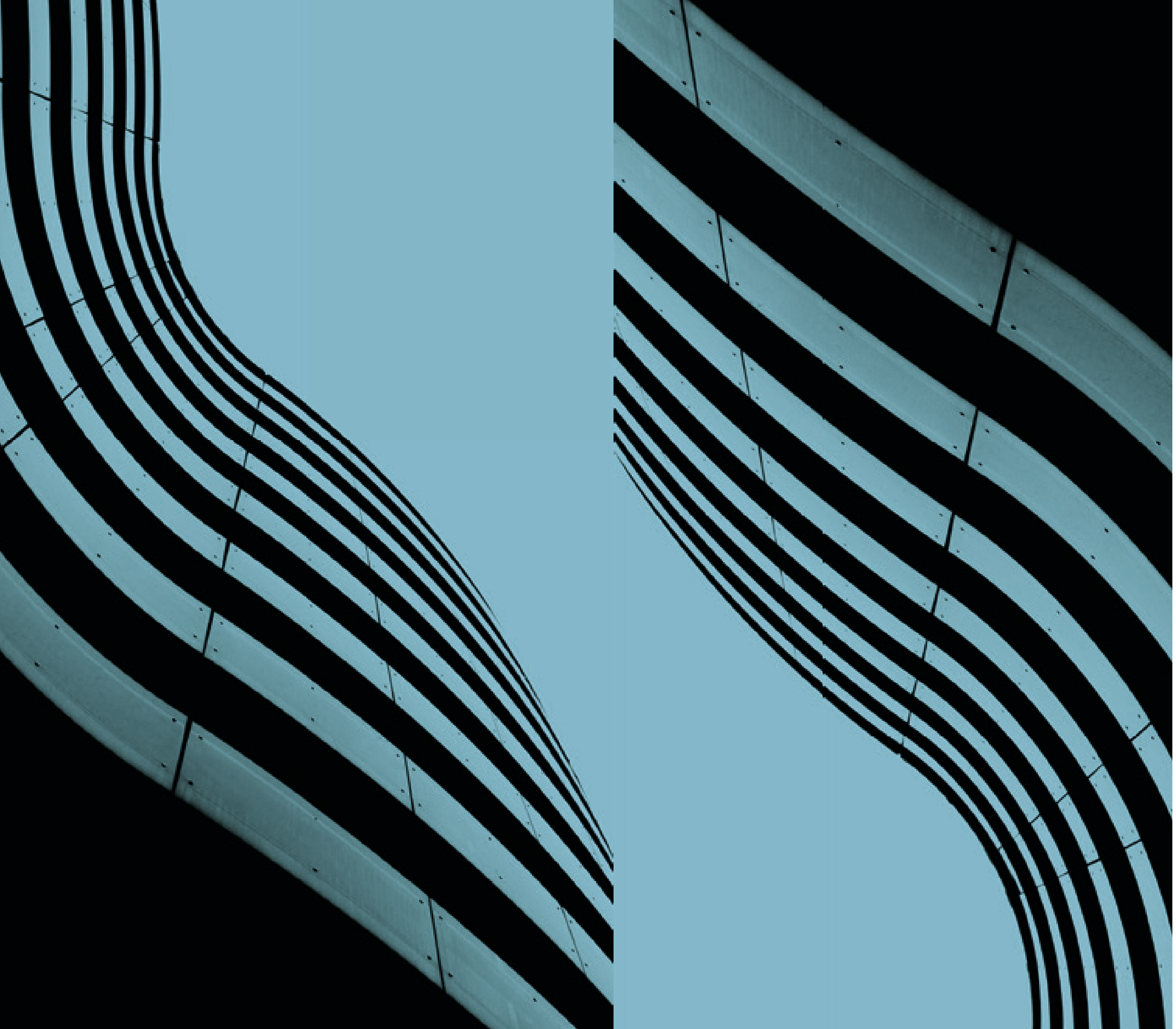
CLYDE&CO

Insurance Growth Report

Charting the ebb and flow of insurance M&A

2020 - Part 2 / 3



Following part one of our Insurance Growth Report, which presented a review of worldwide mergers and acquisitions, here we analyse transaction trends by region.

2019 saw another annual increase in global M&A activity in the insurance industry, with 419 deals completed worldwide representing a 10% increase on 2018. However, the second half of the year saw a steep drop in transactions in major markets – albeit from a high level. This trend was especially marked in Europe and Asia Pacific.

Against a backdrop of geo-political and macro-economic uncertainty, investor sentiment in the first half of 2020 will be one of heightened caution and we expect global deal volume to plateau as a result.

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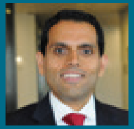
Activity in the run-off market is expected to pick up further in markets across the world. In the US, insurers will likely take further steps to explore divesting legacy books of insurance business through two recently enacted restructuring mechanisms known as Insurance Business Transfers and corporate divisions, which several states have enacted into their laws in recent years. We expect these new tools for legacy business to lead to a burst of new deal activity later this year and beyond.



Vikram Sidhu, New York

The Americas continue to dominate global M&A activity

The Americas remained the world's leading region in 2019 in terms of deal volume, accounting for 43% of the global total. Also, whereas Asia Pacific and Europe saw a steep drop-off in M&A in the second half of the year, the slowdown in the Americas was much gentler.

Overall, we expect 2020 will be characterised by a more cautious approach to deal-making in the US. Despite persistently strong economic fundamentals and strong stock markets, a combination of trade wars, diplomatic tensions and the impact of the coronavirus will further deter interest in cross-border acquisitions. This will result in the completed number of transactions likely to be level with or slightly down on 2019.

