GLOBAL TRENDS IN INSURANCE M&A IN 2014 AND BEYOND

LOOKING BACK ON 2014:
THE RETURN OF THE BILLION DOLLAR TRANSACTIONS

In recent years, insurance companies have largely focused on improving their performance by cutting costs amidst a slow post-global financial crisis environment. However, the past two years have seen the tide change: the industry is now seeking to bolster profits by embarking upon both domestic and the potentially more lucrative emerging market M&A. Economic confidence is growing and those insurance companies that suffered, yet survived, the rock bottom of the economic crisis are beginning to bounce back and consider opportunities to invest in their now well capitalized companies both internally and by external expansion. After a slow 2013, we saw a significant uplift in M&A activity in the sector in 2014. For the first time in a number of years, the industry has seen billion-dollar deals, some of which are identified in this paper.

In this review, we share our top eight observations of the insurance M&A market in 2014: 1) Acquisition volume and value are up; 2) Disposals have increased, impacting on the dynamics of supply and demand as a result of the increasing trend for market consolidation; 3) Private equity firms have continued their interest in the insurance sector, especially within broking, life insurance and annuities; 4) Group reorganizations motivated by regulatory change have been a dominant feature; 5) Increased interest in property investment; 6) Digital and tech strategies are increasingly important drivers; 7) The direction of deal flow has started to shift with Asian companies reversing the 'outward only investment' trend previously associated within Europe and the US; and 8) A run-off market that looks increasingly active again.

1. ACQUISITIONS ARE ON THE UP

The big insurance groups are buying again, even those that suffered during the global economic crisis and have been quiet on the M&A radar for some time. The number of publically disclosed insurance deals in 2014 is up around 11 percent on 2013 from 316 to 354 (*mergermarket*).

> "Not only are acquisitions on the up, the value is up, too."

with some billion dollar deals including Dai-ichi Life Insurance Company's acquisition of Protective Life in a deal valued at US$5.7 billion, Canada Pension Plan Investment Board's (CPPIB's) US$1.8 billion acquisition of Wilton Re, Manulife's US$4 billion acquisition of the Canadian operations of Standard Life, and Onex Corporation's sale of The Warranty Group to TPG for US$1.5 billion.

We have seen a high proportion of acquisitions in the intermediary and broker markets – markets that traditionally attract and have often been backed by private equity (PE) funding. Large deals include Kohlberg Kravis Roberts & Co.'s (KKR's) acquisition of Sedgewick Claims Management Services, Inc. for US$2.4 billion and Blackstone's purchase of US$610 million of Lombard from Friends Life. Brokers actively acquiring have included JLT, who recently acquired FBD Insurance Brokers, an insurance broker based in Ireland and AON plc's Aon Risk Solutions acquisition of Granay Asociados, a Peruvian insurance business.

2. IT'S NOT ALL ABOUT ACQUISITIONS

> We have seen an increasing trend for disposals, generating a renewed supply of buying opportunities.

and in response there's been real demand with an increasingly competitive market for buyers. Insurers are continuing to dispose of under-performing and non-core businesses in order to consolidate and transform into more lucrative, streamlined businesses with a clear business strategy. Aviva is a case in point. With a strategic aim to narrow the group's focus to businesses where it has a leading market position and can generate good profitability, Aviva has spent the past two years disposing of assets including its US annuity business, which it sold to Athene Holdings for US$2.3 billion (£1.5 billion) in October 2013, as well as its Turkish general insurance business and joint ventures in both Spain and South Korea. Yet, in December 2014, it embarked upon its major acquisition of Friends Life to create a new insurance, savings and asset management giant.

Notably, 2014 has also seen Stephen Hester's large-scale overhaul of Royal & Sun Alliance (RSA), which has resulted in a series of disposals of non-core assets in order for the business to focus on core strengths in its main markets. These sales fed the global market with some interesting deals. It kicked-off with PZU, Poland's largest insurer, snapping up RSA's Polish and Baltic assets for £300 million, closely followed by its Chinese business being sold to Swiss Re for £14 million. In August 2014, RSA's Asian assets in Hong Kong and Singapore were also sold to Allied World Assurance Co. for £130 million along with a disposal of businesses in Canada, Italy and Thailand. RSA's sales have certainly gained momentum and have attracted a great deal of attention from some of the world's largest insurance players.

The other high-profile example of streamlining driven by financial distress was QBE's de-leveraging plan, which has seen the Australian insurance company divest its US agency businesses and its Central and Eastern European operations in order to improve financial resilience. More recent disposals have included Zurich's strategic sale of its retail business to OLMA group in Russia and Allianz's sale of Fireman's Fund to ACE for US$365 million.

