M&A activity
A global overview
2009-2013
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Welcome to our third annual report on mergers and acquisitions (M&A) activity in the global insurance market. Based on data supplied for completed transactions between July 2012 and June 2013 by Thomson Reuters, our global team of corporate insurance specialists offers their view of key trends in each of their regions.

In last year’s report we observed an overall decline in global activity, albeit with some regional variation, with transactions dropping to the lowest level for three years in the first half of 2012 – despite the deal environment remaining relatively robust throughout 2011. However, there were a number of factors that could have caused M&A activity to increase during the second half of 2012 and early 2013 – e.g. a significant catastrophe creating widespread balance sheet damage, a sharp turn in the pricing cycle or continued solvency deterioration in the Eurozone forcing more asset sales or corporate transactions. However, while Eurozone issues rumbled on and the market suffered from a number of catastrophic events – not least Superstorm Sandy – the pricing environment has remained stubbornly soft – and overall the number of transactions has continued to decline.

The US remains the most active country overall, accounting for more than 30% of global M&A activity, but in the last 12 months its activity has fallen by around 40%. Poor valuations, insurance pricing at the bottom of the cycle, uncertainty around ultimate exposure to Superstorm Sandy and lacklustre economic performance are all contributing factors. Outside the US, Latin America continued to interest investors, with Brazil and Argentina leading the activity. However, other parts of Latin America are also of interest and two of the largest deals worldwide involved acquisitions in Chile and Mexico.

Europe is still the second most active region for M&A activity, after the Americas, although the downward drift in deals has continued, with volumes falling by almost 30% year on year between 2009 and 2013. Activity in the UK however increased in the last 12 months. There were transactions in Spain, France, Germany and Italy, frequently driven by the ongoing problems in the Eurozone and fall-out from the global financial crisis, as insurers sold off non-core and sub-scale assets as part of turnaround programmes.
Across Asia Pacific, levels of deal activity have been stable, with 57 deals in total in the last 12 months, compared to 58 the year before. However, this probably is not an accurate reflection of the level of interest in the region which remains keen, with global re/insurers, regional players and private equity houses all looking at the considerable growth potential available.

Two of the most significant opportunities due to the size of their markets are China and India. While the former is open to foreign investment, the actuality of establishing a presence is very challenging and, as a result, foreign life and property and casualty players only held 4.3% and 1.2% respectively of the Chinese insurance market in 2012. However, the potential of the Chinese market is illustrated by the opening of the motor third-party liability insurance market to foreign investors by the regulator, a trend expected in other key areas of the market.

In India, while the insurance industry struggles to overcome the challenges and uncertainties of the last few years, there can be little doubt that the fundamentals that underpin future growth remain strong. While deal activity is likely to remain fairly stagnant until the government opens up the insurance sector (in particular the 26% cap on investment), longer term, India is huge market with lots of potential, so it should stay on the radar of insurers.

Deal activity in Japan picked up in the last 12 months, the majority of which were outbound investments as domestic insurers seek to diversify beyond their mature, local markets. The maturity and consolidated nature of Australia’s insurance industry makes for little in the way of M&A activity, and the activity that is underway is being driven by insurers looking to rationalise legacy books of business or outdated structures.

The Middle East is a story of ‘wait and see’. While the future of insurance in the region is very positive with governments making significant infrastructure investments and looking to develop mandatory health insurance, this is not being reflected in transactional activity in the sector. Despite this positive background, the insurance industry in the Middle East needs to overcome some fundamental challenges. Domestic markets are suffering from over-supply and a lack of skilled staff and expertise. The growth potential is attracting considerable foreign interest – all of which should be leading to a growing number of transactions in the region. However, as the data above illustrates very clearly this is not the case.

**Global trends**

Probably the most dominant trend in the deals that have taken place in the last year has been the search for growth – whether that is by expanding into those less mature markets with greater potential, or by diversifying through acquisition into new sectors or distribution channels.
Examples of this trend include insurers from Japan looking across both Asia and the Middle East for growth and profitability. While their primary targets appear to be in the regional emerging markets such as Indonesia and Malaysia, they are increasingly looking to the Middle East where Japan has significant trading relationships. For example in the last 12 months, there were two significant acquisitions by Japanese insurers with ORIX Corporation acquiring Bahrain’s MEDGULF, while Tokio Marine & Nichido Fire bought Egypt’s Nile Family Takaful Co SAE.