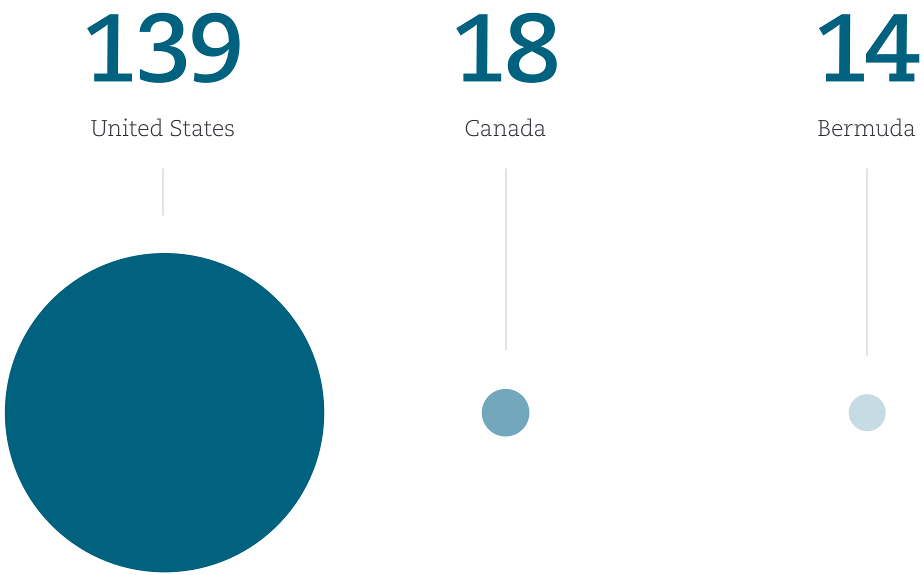
M&A activity in Canada in 2019 – the second busiest country in the region – was predominantly driven by domestic consolidation. One of the largest deals saw Intact Financial Corporation – Canada's largest property and casualty insurer – acquire specialty insurer The Guarantee Company of North America for around USD 750 million.

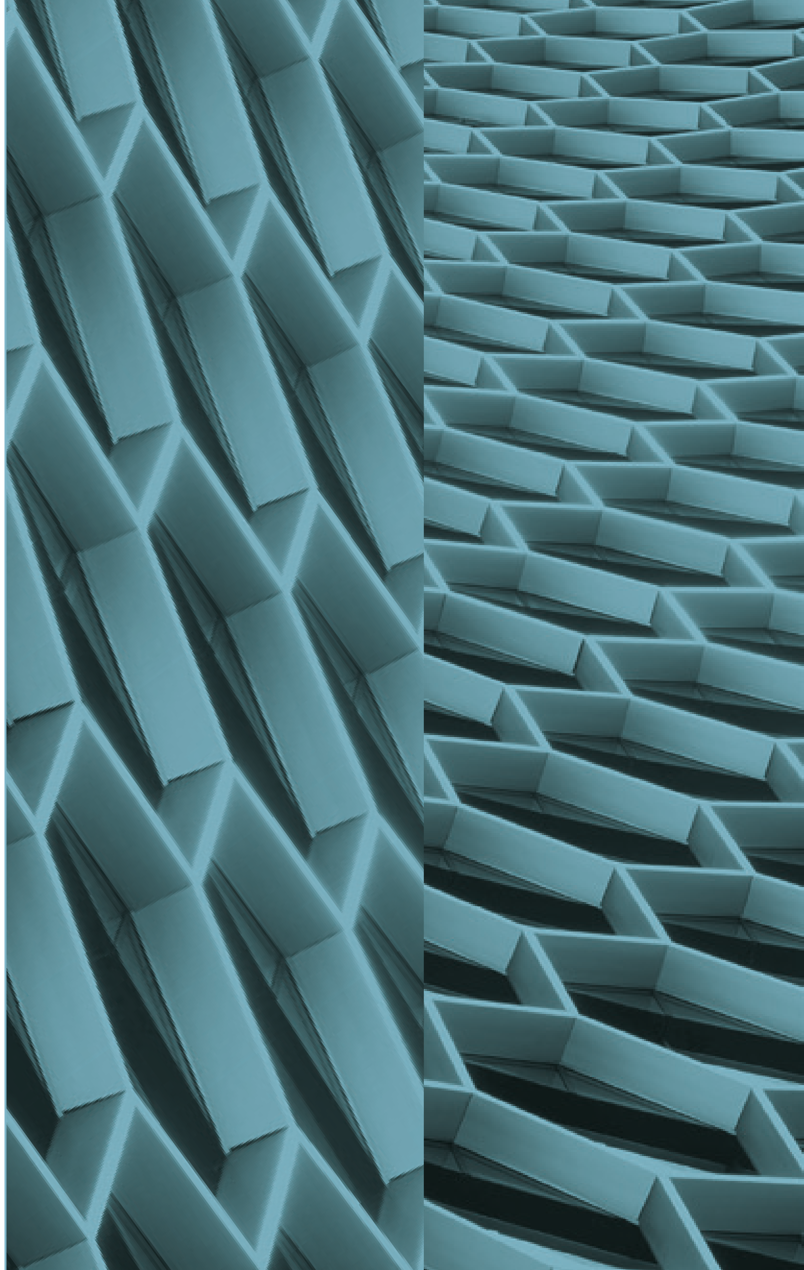
This was in contrast with Bermuda, which until recently was a location ripe with targets for acquisition. In 2019 the tables were turned with the vast majority of deals being outbound by Bermudian acquirors involving overseas targets. These included RenaissanceRe's USD 1.2 billion acquisition of Tokio Millennium Re and Athora's move on Generali Belgium for USD 667 million.

