

New findings in insurance M&A amid near record deal values

What's driving the resurgence

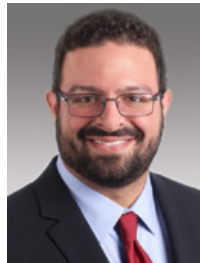
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Following the release of the latest Willis Towers Watson/Mergermarket study¹ of insurance M&A, *Emphasis* caught up with four of our M&A experts to discuss some of the underlying market trends.

Emphasis: This is the fifth edition of the report. What are the principal changes you've seen in insurance M&A in that time?

O'Shea: When we started the report in 2013, private equity (PE) investors were really fringe players in the market. Now they are very prominent in a large number of transactions, partly because of the current chase for yield, making insurance stocks relatively more attractive. In Europe, at least, I would say the principal motivating factors for deals taking place are still typically highly focused on capital management and scale.

Milicia: PE participants are also typically quite opportunistic investors. The focus of many insurers on capital actions and consolidation, or the need for distress sales – sometimes linked to recent increased natural catastrophes – have created those kinds of buying opportunities. Moreover, PE investors are less focused solely on distribution these days.

Gibson: To add to that, a number of companies are more active in the market now and are labeled as PE by others,

even though they see themselves differently. Regardless of labels, what you're seeing is a broad, diverse array of investors with an ability and willingness to take on complexity that a traditional insurance company or bank might deem unappealing. They're backed by a plentiful supply of capital. This has manifested itself, in particular, in more deals involving a consortia of financial investors – deals that would have been very difficult to complete in the past.

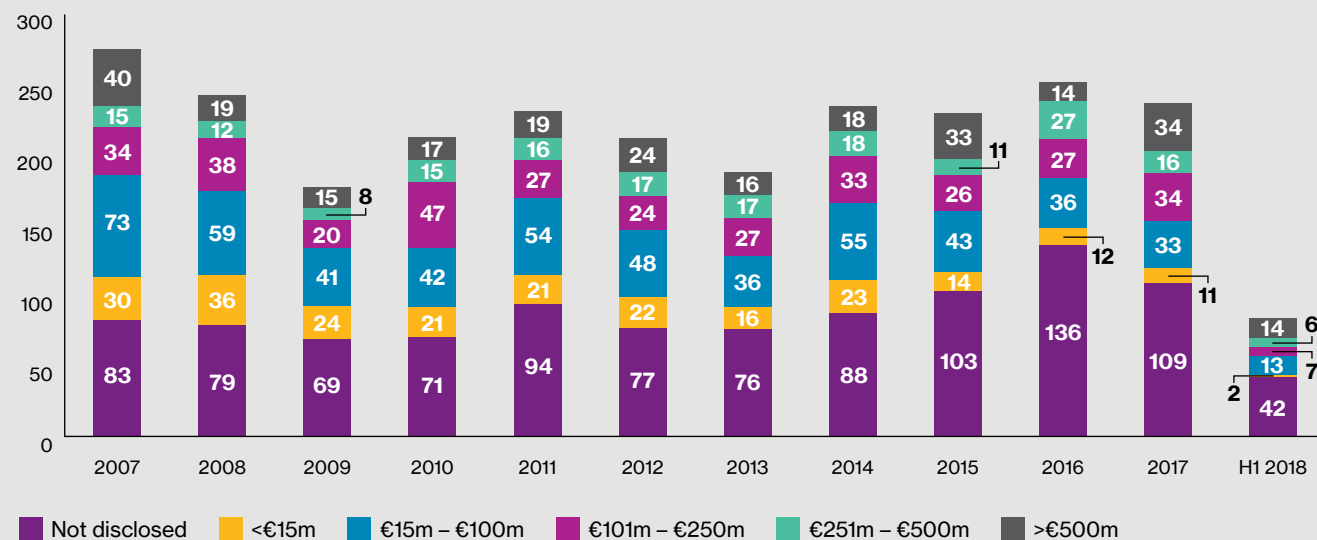
I would also mention that the idea that “the whole is greater than the sum of the parts” has changed. MetLife, for example, created Brighthouse Financial and then spun it off in a bid to create more value for stakeholders. AIG has more recently pursued a similar strategy.