3. AND IT'S NOT ALL ABOUT BUYING AND SELLING

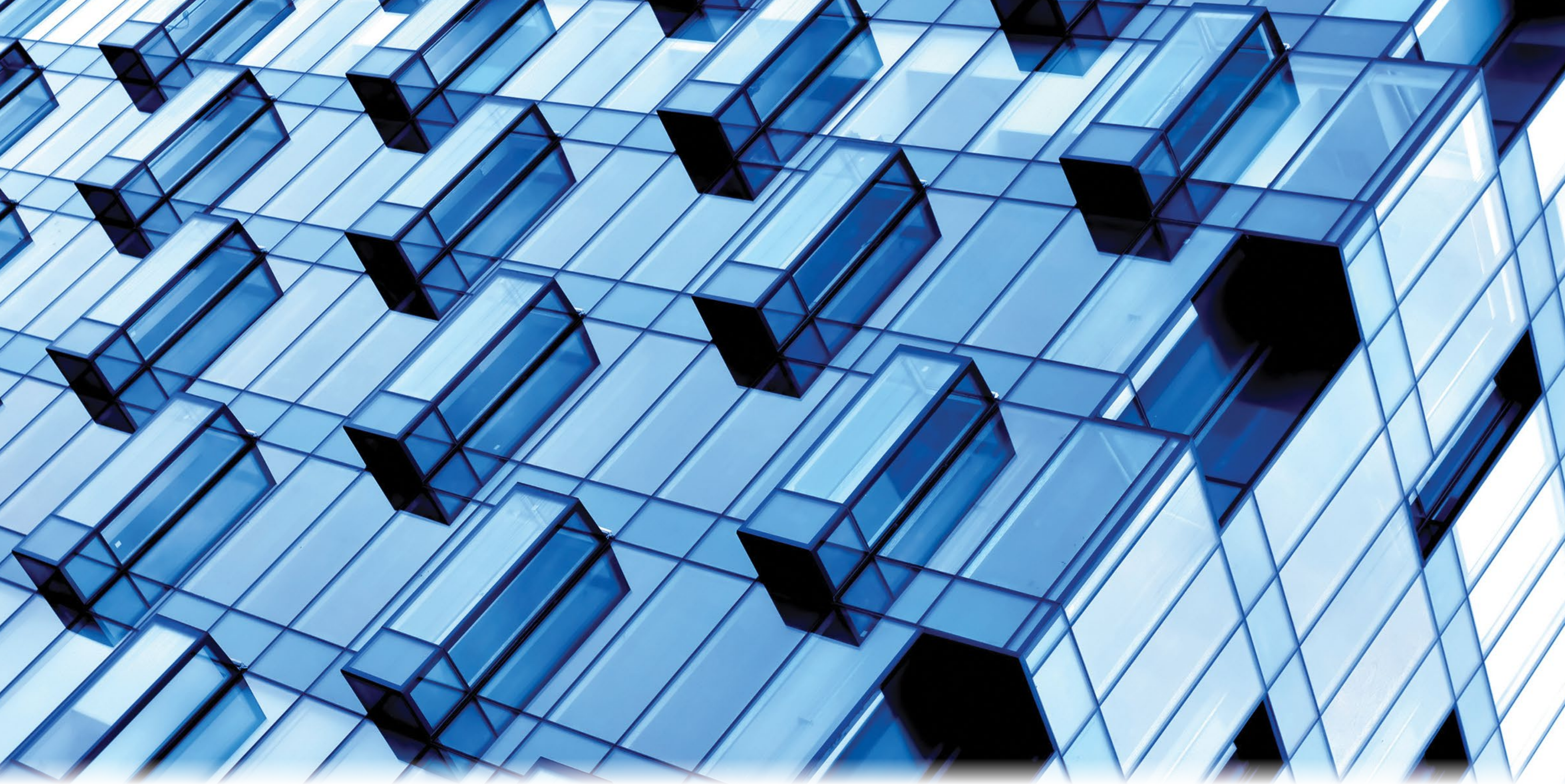
> Group reorganisations and mergers are on the rise.

As we predicted last year, activity has undoubtedly been spurred on by regulatory changes and the looming implementation of Solvency II in Europe. As a direct result of Solvency II coming into force on January 1, 2016 across the EU, we are seeing some large insurance companies committing to significant group reorganisations in the UK and across continental Europe. Despite the lack of clarity on the details of Solvency II and regulation elsewhere, companies have been taking a common approach: seeking improved internal economies of scale and crucial compliance with capital requirements. Such capital adequacy uncertainty, however, will impact how companies address retained cash that would otherwise have been invested internally, through M&A or by return to shareholders demanding higher returns on equity. Such uncertainty is a barrier to M&A and boards are likely to vote for caution until required capital levels become clearer.