Latin America remains an important market, but deal activity is still muted. Brazil and Chile each saw a handful of predominantly small domestic deals in 2019, but in-bound interest was negligible. Latin America is a challenging environment in which to operate, and we will continue to see some one-off deals as foreign players re-set their expectations and retreat, following the example of Australia's QBE, which sold its operations in Argentina to Zurich for USD 350 million. Overall, however, businesses are staying the course and remain focused on cautious growth, including via acquisition, providing suitable targets can be found.

Most active countries 2019

by number of deals





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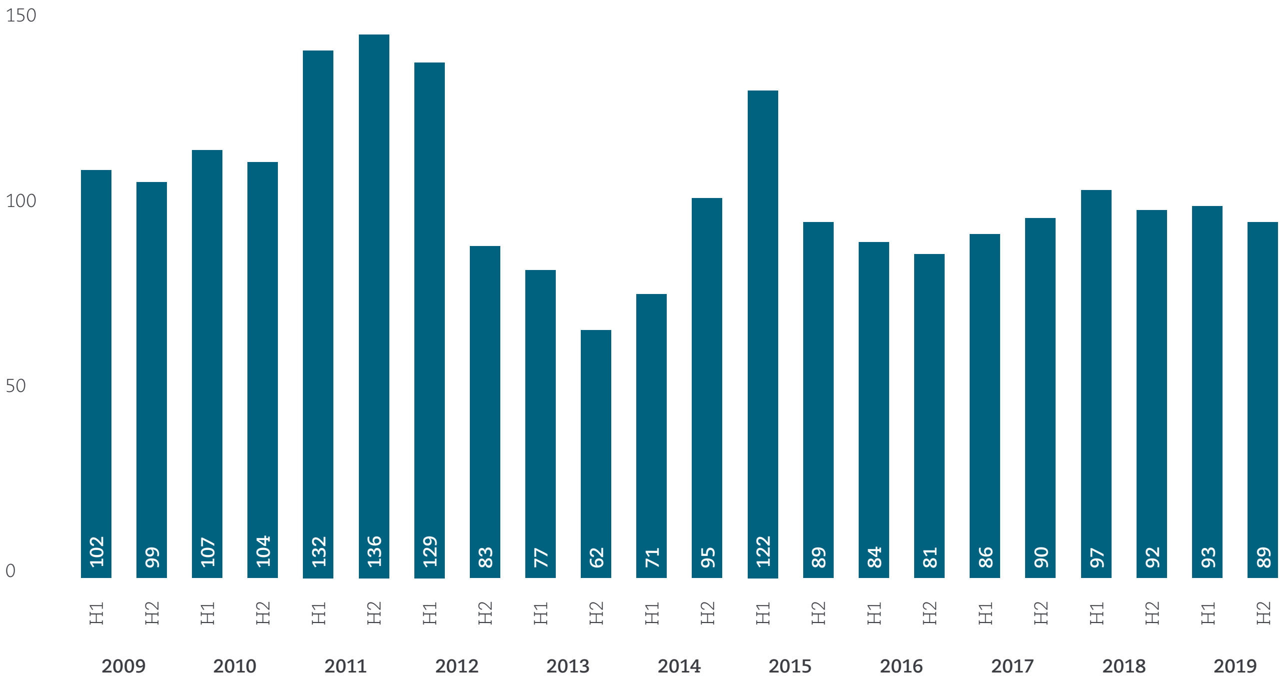
Technology remains a powerful deal driver and was a key factor behind some of the year’s biggest transactions in the Americas. This trend is set to continue and with insurtech start-ups now reaching the point of maturity where their business models are proven, we expect a new wave of acquisitions in the coming year.

Cheryl Yakey, San Francisco

Volume of deals in the Americas

2009 - 2019



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Significant opportunities remain for insurers in Asia Pacific, especially in dynamic emerging markets, but the coronavirus has the potential to be a black swan event. We are already seeing an impact in terms of business interruption, supply chain losses, event cancellation and exposure liabilities that will impact insurers’ top and bottom lines. Given the stock market volatility caused by the outbreak, we will likely see a decline in interest in M&A until asset prices have stabilised.

Joyce Chan, Hong Kong

Growing headwinds offset opportunities in Asia Pacific

Deal-making has continued to grow in Asia Pacific with 2019 marking the third consecutive year of increasing M&A volume. Once again Japanese acquirors were the region’s busiest with 26 completed transactions involving a mix of domestic and overseas targets. Stiff competition at home means top-line growth is hard to come by in a mature market. Technology is inevitably one solution being deployed in a bid to reach new customers and generate better returns across the region. Recent examples include Sumitomo Life’s investment in Plus Medi, the developer of the MyHospital medical care and management app offering personal health record solutions, and separately in online insurer Singapore Life.

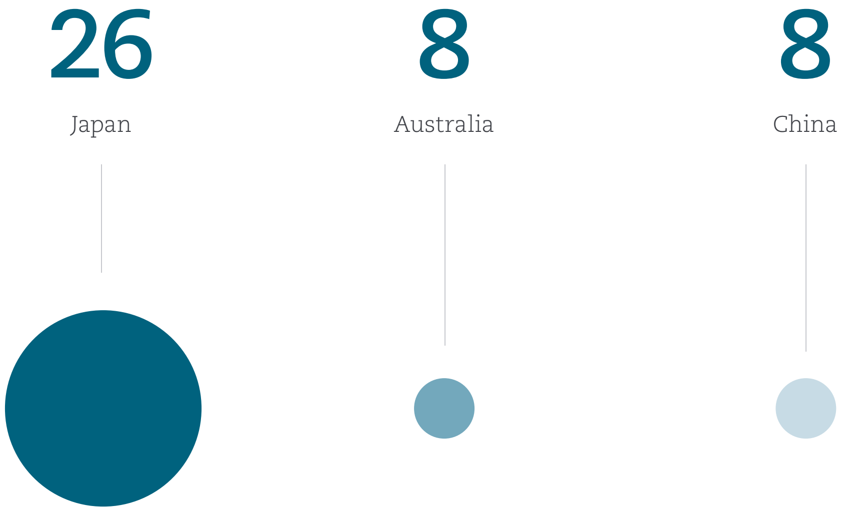
Despite a slew of regulatory developments designed to make it easier for foreign investors to enter the market, M&A in China has been subdued. Although interest is picking up, a number of other factors – including access to foreign currency and regulatory controls – are preventing discussions leading to action.