In terms of activity, Indonesia is a good example of a market where international insurers are making significant investments. In a region that offers promising growth for the insurance industry, Indonesia is widely held to be a stand-out market with some staggering metrics. Premiums are increasing 11% year-on-year – five times the growth rate of Europe or the US. In the last 12 months Hanwha General Insurance from South Korea made two acquisitions, as did Japan’s Tokio Marine Holdings Inc. ACE continued its Indonesian expansion with the acquisition of 80% of PT Asuransi Jaya Proteksi in a transaction worth approximately USD 130 million.

In April 2013, ACE also bought Mexico’s Fianzas Monterrey for USD 295 million, highlighting a new market that is increasingly on the acquisition radar. With an underpenetrated insurance market, and a National Infrastructure Plan investing USD 400 billion over five years, Mexico offers plenty of opportunities for foreign insurance and reinsurance since there is not currently sufficient capacity in the domestic market to carry the large risks that these projects will entail.

**Under the regulatory microscope**

Another long term trend in almost every region is regulatory reform. The desire by regulators is to build businesses that understand the risks they are writing, hold the appropriate levels of capital and have strong balance sheets. In the European Union, the delay in implementing Solvency II and uncertainty around its final form has left the management of European re/insurers in something of a quandary as to the shape and size of their businesses going forward. This has undoubtedly slowed down some transactions which might otherwise have resulted from insurers reviewing their books of business.

Regulators in the Middle East and Asia are looking at the actions of the authorities in Europe and the US to strengthen insurer solvency, and are taking similar steps in this direction. The Life and General Insurance Capital framework in Australia is one good example. While the specifics may be local to each country, the overall trend to fewer, stronger insurers will undoubtedly lead to market consolidation in many places.

**Riding the pricing cycle**

The longed for market hardening was very patchy between July 2012 and June 2013, and this definitely affected transaction levels in more mature markets. In the US for example, insurance companies – across property & casualty, life & health and reinsurance – are still trading well below their historical book value, which prevents many deals from being consummated. Last year this meant that many insurance companies with excess capital were buying back stock rather than going for M&A. This however is unlikely to satisfy shareholders looking for growth in the longer term, so this year has seen more interest in plowing capital back into the business to drive organic growth through initiatives such as differentiating technology and improved customer experience. It may also lead to more niche acquisitions that can improve the bottom line. In Bermuda – another very competitive market place – deal activity last year was more focused on the acquisition of small to mid-tier businesses to bolt-on specialist activity.

**Feeling the fallout**

The ripples from the global financial crisis continue to be seen in transactions across the insurance markets worldwide. Whether it is the IPO of Directline in the UK or Italy’s Generali selling its US life reinsurance business to SCOR as part of its turnaround programme – the effects of the fallout continue to be felt.

Having, perhaps prematurely, called the turn on the M&A market last year, we do still believe that the tide is turning. We are already starting to see more deals announced and there is much greater confidence that rates are rising and economic conditions are improving overall. Our regional partners, listed at the back of this report, will be able to provide in-depth insight and perspective wherever you might be considering a corporate transaction.

**Andrew Holderness**

Global Head of Corporate Insurance
The Americas

The overall level of M&A deal activity in the Americas from 2009 to the end of June 2013 has been broadly flat. After peaking in the first half of 2011, the trend since then has been downwards. Within the Americas the US is the country with by far the most activity with 75% of all deals in the region.
Although this US-dominant trend continued into 2013, Canada, Brazil and Bermuda also saw significant activity – albeit at a lower level. There was also steady activity across other countries in Latin America, mainly in Argentina, Chile and Peru.

**Volume of deals in the Americas**

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**USA**

While the US remains the most active country in terms of M&A activity overall – not surprisingly given its maturity and size – the overall trend has nevertheless been downward. The US accounts for around 32% of global M&A activity in the insurance sector over the last four years, but activity has fallen by around 40% in the last 12 months.

Undoubtedly, this drop in activity level has been driven by the lacklustre economic performance in the US, insurance pricing being at the bottom of the cycle and poor valuations. However, there may be some shifts in different sectors of the industry and alterations to trends that may affect the deal environment going forward.

For example, in the P&C sector, uncertainty as to the ultimate exposure to Superstorm Sandy will have undoubtedly put some business plans on hold while they work through the full claims picture. However, a desire to improve both performance and top line revenue will cause some either to look for domestic acquisitions or to expand their horizons into the faster growing markets outside the US.