in 2017 marked record levels of **dry powder for PE**, with firms now looking to perform **complex investments within the insurance space.**

¹ Transformation in the global insurance market, Willis Towers Watson, 2018 <https://www.willistowerswatson.com/en/insights/2018/10/MnA-transformation-in-the-global-insurance-market>

Figure 1. Global insurance M&A split by deal size, 2007 to H1 2018 (number of deals)



Source: Mergermarket

Angelini: The focus in Asia Pacific is still mostly on growth opportunities, particularly around new distribution in developing markets. The latest developments, though, suggest a reduction in the up-front consideration paid for access fees and more emphasis on deferred contingent performance payments.

Emphasis: The report shows megadeals were up in 2018 from 2017. How much steam do you think is left in the megadeal train?

Angelini: In Asia, megadeals are, and will be, rare.

O’Shea: Scale is important in a lot of sectors experiencing megadeals, so where there are suitable targets, there almost always will be megadeals – but their frequency will be very lumpy by nature.

Gibson: For megadeals to happen, a number of factors need to align. Going back to my earlier comments, I believe PE consortia enable larger deals, as does “separation then sale.”

Milicia: Macroeconomic indicators that have influenced market consolidation are still largely dominant. And there are companies that have mainly focused internally on getting the balance sheet right and, having achieved that, will be willing to look outside for the right opportunities. Personally, I wouldn’t be surprised if some larger deals involve Japanese investment in North America. A relatively flat domestic economy is one incentive, and Japanese companies have also shown a willingness to pay a full price for a quality asset owing to a relatively lower cost of capital.

Emphasis: Conversely, the number of smaller deals fell in 2018. Is there any obvious reason why?

O’Shea: That statistic surprised me, given some of the opportunities to build scale and for life insurers to link to blocks of the savings business. I see a diverse population of potential buyers with different mandates, so I think that’s a trend that could well reverse.

Milicia: Nothing obvious, no. But deals are typically taking longer to consummate, so that could reflect the reduced number.

Angelini: As a follow up to my earlier comment about megadeals in Asia, deals will be smaller as most markets there are emerging. I think the figure just points to a temporary change in the distribution of deal size.

Emphasis: Are there any regulatory or reporting factors that could stimulate M&A in the near term?

O’Shea: Although the report noted that Solvency II-driven activity has subsided somewhat, it’s certainly not finished because of European insurers’ continuing focus on capital management. Outside the U.S., companies are still working through how IFRS17 impacts dividend capacity, so that could also be a factor.



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—Joe Milicia

Angelini: Not immediately, but risk-based regulatory regimes along the lines of Solvency II are becoming more common. For example, most life insurers in Asia are headquartered in Hong Kong, which is introducing risk-based rules to replace a fairly simple regime based on the old Solvency I. These kinds of changes will almost definitely impact risk-adjusted returns.

Gibson: The changes that Bermuda made to achieve Solvency II equivalence partly fueled AIG's successful creation of the Fortitude Re legal entity, but I don't see anything seismic that is imminent on the regulatory front.

Milicia: Tougher regulation means more expense. In a world where insurance regulation is constantly evolving, you can't rule out subsequent greater M&A activity.

Angelini: Actually, that's an interesting point when you look at Asia. Unlike other regions, only a handful of insurers in Asia are publicly traded and most are private companies, including some that are owned by family businesses. With privately held groups, transactions take longer to negotiate and

complete, reflecting the strong emotional ties to the business. Consequently, these companies and the opportunities they offer haven't typically been available in the market. But the expense and complexity of more stringent regulations will almost definitely force some to contemplate sales, regardless of innate reluctance from shareholders.