While deal activity in Hong Kong has been muted in terms of volume, it was home to a number of blockbuster deals in 2019, including Earning Star’s USD 2.7 billion move for FTLife, which was the year’s fifth largest worldwide by value.

Access to new distribution channels remains an important driver of M&A in the region. A key factor in Zurich’s USD 2.1 billion acquisition of ANZ’s life insurance business was the opportunity to offer insurance products to up to six million new customers via the bank’s channels. Similarly, in another huge deal, FWD Group paid USD 3 billion for Thailand’s SCB Life Assurance, which included a significant 15-year bancassurance agreement. The search for new customers and ways to reach them will remain a feature of the market in 2020.

Most active countries 2019

by number of deals



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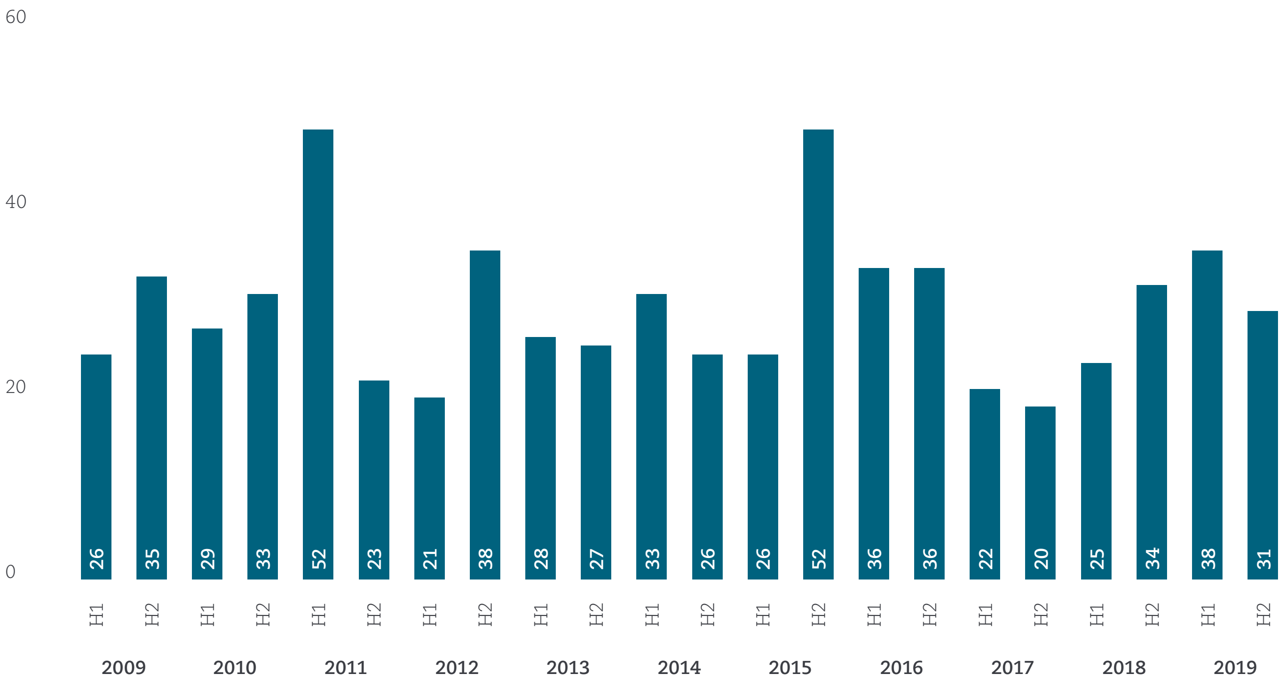
> A combination of heavy nat cat losses and the tightening of the regulatory environment is deterring inbound interest into Australia. However, we are seeing opportunities for consolidation in the intermediary market, driven by smaller players struggling to find capacity providers and to manage the raft of regulatory reforms that are flowing through the legislative system.

Avryl Lattin, Sydney

Volume of deals in APAC

2009 - 2019



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Insurers have been cooperating to various degrees with tech start-ups but now that many have a more proven track record and a few have achieved some level of maturity in, what is a highly regulated market, interest is increasing. However, insurtech tie-ups of all kinds take a while to get up and running. It is vital that they are structured correctly and this requires agreement over a range of factors including pricing of products, policy documentation and claims handling.

Yannis Samothrakis, Paris

M&A in Europe marked by more smaller deals and search for innovation

2019 was a year of two halves for insurance M&A in Europe. There were 88 transactions completed in the first six months as deals that had been put on hold due to Brexit preparations finally got over the line. There were 67 in the second half as activity dropped back to a level more in line with recent years.

In the UK – historically Europe's most active market for M&A – deal volume dipped to 17 compared to 21 the previous year. More interesting was the decrease in deal size however. The largest deal in 2019 was the acquisition of Co-op's CIS General Insurance Limited by Markerstudy for USD 238 million. By comparison, the largest UK deal in 2018 was valued at USD 4.1 billion.