The life and health sector has only seen lacklustre activity with most focus being on annuity business, which has been badly affected by the ongoing low interest rate environment. Some examples include blocks of business being sold to PE firms or European companies selling US assets as they review their balance sheets in preparation for Solvency II. It is likely that there will be a continuation of this trend as life insurers look to spin off non-core or underperforming assets.

In early 2013 for example, Hartford Financial Services Group sold its individual life insurance business to Prudential Financial for USD 615 million in cash. The deal allowed Hartford to increase shareholder value by concentrating on its property and casualty business, while Prudential gained scale and expanded distribution.
2012 also saw the acquisition of SRLC America Holding Corp. from Swiss Re by Jackson National Life Insurance Company. According to a statement from the company, the acquisition will add about 100 million pounds of pre-tax profit to Jackson National Life in the first year of ownership. For Swiss Re, the transaction unlocks capital for use across the group and is expected to boost the reinsurer’s return on equity, earnings per share and economic net worth growth targets.

The intermediary sector has also seen some activity as brokers continue to look for acquisitions that will provide new clients or additional revenue sources. This is also a sector that interests PE houses since the businesses are cash flow, not balance sheet, based. The former trend is illustrated by the acquisition of John T Fretz Insurance Agency by Univest Insurance. This was Univest’s seventh acquisition since 1999 and was aimed at broadening the product base and increasing market share in their home market in Pennsylvania.

In December 2012, Canadian private equity firm Onex Corp completed its acquisition of USI Insurance Services for approximately USD 2.3 billion. USI is ranked in the 10-largest insurance brokerages in the United States and the 13th-largest brokerage in the world by revenue, according to insurance ratings agency A.M. Best Co. Michael J. Sicard, USI Chairman, President and CEO, commented that the investment will allow them to continue with their growth strategy of actively acquiring smaller insurance agencies and brokers, most recently buying TD Bank’s US insurance subsidiary.

**Economic and regulatory uncertainty**

The difficult economic conditions of 2012 have improved somewhat in 2013, which may encourage more consumers and businesses to buy more insurance to protect valuable assets. Equally, it may give more overall confidence to the M&A market. On the regulatory front, there is increased clarity around legislation and regulations of importance to the insurance industry that may help market confidence, even if they also increase compliance costs and oversight. For example, the implementation of the Dodd-Frank Act and the creation of the US Treasury’s Federal Insurance Office, as well as the finalisation of the criteria for Systemically Important Financial Institutions (SIFI).

The uncertainty around these criteria has meant that some companies have been deterred from substantial acquisitions in case that would put them into the SIFI category. So, greater certainty may unblock that log jam as well as encouraging some to divert assets so they become smaller and less connected.
Driving deals
As we reported last year, insurance companies – across property & casualty, life & health and reinsurance – are still trading well below their historical book value. This creates a disconnect between the company’s view of how much the business is worth, and Wall Street’s view. Currently, the mis-match of pricing expectations is preventing many deals being consummated, however it could be that other pressures (possibly regulatory) will impact activity.

The first half of 2013 has seen some rate hardening across most lines and, as a result, revenue growth which – if sustained – could push analysts to increase valuations. However they are likely to stay below book value for some time.

Last year this meant that many insurance companies with excess capital were buying back stock rather than going for M&A. This however is unlikely to satisfy shareholders looking for growth in the longer term, so this year has seen more interest in plowing capital back into the business to drive organic growth through initiatives such as differentiating technology and improved customer experience. It may also lead to more niche acquisitions that can improve the bottom line.

While the bulk of M&A activity in the US is likely to be domestic, many are expected to invest in emerging markets where there is a prospect of higher growth and less competition. For example, Principal Financial Group Inc. agreed to buy Chile’s AFP Cuprum SA in a USD 1.5 billion deal early in 2013. Principal’s Chief Executive Officer Larry Zimpleman has been clear about his ambition to expand in Latin American nations including Chile, Brazil and Mexico to capitalise on the region’s growing middle class and the increasing role of private companies managing retirement funds.

ACE Limited also completed its acquisition of Mexican personal lines insurer ABA Seguros from Ally Financial – aiming to take advantage of the growth opportunities in both Central and Latin America with a well established brand and wide network of agents. Examples such as these illustrate the tremendous potential of moving into new markets, but regulatory and compliance considerations as well as operational and investment issues should not be underestimated.

