms of quality of assets and data"

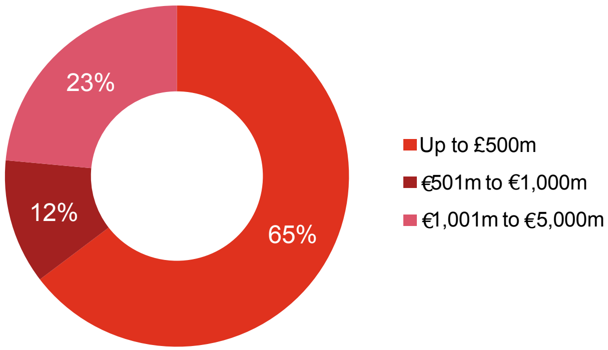
Appendix - other insights (1 of 2)

Size of the equity committed funds available for investment in European loan portfolios (% of investors)



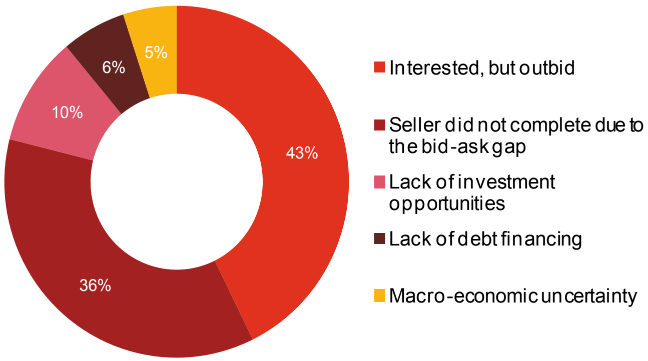
The majority of investors have up to €500m of equity committed funds to invest in European loan portfolios.

Size of funds invested in European loan portfolios in 2011 (% of investors)



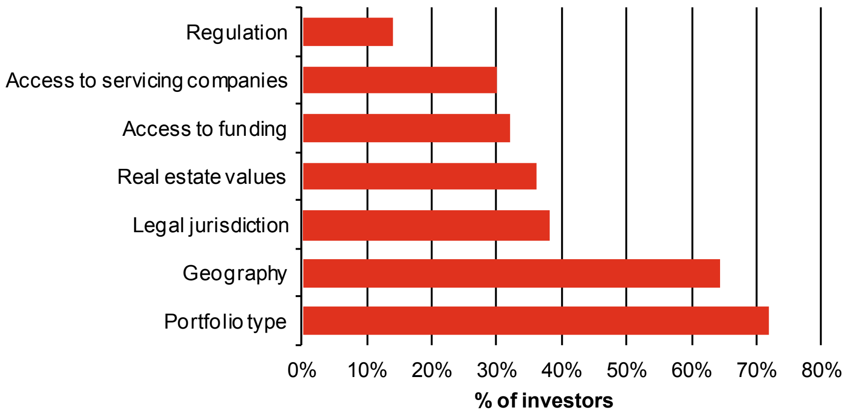
Most respondents invested up to €500m in European loan portfolios in 2011.

Reasons for not investing in 2011 (% of investors)



The most common reason for not investing in 2011 was competition. As the number of European investors has increased, competition for investment has intensified.

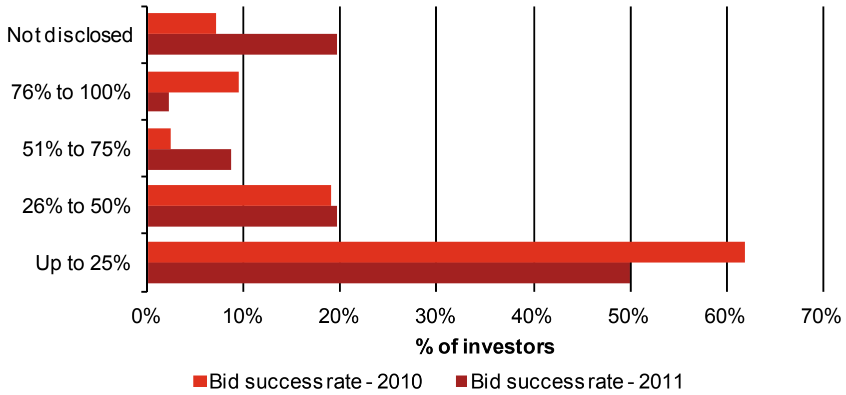
Factors influencing investment decision



Portfolio type and geography are the most important factors for investors when considering investments in Europe.

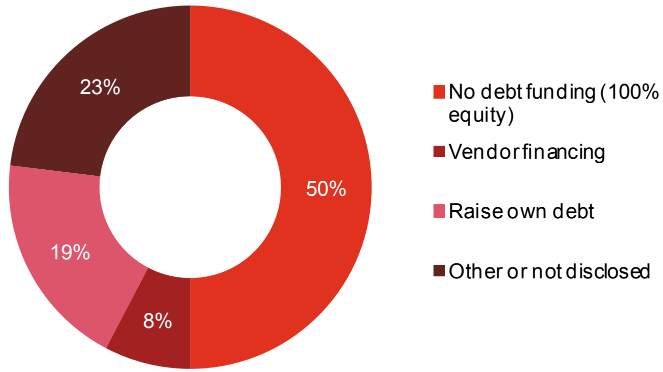
Appendix- other insights (2 of 2)