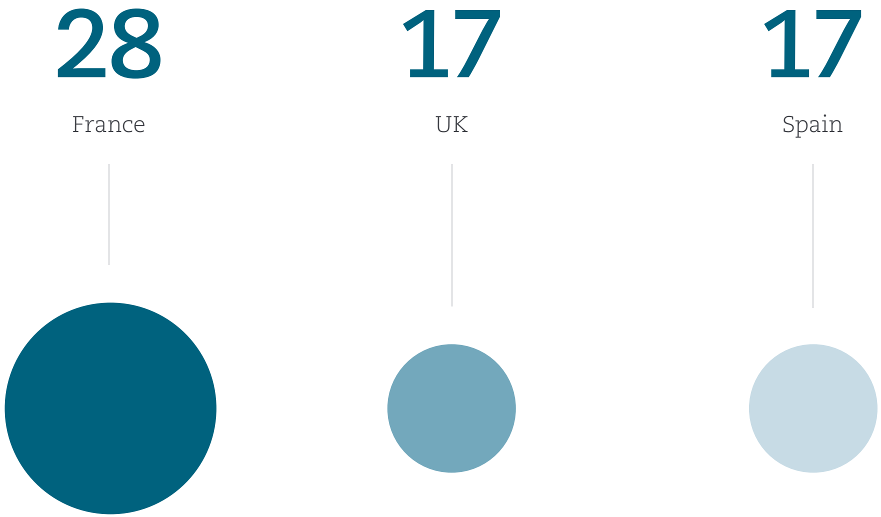
A clear trend is that a number of these smaller investments continue to be driven by the need to access new technologies. Examples in 2019 included MS Amlin's purchase of an undisclosed stake in Envelop Risk, a Bermudian start-up that provides artificial intelligence-driven cyber risk modelling, and Phoenix Group merging with Telesto Digital, a platform development company advancing digital engagement in the health and wellness sector.

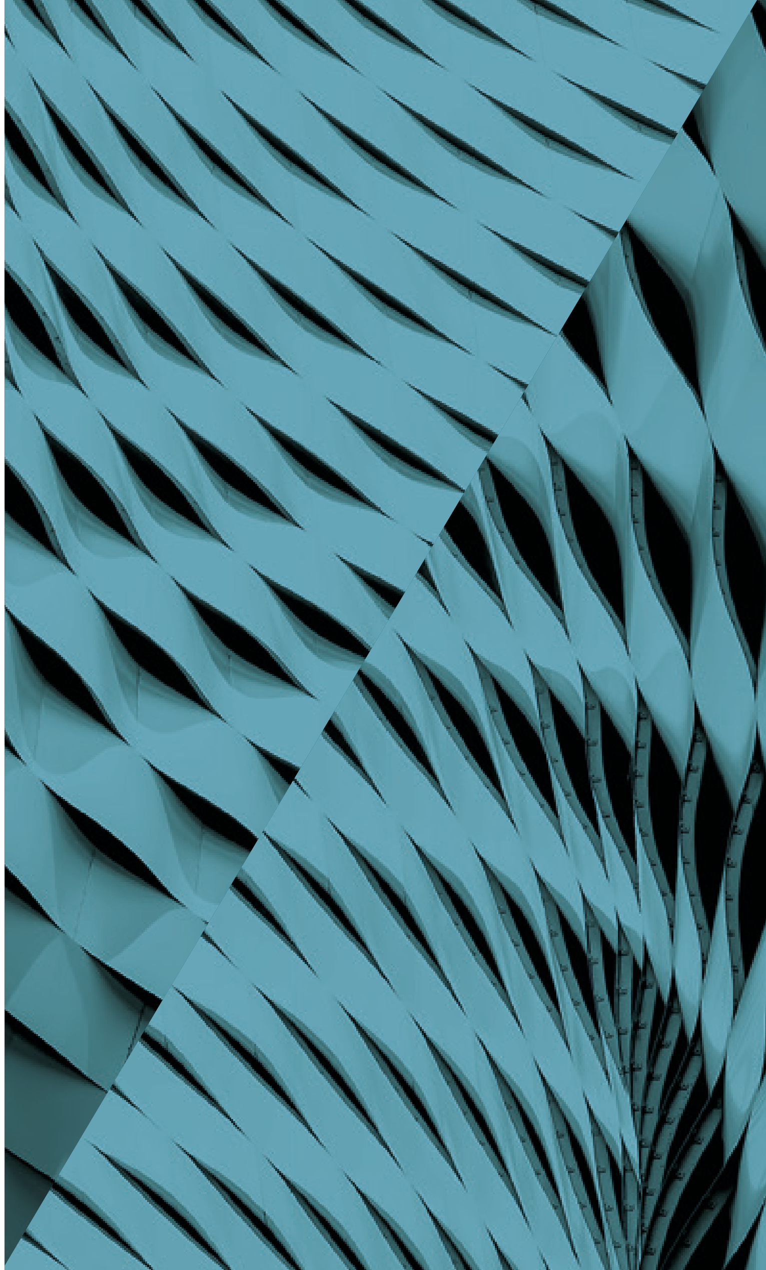
France overtook the UK in 2019 to lead in Europe in terms of deal volume. Although bigger deals continue to hit the headlines – AXA's continued restructuring with the sale of its units in central and eastern Europe to Uniqa of Austria for example, and Covea's USD 9.0 billion move for PartnerRe – the majority of transactions in the country have been much smaller, as elsewhere in the region. Here too, technology is moving up the agenda. Groupama took a stake in Objetdomotique, a company offering smart home automation that specialises in the field of e-health and safety while Paris-based Alan – a purely digital health insurer – secured USD 45 million from a US investor group.