Pricing
2012 had been a relatively quiet year for catastrophes until Superstorm Sandy struck the East Coast on October 29. Once this is combined with the Mid West drought and some tornado/severe weather damage, 2012 is likely to be the United States’ second costliest year on record (after 2005) for weather and climate disasters. RMS estimated that insured losses from Sandy alone could top USD 50 billion.

While this undoubtedly helped to drive rates higher at the beginning of 2013, it appears that the momentum was hard to sustain for even six months and by July 2013 a more pessimistic tone was prevalent in the stock market. The recent upturn in US primary insurance prices appears to be running out of steam, with prices in the key US property market coming under pressure because of stiff competition from new entrants, including the recently launched Berkshire Hathaway Specialty Insurance and Chinese heavyweights such as People’s Insurance Company of China, according to brokers. Analysts estimated that reinsurance and specialty rates fell by about 5% between April and June. At the 1 July renewals, catastrophe insurance prices were falling as a result of the growing availability of cheap reinsurance cover in the insurance-linked securities (ILS) market, driven by burgeoning demand for ILS investments from pension funds.

Taxation
Tax reform typically creates M&A uncertainty as taxes can have a significant impact on deal values. The insurance industry has enjoyed a long history of favourable tax legislation. However, as Congress searches for increased revenue, it may feel that it is time to alter models or increase rates. While there is not yet clarity about what form this might take, the industry is considering reform elements that could include capital gains and dividend rate increases, changes in US taxation of foreign entities, limitations on the tax-free benefits of life policies and the tax-free increase in value of whole life policies.
Canada

The structure of the Canadian insurance market has changed considerably in the last few decades as the market has become more domestically-owned, with the market share of Canadian-owned insurance companies increasing significantly, while the Canadian operations of European and American insurers’ have decreased. There are a number of reasons why this might have come about but there are two structural issues: the relatively onerous Canadian regulatory environment which may have made it less attractive for foreign companies to invest in Canada and a very robust independent broker channel that domestic insurers have been able to leverage very successfully.

2013 saw rising activity in the regulatory arena as authorities followed the global trend and focused on strengthening insurance solvency and corporate governance. In January 2013, the Office of the Superintendent of Financial Institutions (OSFI) finalised the Corporate Governance guidelines which applies to all federally-regulated financial institutions. While large insurers are more likely to have the resources and capabilities to meet these increased requirements, mid-sized and smaller underwriting businesses may have more difficulty.

These increased compliance costs combined with weak investment returns and a very competitive market may drive increased consolidation in the P&C sector which is still very fragmented and has several hundred carriers competing for business. Consolidation has also been a trend in the brokerage sector as intermediaries look to expand their regional footprint. Western Financial Group has remained acquisitive with several deals expanding their operations into more specialised niche services – such as their purchase of BC Yacht Insurance Brokers – and People Corporation acquired three agencies in the last 12 months.

The federal government has not – at the time this report went to press – published its regulations for the demutualisation of property and casualty insurers, proposals which have been in the works for almost two years. This issue is of interest to brokers because Canadian-owned insurance companies represent nearly half of the Canadian insurance market, and there are 106 mutual insurers operating in Canada – about a third of the market by number. Demutualisation could potentially open up the ownership of mutual insurance companies, making them the targets of mergers or acquisitions.
Bermuda

While there have been some mergers and acquisitions in the last 12 months, including the acquisition of the Bermuda-based Alterra Capital Holdings Ltd by Markel Corp, the levels of activity have not picked up noticeably from previous years. Nevertheless, the fact that opportunities for organic growth remain limited and the underwriting market highly competitive might increase the momentum for future deal activity.

Although there has been some expectation of consolidation amongst the island’s re/insurance community, the deal activity this last year has been more focussed on the acquisition of small to mid-tier businesses to bolt-on specialist activity. For example, Partner Re made a substantial investment in Entitle Direct Group – a direct-to-consumer title insurance company as well as acquiring specialty accident and health reinsurer Presidio. Both of these were part of Partner Re’s long standing strategy of diversification into areas that have limited correlation with their existing books of business. Endurance Speciality Holdings acquired the assets of Galileo Weather Risk Management to form a new unit offering a suite of customised products to help manage the risk of weather variability. This will complement Endurance’s current property catastrophe and agriculture products. The other key Bermudian deal was the purchase by Validus of Flagstone Reinsurance. This illustrates the trend for mid-sized reinsurers to merge in order to both diversify their business mix and increase their balance sheet in order to take on larger risks from primary insurers.