Emphasis: *While we're talking about Asia, can you help us understand the impact of the Chinese Belt and Road initiative on insurance markets and future potential deal activity, as touched upon in the report?*

Angelini: In essence, it's all about creating new land and maritime trade routes for Chinese goods, both of which will have consequences for the insurance industry as these routes and trade flows become more established. Ultimately, the intention is that the land route will stretch into Central Europe. The Chinese government has already made investments in marine facilities in Sri Lanka and Croatia, with others in the pipeline as part of its plan. The expectation is that state-owned insurance enterprises will take the initial risk management lead, but that other insurers will seek to gain more of a presence in Southeast Asian countries such as Indonesia and Malaysia to benefit from Belt and Road in the second wave.

Emphasis: *InsurTech is a hot topic in insurance, but a lot of the investments made by larger insurers seem quite small and tactical. Do you see insurers developing these future investments into an overall game plan to advance innovation?*

Milicia: It's a hot topic all right, particularly on the P&C side, but so far it's not a major driver of insurance M&A activity. As we see in Willis Towers Watson's quarterly InsurTech updates, a lot of the investment activity in InsurTech is coming from PE and angel investors. That's not to downplay the several incumbent insurers that have, in effect, set up their own venture capital operations to exploit InsurTech or, in some cases, bought up early stage businesses. For the most part, though, the industry has pursued a little bit of everything, presumably assuming that the consistent churn of activity will help keep companies at the forefront of the most promising aspects of InsurTech, get them on board with those technologies and ultimately create value for shareholders.

O'Shea: P&C companies are undoubtedly more advanced in this area than life companies. However, we're starting to see the potential for technologies, such as wearables, to impact health by promoting greater wellbeing and also

support related insurance propositions. Right now, I think the vast majority of life companies are thinking about InsurTech opportunities incrementally rather than with business transformation in mind. I don't see any imminent changes.



Gibson: I do think there is a case for companies to start thinking about InsurTech in a more transformational way, but a start-up mentality may be needed to kick-start it. Some companies may have to go through the kind of separations I mentioned earlier and start fresh to succeed.

Emphasis: The latest Willis Towers Watson/ Mergermarket report shows the insurance M&A market is vibrant, with €37 billion of deals in the first half of 2018. We've already spoken about why this is, but do you see any new drivers or hindrances to future deal activity, or a change in the relative importance of any existing factors?

Milicia: One thing that could change things for P&C insurers is the reserving cycle. The current cycle of companies making large annual reserve releases has already lasted longer than expected, and there are signs that reserve releases are starting to tail off or reverse, possibly impacted by the recent spike in natural catastrophe claims. Previously, when the reserving cycle has strengthened, this has typically dampened M&A activity – as no company wants to be perceived as selling at “fire sale” prices. If pressures on some companies' balance sheets do build, I think we could see M&A activity slow.

Gibson: Tax reform in the U.S. has provided something of a steroid kick for insurers' earnings, which could be a lure to overseas acquirers. This hasn't led to a significant volume of activity so far, but it could well change the attractiveness of some potential U.S. targets.

O'Shea: Interest rates and monetary easing policies remain wild cards. Money is cheap. Any change in that could obviously have an impact. It's a potential factor, but not an immediate one.

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Angelini: There has always been a supply of deals from multinationals pulling out of Asian markets because of the inherent difficulties, but these forces are perhaps stronger now. One area starting to gain more attention is the large in-force books of some Australian life insurers and whether these may generate deal activity.

Milicia: It will be interesting to watch how deals could potentially impact the disintermediation of the insurance value chain. Markel's plays in recent years have given it two significant insurance-linked securities platforms. Similarly, AIG's acquisition of Validus gives one of the world's largest primary insurance operations the ability to access alternative capital from within. I haven't seen anything in the market to suggest that these are indicative of a significant change in strategy across the industry, but it's something that bears watching given the scale of the companies I've mentioned.

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