Germany is mirroring the same trends. Despite seeing Europe's largest deal of the year – the USD 2.2 billion move by Viridium Gruppe to acquire a 90% stake in Generali Leben – M&A appetite has been muted in the face of gathering headwinds. Stock market volatility, rising populism, and political and economic uncertainty are impacting dealmaker confidence. With large insurers particularly under pressure, we expect a greater focus on acquiring smaller books of business that align with strategic investment as well as a continued emphasis on deals that can deliver innovation. In addition, we also further consolidation in the broking sector with smaller intermediaries and books being acquired, as well as those with international reach.

Most active countries 2019

by number of deals





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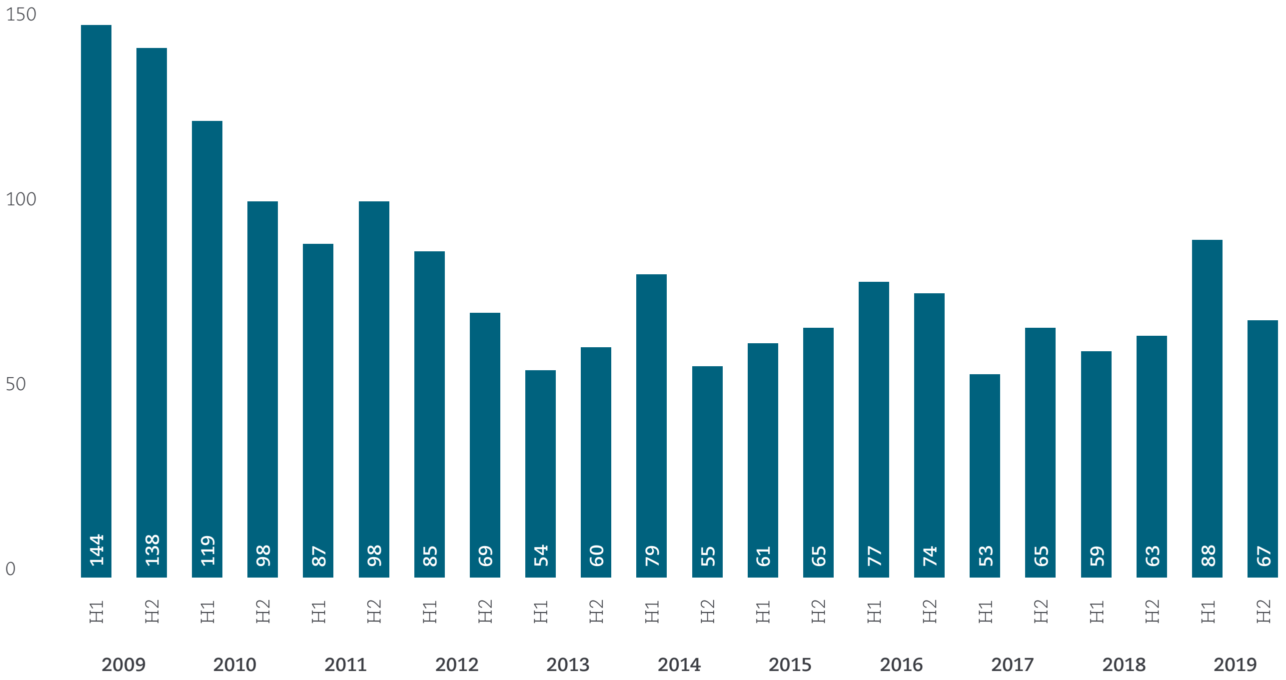
> Insurers can expect cost and margin pressures and tough market conditions to endure throughout 2020. As they look to innovate, generate efficiencies and drive growth, a merger or acquisition will be one route to deliver on these objectives, but they will need to approach any transaction with a clear strategic focus on the benefits it can deliver to the business.

Henning Schaloske, Dusseldorf

Volume of deals in Europe

2009 - 2019



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M&A on the carrier side is likely to remain muted through 2020. However, intermediaries in markets including Saudi Arabia and the UAE will need to get to grips with rapidly changing regulations – coupled with much tougher enforcement – which will impact the cost of doing business. We expect an increase in deals will follow.

Peter Hodgins, Dubai

Regulatory pressures weigh on Middle East and Africa

M&A in the Middle East continues to bump along at a low level. Although there was anticipation that new regulatory requirements to increase capital in jurisdictions and pressure from regulators across the region would translate into a flow of deals as businesses moved to consolidate, this has yet to materialise. One significant exception to this trend was the recent announcement of the merger of MetLife AIG ANB Cooperative Insurance Company with Walaa Cooperative Insurance Company in Saudi Arabia.

In terms of foreign investment, Bupa's acquisition of Acibadem Sigorta, the second largest health insurer in Turkey, was one of a handful of completed inbound deals. The more prevalent trend has been multinationals continuing to close parts of their operations in the region as pressures at home force them to divest underperforming assets and refocus on their core businesses. Swiss Re and Allianz have both recently announced decisions to close their operations in the DIFC and HDI Global is placing its Bahraini operations into run-off. Other players are seeking to focus on core regional markets with AIG, for example, having pulled out of Oman through a portfolio transfer and put its business in Bahrain into run-off.

Looking ahead, the backdrop of a mixed economic outlook and political tension in Iran and Qatar will continue to act as a brake on deal activity.

Saudi Arabia, the UAE and Egypt have sufficient scale to be attractive to inbound investors, while other markets are either too competitive or lack sufficient population size to generate an adequate return on equity.