Despite the losses from Superstorm Sandy in the last quarter of 2012, capacity in the market remains high with re/insurers still sitting on considerable capital. This has been exacerbated by the emergence of the new hedge-fund-backed reinsurance providers and additional reinsurance capacity in the form of sidecars, catastrophe bonds and Industry Loss Warranties (ILWs). All of this has increased the levels of competition as well as further reducing the demand for more traditional forms of reinsurance and retrocessional capacity. This may in turn increase pressure for consolidation among existing reinsurers.

It is also possible that the coming year will see more activity amongst those companies that are owned by private equity firms as they seek an exit strategy. Most of these businesses date from before 2009 – in fact some go as far back as 2007 – which means the PE houses have been invested from five to seven years, a time period after which they will want to realise some value.

Outside the US, the dynamic Latin American markets continued to be of interest to investors, with Brazil and Argentina leading the way in terms of transaction activity. The last months have also seen considerable interest in other emerging markets in the region; in fact, two of the year’s biggest deals worldwide involved US insurers making acquisitions in Chile and Mexico.

Brazil

Brazil’s insurance sector is one of the world’s most dynamic. It has seen a decade of significant growth, fuelled by strong economic development, expanding broker channels and the rise of lines including motor and property. The Brazilian market is predicted to grow in the region of 7-10 per cent a year for the next few years, with continued real GDP growth supporting the demand for insurance products. The growing middle class will increasingly buy insurance to cover their newly-acquired assets, while people on lower incomes are driving demand for micro-insurance products. In addition, the insurance market will benefit from significant near-term infrastructure development, driven in part by preparations for the country to host the 2014 FIFA World Cup and the 2016 Olympics.

With more than 100 insurance companies the market is ripe for consolidation and, during the period from July 2012 to June 2013, Brazil saw a spate of deals in the insurance sector. The majority of these transactions were domestic, with activity being driven by the desire from regulators to have fewer, stronger insurers serving the market. In the largest domestic deal, Yasuda Seguros SA (a subsidiary of Sompo Japan Insurance Inc) acquired a 37 per cent stake in Maritima Seguros SA for USD 98 million.

Bancassurance is dominant in Brazil, with the three giant bank-related insurance groups, Itau, Bradesco and Banco do Brasil controlling around 65 per cent of the insurance market in terms of assets, either directly or through
strategic alliances or exclusivity agreements. Their position is only likely to strengthen as they continue to develop their brands, invest in systems, improve underwriting and profitability, and introduce new products. This will put further pressure on smaller players in the market and will likely serve as a driver of further transactions.

Unsurprisingly, the country is also very much on the radar of large international insurers looking for acquisition targets to offset stagnant growth in more developed markets and in 2012 US company International Finance Corp bought a 79 per cent stake in SulAmerica SA for USD 197 million. In addition, US-based The Travelers Companies, Inc increased its ownership stake in J. Malucelli Participações em Seguros e Resseguros SA to 49.5 per cent. On the completion of the deal, Alan Schnitzer, Vice Chairman and Head of Travelers’ Financial, Professional & International Insurance business segment, said: “We are very pleased with the performance of our joint venture in Brazil. It continues to be the market leader in the surety insurance business, with a market share of approximately 30 per cent. In addition, we are making good progress on our early efforts to expand beyond the surety business into the growing property and casualty market.”

It is perhaps surprising that Brazil did not see more cross-border transactions in the period 2012-2013. This may be a case of the majority of larger players already having a presence in the market, or potential entrants may have been put off by a combination of factors. The country’s growth rate has slowed – the question is how much further it will do so. The riots that took place in early 2013 may have raised a note of caution among those considering a transaction, but they are more likely to be concerned by some evidence of protectionism after the authorities began to restrict the outward flow of premiums, recently stipulating that 40% of reinsurance should be placed with local carriers and limiting intra-company cessions to 20%.

However, it is likely that these factors will cause a slight slowdown in transactions at worst. The underlying fundamentals of the market point to continued M&A activity. This would be bolstered if plans that are afoot to create a national insurance centre in Rio de Janeiro to concentrate insurance and reinsurance expertise in one hub, based on the London model, come to fruition. Both domestic and international insurers are eyeing this potential development with interest.

Argentina

The insurance industry in Argentina is the third largest in Latin America and has sustained significant growth in recent years, with levels of premium reaching USD 12.8 billion in 2011. This has long attracted overseas insurers, leading to a significant level of transaction activity in the period 2009 to 2012, including notable deals such as Australia’s QBE acquiring HSBC’s Argentina Holdings SA and the UK’s RSA Insurance Group acquiring Aseguradora de Creditos and El Comercio Compania de Seguros.