4. PRIVATE EQUITY FIRMS REMAINED VERY ACTIVE IN THE SECTOR

Meanwhile we have seen the PE players have a renewed and expanding interest in insurance investments, often primarily on the intermediary and broker front which PE houses favor for their lack of underwriting risk, strong cash flow and low asset holdings. PE interest increased in 2014 despite historic reluctance due to debt burden, low margins and ever-tightening regulation.

Yet the low interest rate environment meant that PE firms (and indeed all companies seeking debt financed led acquisitions) were more attracted to businesses in the insurance sector. This trend was illustrated in the Towers Watson and *mergermarket*'s annual survey of the industry, in which 84 percent of respondents said they expected investment to continue into the insurance market with a particular interest from the private equity firms. Over recent years we've seen large PE firms such as Carlyle Group, Apollo Global Management and Blackstone



Group make significant investments in the insurance industry. Earlier in 2014, we saw Carlyle raise US$1 billion for its second fund to invest in financial institutions and insurance companies and the February KKR Sedgwick acquisition mentioned above. 2014 also saw some high-profile PE exits such as Bregal Capital's successful sale in May of Canopius to Sompo Japan Insurance Inc., one of the largest insurance companies in Japan.

5. REAL ESTATE INVESTMENT HAS BECOME MORE POPULAR

Over the past 12 months we have heard from a number of insurance companies with big plans to invest heavily in property. Asian insurance companies in particular are making the most of increasingly relaxed regulations on insurance funds with the likes of Ping An, who are well known to be actively interested in investing in property in international markets following their purchase of the Lloyd's of London building in 2013. In fact CBRE, estimated that an additional US$75 billion would enter the global insurance market by 2018 through property investment – the UK and US being the primary target markets. With banks reluctant to lend and interest being low combined with Solvency II regulations making property investment particularly attractive, insurance companies are increasingly plugging the funding gap as alternative lenders, offering them attractive yields. The investment arm of Prudential, M&G has invested £900 million over the last 18 months through its secured property income fund.

6. DIGITAL STRATEGIES ARE INCREASINGLY IMPORTANT DRIVERS

As the insurance industry begins to wake up to the reality that it's way behind other consumer sectors in the digital world, 2014 has seen potential for M&A driven by demand for new distribution channels and access to technology platforms; a trend likely to continue and grow into 2015 and beyond. Aetna is one example of a business investing in technology when the US based insurance provider acquired bswift for US$400 million late in 2014, giving the provider access to consumer-friendly cloud based technology to aid consumers shopping for insurance.

7. THE DIRECTION OF DEAL FLOW HAS STARTED TO CHANGE

Over the past few years the M&A landscape has been dominated by western insurers investing in high growth developing markets, with Western Europe and the US receiving little in the way of inbound investment. While developing markets, particularly in South East Asia, Latin America and Africa, continue to attract investment from the US and Europe – such as Swiss Re's entry into the Kenyan market and its acquisition of a 51 percent stake in Colombian specialty insurer Confianza – we have certainly seen a reverse trend increase momentum throughout 2014.

> "A number of Asian investors in particular have invested capital into Europe and the US despite slow growth rates. Some of the biggest and highest profile deals have involved Asian companies entering these mature markets."

A prime example is Fosun, a leading Chinese investment group, with more than one third of its total assets invested in the insurance industry. Over the past 12 months we advised on its acquisition of state-owned Caixa Seguros, Portugal's largest insurance group for €1 billion; Ironshore, the Bermuda reinsurer, for US$460 million and, just last month, the US property casualty insurer Meadowbrook Insurance Group Inc. for US$433 million. Dai-ichi Life's US$5.7 billion purchase of Protective Life is another example. Further, European and American investments by Asian buyers are also rumored to be in the pipeline in the near future. There has also been a similar pattern in reinsurance with developing economies expanding into mature markets, unsurprisingly dominated by Brazil (the region's largest M&A player) whose Grupo BTG Pactual S.A. acquired property and casualty specialist Ariel Re in July.

However, despite this emerging market counter-trend, it would be remiss not to mention the activity seen in Eastern Europe, with Poland and Turkey being particular hotbeds of insurance M&A transactions over the past 12 months. As we've already mentioned, PZU have been active in Poland, completing multiple acquisitions of RSA's non-core businesses across the Baltic region.

And, after years of discussion of potential consolidation among the Bermuda reinsurers, we have recently seen a number of transactions including the US$4.2 billion XL-Catlin transaction and the RenaissanceRe Holdings Ltd. deal to purchase Platinum Underwriters Holdings Ltd. for about US$1.9 billion which completed in March 2015. With reinsurers reeling from a perpetually soft market, spurred to a great extent by the expansion of insurance-linked securities and alternative capital, insurers as buyers of reinsurance have begun tiering reinsurers – with those in tier 2 possibly forced to look at strategic transactions.