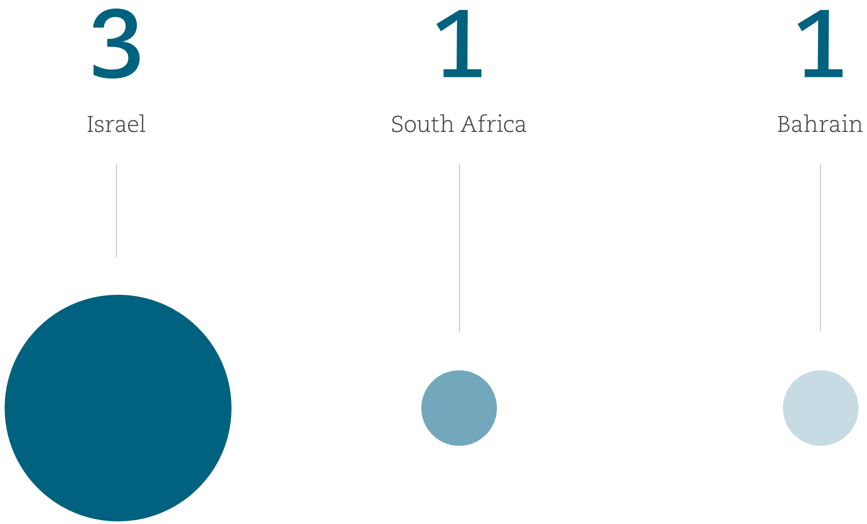
In Africa, 2019 saw sporadic consolidation in some markets and a small number of cross-border deals. The most notable of these was Prudential's acquisition of a majority stake in Group Beneficial, a leading life insurer in Cameroon, Côte d'Ivoire and Togo. However, while there are clear opportunities in markets including Nigeria and Kenya, on-going political instability is deterring potential investors.

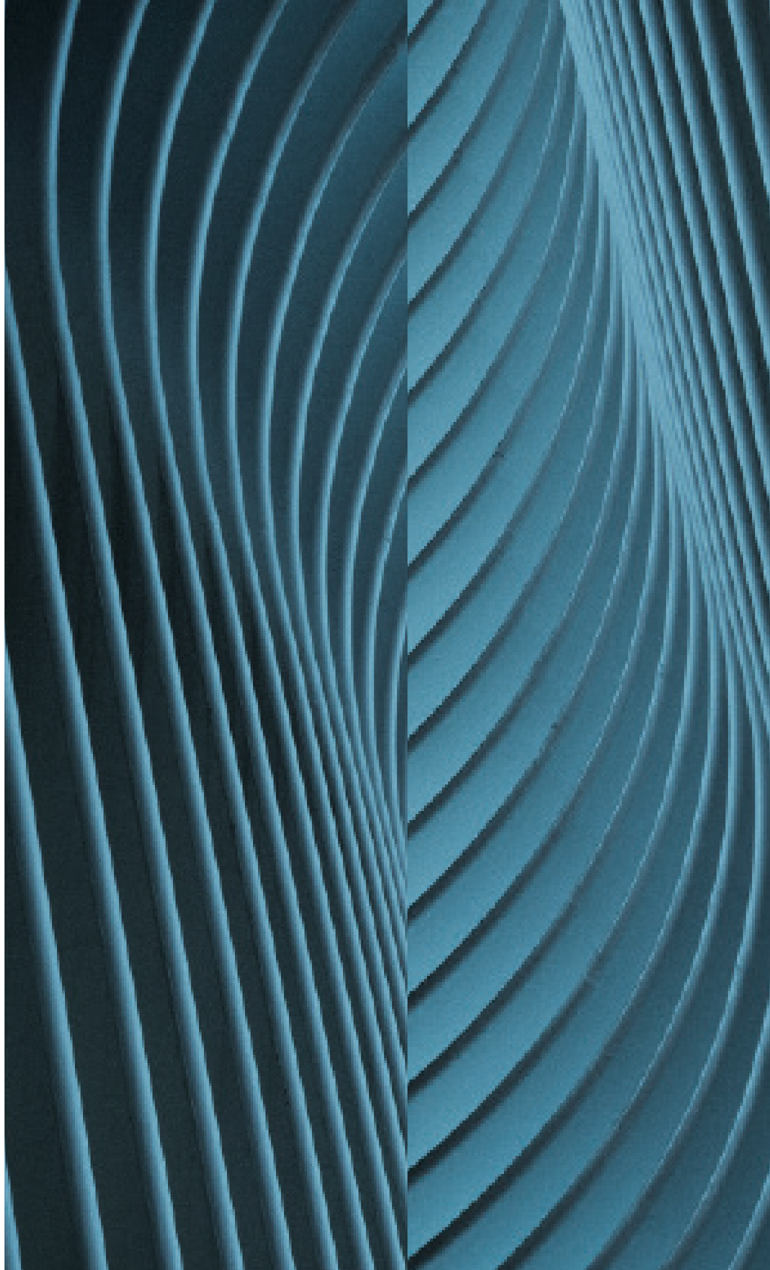
In South Africa, the continent's leading insurance market, the Solvency II-style capital requirements that came into force in mid-2018 have undoubtedly increased pressure on some insurers, but have yet to lead to any significant deal activity. This could be set to change with the introduction of new Group Supervision rules that will demand new board and licensing requirements, leading some insurers to consider whether to spin out certain businesses.

On the broker side, recent and upcoming changes in the insurance regulatory landscape, combined with continuing digitalisation, will shake up traditional distribution channels, leading to a decline in the number of traditional insurance intermediaries.