Bid success rate



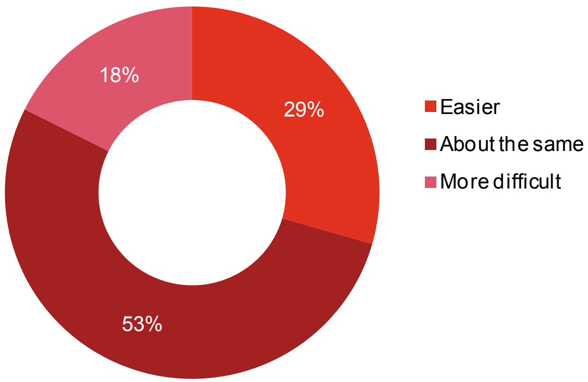
The majority of investors experienced limited success in bidding on portfolios in 2011. Half of the investors surveyed were successful in only one in four bids.

Investments in 2011 - sources of funding (% of investors)



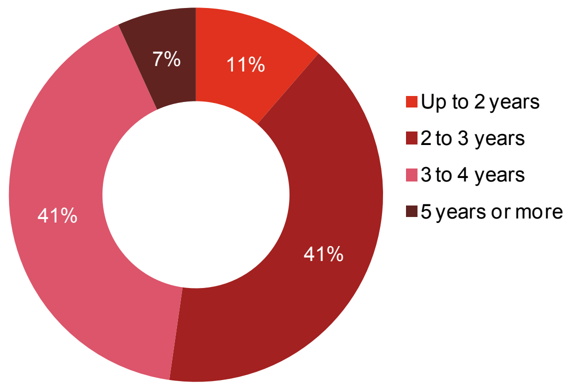
Investors typically paid cash or raised their own debt funding for investments in 2011.

Will raising debt for European loan portfolio investments become easier or more difficult in 2012? (% of investors)



The majority of investors do not think raising debt for European loan portfolio investments will become more difficult in 2012 compared to 2011.

Exit period - non performing loans (% of investors)



Short exit periods are likely to lead to higher prices for non performing loans, where investors will look to place the borrower into default and accelerate the loan.

European and global contacts

Across Europe and the UK we have experienced partners and directors to assist you with your non-core asset and NPL related needs. Through this group both buyers and sellers of non-core assets and NPLs can receive consistent and seamless service across the world, integrated with country-specific knowledge and expertise.

Central Team

Richard Thompson
+44 20 7213 1185
richard.c.thompson@uk.pwc.com

Jaime Bergaz
+34 915 684 589
jaime.bergaz@es.pwc.com

Jens Roennberg
+49 69 9585 2226
jens.roennberg@de.pwc.com

Antonella Pagano
+39 8064 6337
antonella.pagano@it.pwc.com

Robert Boulding
+44 20 7804 5236
robert.boulding@uk.pwc.com

Chris Mutch
+44 20 7804 7876
chris.mutch@uk.pwc.com

Jonathan Wheatley
+44 (0) 20 7213 4511
jonathan.wheatley@uk.pwc.com

Czech Republic and Slovakia

Petr Smutny
+420 251 151 215
petr.smutny@cz.pwc.com

Denmark

Bent Jørgensen
+45 3945 9259
bej@pwc.dk

France

Hervé Demoy
+33 1 56 57 70 99
herve.demoy@fr.pwc.com

Germany and Austria

Jens Roennberg
+49 69 9585 2226
jens.roennberg@de.pwc.com

Thomas Veith
+49 69 9585 5905
thomas.veith@de.pwc.com

Greece

Emil Yiannopoulos
+30 21 0687 4640
emil.yiannopoulos@gr.pwc.com

Hungary

Miklos Fekete
36 1461 9242
miklos.fekete@hu.pwc.com

Ireland

Aidan Walsh
+353 1 792 6255
aidan.walsh@ie.pwc.com

Italy

Antonella Pagano
+39 8064 6337
antonella.pagano@it.pwc.com

Poland

Janusz Sekowski
+482 2 523 4476
janusz.sekowski@pl.pwc.com

Portugal

Luis Boquinhas
+35 12 1359 9239
luis.boquinhas@pt.pwc.com

Romania

Cristian Ravasila
+40 212 253 605
cristian.ravasila@ro.pwc.com

Russia

Tim Nicolle
+74 952 325 589
tim.nicolle@ru.pwc.com

Slovenia and Croatia

Philippe Bozier
+38 615 836 068
philippe.bozier@si.pwc.com

Spain

Jaime Bergaz
+34 915 684 589
jaime.bergaz@es.pwc.com

Sweden

Per Storbacka
+46 85 553 3132
per.storbacka@se.pwc.com

Turkey

Aykut Tasel
+90 212 355 5838
aykut.tasel@tr.pwc.com

United Kingdom

Robert Boulding
+44 20 7804 5236
robert.boulding@uk.pwc.com

Chris Mutch
+44 20 7804 7876
chris.mutch@uk.pwc.com

North America

Mitchell Roschelle
+1 646 471 8070
mitchell.m.roschelle@us.pwc.com

Jeff Nasser
+1 267 330 1382
jeffrey.nasser@us.pwc.com

Asia Pacific

Michael McCreadie
+61 38 603 3083
michael.mccreadie@au.pwc.com

Latin America

Marcia Yagui
+55 11 3674 3748
marcia.yagui@br.pwc.com

Middle East

Ian Schneider
+971 430 43122
ian.schneider@ae.pwc.com

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