8. THE RUN-OFF MARKET LOOKS INCREASINGLY ACTIVE

Particularly in Europe, where the value of the run-off market has grown by €7 billion in 2014 on 2013 from €235 billion to €242 billion. Growth is largely been fuelled by a change in mind set and growing acceptance that placing a business in run-off or selling that business is not a negative move but can be beneficial for insurers and policyholders alike. Of course Solvency II and its capital requirement is also playing a role in this trend, encouraging M&A in the run-off space as insurance companies assess all financial risks and focus on investment returns. As Solvency II implementation deadlines move nearer, we expect to see more M&A activity here.

In the life insurance run-off space, 2014 was a quieter year than 2015, with the notable exception of Wilton Re. Wilton Re acquired Continental Assurance Company from CNA Financial in February 2014 at an announced value of US$615 million, with the block consisting mostly of group annuities and structured settlements. In March, Wilton Re announced both the acquisition of Conseco Life Insurance Company from CNO Financial for US$237 million as well as Wilton Re's acquisition by the CPPIB for US$1.8 billion from a group of investors led by Stone Point Capital, Kelso & Company, Vestar Capital Partners and FFL. In October, Wilton Re announced that it would acquire the majority of the Aegon N.V. operations in Canada for CA$600 million, consisting of Transamerica Life Canada, Canadian Premier Life, Legacy General Insurance Company, Aegon Capital Management, Aegon Fund Management, CRI Canada and Selient, Inc. (Transamerica Canada Business). Not the only acquirer, RGA announced in August it would reinsure approximately 170,000 life insurance policies from insurance company subsidiaries of Voya Financial with a reported face value of US$100 million.

2015 may be a busier year than 2014 for life insurance run-off dispositions and reinsurers, continuing the lasting effects of private equity firms seeking "permanent capital" vehicles through life (re)insurance.

THE OUTLOOK FOR THE REST OF 2015

We anticipate global M&A activity volume and value to continue to rise during the course of 2015.

While the Lloyd's of London market has been active over recent years with a high number of transactions, we haven't seen many mega deals. This has already changed in 2015 with XL's £2.79 billion deal for Catlin, which is the largest ever purchase of a Lloyd's insurer. Clearly, Lloyd's continues to be a very attractive market, not least for its international reach and profile. Entry by acquisition, rather than start-up, remains an appealing route into Lloyd's, particularly the PE players who are becoming increasingly active in the sector. Further testament to there being a very active market is the recent $11 billion reinsurance merger between Axis Capital and PartnerRe and the $1.8 billion acquisition of Montpelier Re by Endurance meaning global M&A volume in the insurance sector is now off to its fastest annual start since 2007.

Cheap lending, strong levels of capital and low growth in the mature markets will continue to drive acquisitions of targets in Latin America, Asia and also the Middle East and Africa – we expect countries including Turkey, Brazil and Chile to carry on attracting investors seeking high levels of growth in 2015.

In the US, 2015 may lead to further investment by Asian companies in the insurance market, as well as the continued involvement of private equity and private equity-like investors (e.g., CPPIB) in life insurance M&A and capital markets transactions. Moreover, we can also expect Asian companies to have a very specific interest and activity in mature markets (US and Western Europe). In addition, the continued impact of insurance linked securities and alternative capital on the property/casualty reinsurance market, as well as the impact of tiering of reinsurers by major insurers, will likely lead to increased consolidation, particularly among "Bermuda" reinsurers (including those domiciled in Switzerland).

We also expect to see an increasingly competitive market leading to further market consolidation throughout 2015. As we move ever closer to the Solvency II implementation date, smaller companies will buckle under the burden of increasingly tight regulation and this will undoubtedly lead to further regulatory driven M&A deals and group reorganisations.

> "All the signs are there for 2015 to be a significant year for insurance M&A activity."

With economic conditions and confidence improving, deal value and volume increasing and the ever dominant presence of the PE sector, the shape of the industry is likely to continue changing positively at a pace over the next 12 months.

KEY CONTACTS

William Marcoux
Partner
Global Head of Insurance Transactions
T +1 212 335 4885
william.marcoux@dlapiper.com

PK Paran
Partner
International Head of Insurance Transactions
T +44 20 7153 7529
pk.paran@dlapiper.com

Paul Chen
Partner
Hong Kong
T +1 650 833 2225
paul.chen@dlapiper.com

David Luce
Partner
US
T +1 212 335 4735
david.luce@dlapiper.com

Melanie James
Partner
UK
T +44 (0)20 7153 7559
melanie.james@dlapiper.com

Heng Loong Cheong
Partner
Hong Kong
T +852 2103 0610
hengloong.cheong@dlapiper.com

Joyce Chan
Partner
Hong Kong
T +852 2103 0473
joyce.chan@dlapiper.com

www.dlapiper.com