Most active countries 2019

by number of deals





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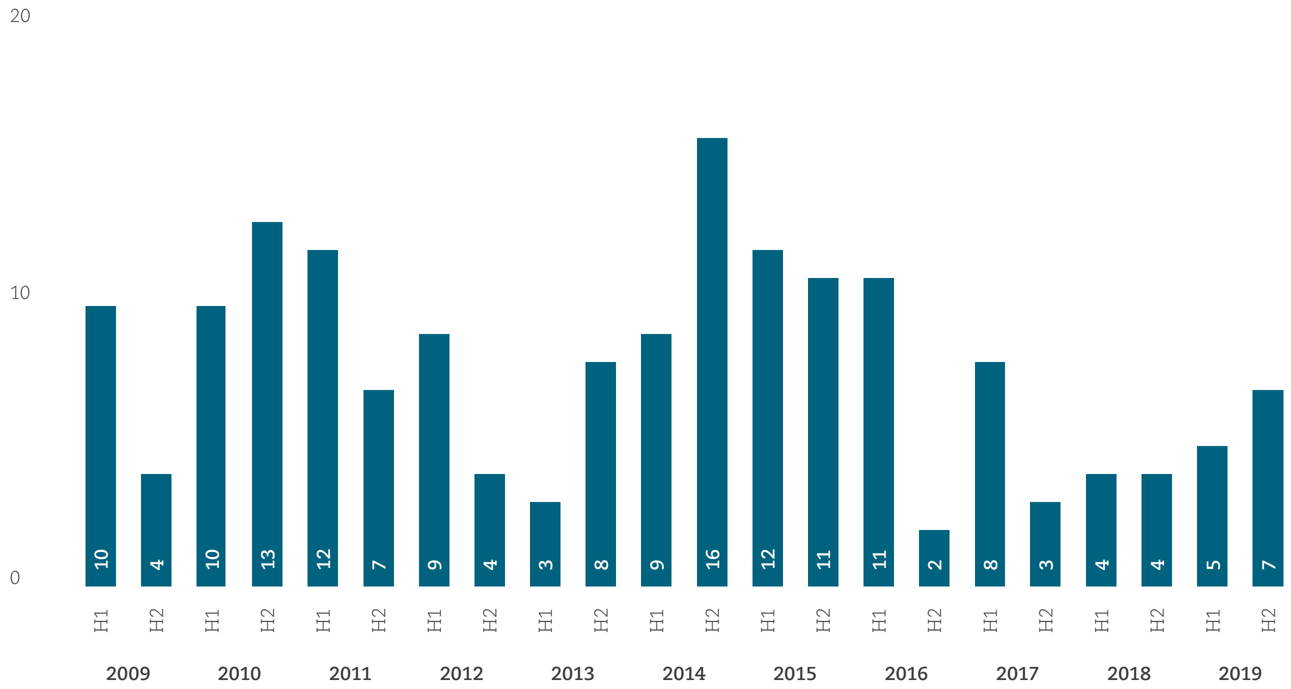
On top of a combination of a weakening economic outlook and tighter capital requirements, the new Group Supervision rules will heap pressure on insurers. For some, this could be the final straw, leading to a rush of businesses being put up for sale.

Ernie Van Der Vyver, Johannesburg

Volume of deals in MEA

2009 - 2019



Spotlight on: Brexit

The UK's drawn out departure from the European Union has certainly had an impact on insurers in the region and beyond, both operationally and consequently on their appetite for M&A.

Existing passporting arrangements allow UK-based firms to access and offer services throughout the European Economic Area (EEA), and vice versa, without the need for separate authorisation in each jurisdiction. However, at the end of the Brexit transition period – slated for 31 December – these arrangements could cease.

Firms in the EEA that are currently authorised to conduct regulated activities in the UK insurance market will be able to continue doing so for a maximum of three years while they seek UK authorisation under the temporary permissions regime offered by the UK regulator. However, there are no reciprocal arrangements in place from the EU, so UK insurance firms currently accessing the EEA market through a passport could lose their authorisation to do so. They have been aware of this for some and have been planning for the worst-case scenario – a so-called 'hard Brexit' where the UK would leave the EU without a trade agreement in place.

For those that wish to continue operating in the EU, this has meant establishing a presence in one of the EU 27 nations. Most of the larger businesses have opted to do this via the setting up of a subsidiary rather than through an acquisition. There have been a number of popular destinations perceived by insurers as being best suited to support their business and their clients' interests going forward, including from a regulatory perspective. For example, Lloyd's has set up a European platform in Brussels, AIG in Luxembourg, Beazley in Dublin and Markel in Munich. Newly formed subsidiaries across the market have already begun renewing 2020 business, so the industry is well prepared for the post-Brexit world.

However, reaching this point has been a lengthy and complicated journey that has consumed considerable amounts of management time and attention.

Unsurprisingly, M&A slipped down the agenda while Brexit preparations were on-going but we saw a spike in acquisitions in Europe in the first half of 2019 as deals that had been put on hold finally made it over the line.

Going forward, it may well be that Brexit acts as a spur for a further flurry of deals, especially in the legacy market. Some smaller operators in the UK will look at the cost of setting up operations in the EU and decide to end their overseas operations and sell books of business. At the same time, EU insurers will be considering their structures and where they might exit non-core lines, leading to opportunities for acquirors.

Deal-makers are already sensing these opportunities. European run-off specialist Darag set up in Britain in 2019 in expectation of Brexit-related deals. Market reports suggest that Fortitude Re, a vehicle set up by AIG with investment from private equity firm Carlyle, is also planning to buy or reinsure other closed books and expand into Europe. We expect more to follow.

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