In a reversal of this trend, Argentina’s insurance sector saw very limited deal activity between July 2012 and June 2013. The competitive landscape in the Argentinian insurance market remains relatively fragmented, suggesting that consolidation should be welcome and on-going, and those transactions that did take place were domestic. The 12-month period saw Galeno Argentina SA buy Mapfre Salud’s workers’ compensation and health business for an undisclosed sum in October 2012. Antonio Huertas, Chairman of Mapfre, said the deal would expand his company’s distribution network of insurance products in Argentina. In another domestic deal, Grupo Supervielle SA and Sofital SA bought Aseguradora de Creditos in June 2013.

However, there were no transactions involving foreign insurers during the period. They will likely have been discouraged by the country’s relative political and economic instability, and by reforms introduced in 2011 that limited the amount of risk companies could cede to international reinsurers.

This sentiment will have been reinforced by the announcement in December 2012 by rating agency Fitch that it was placing all its rated insurers in Argentina on negative outlook, warning that “the strong premium growth and profitability ratios of Argentine insurers may be hindered by a scenario of possible sustained lower economic growth, rising inflation and macroeconomic volatility”. The agency also indicated that the array of controls and new regulations introduced by the government – including the recent imposition of a compulsory investment rule for all insurers – “limits the ability of insurance companies to deal with changes in the operating environment”. 
In another sign that deal-making activity in Argentina is likely to remain subdued, in July 2013 Moody’s followed suit, changing its outlook for Argentine insurers from ‘stable’ to ‘negative’ for life and P&C sectors, citing high inflation and political uncertainty as continuing to have a detrimental impact on insurers’ credit profiles.

**Chile**

Chile is the most developed market in the region. Its USD 9.67 billion in GWP means the country has the highest insurance penetration in Latin America, at 4.1%. This maturity, coupled with a small population, means there’s less potential to grow in the long term. But in the near term, fuelled by a strong economy, business is thriving. In addition, despite facing significant catastrophe exposures, under-insurance remains an issue in the country. For example, the 2010 earthquake caused nearly USD 30 billion of damage, of which just US 8.2 billion was insured. However, since then, premiums have risen substantially, with demand for more sophisticated risks.

The Chilean insurance market remains relatively open to foreign companies, with potential entrants aided by a lack of regulatory barriers. In the tenth largest M&A transaction worldwide of the 12-month period, US Principal Financial Group Inc bought AFP Cuprum SA for USD 1.25 billion. Commenting on the transaction, Principal Chief Executive Officer Larry Zimpleman said: “This acquisition continues our effort to find targeted, strategic targets that strengthen our competitive position in the most attractive emerging retirement and long-term savings markets. Cuprum represents our sixth such transaction in the past two years and adds meaningfully to our fee-based earnings.”

The period also saw a number of domestic transactions, the largest being the acquisition of Cia de Seguros de Vida Cruz Del Sur by Grupo Security SA for USD 300 million. These deals are likely to have been driven by pending regulation, with Chile moving toward stricter risk-based capital measurements. The Chilean insurance regulatory agency, Superintendencia Valores y Seguros, has issued its first risk-based capital (RBC) model as part of a bill that establishes a risk-based supervisory system for the insurance industry.

Although the initiative is currently under discussion and is yet to be approved by The Chilean Congress, this is surely a question of when rather than if, as the oversight authority moves to step up protection for insureds and the State, and looks to minimize the risk of insolvency in the insurance industry. However, implementing the complex requirements will present significant challenges that will see many insurers struggling to comply, leading to a rise in potential targets for acquisition.

**Peru**

Peru’s insurance sector has enjoyed strong, steady growth in recent years. The market has grown more than 13% a year over the past decade, and between 2011 and 2012 the country’s total insurance premium increased 9.6% to USD 3.1 billion. With penetration among the lowest in the region at 1.3%, combined with a positive macroeconomic outlook, rising consumer interest in buying insurance and the increasing sophistication of insurance industry players, the insurance market in Peru has significant growth potential.

These factors led to several M&A deals between July 2012 and June 2013. The most significant was Colombia’s SURA Asset Management acquiring 70 per cent of Peru’s Invita Seguros de Vida y Pensiones in November for USD 96 million. In another cross-border transaction, Spain’s Sura Asset Management acquired Seguros SURA for an undisclosed fee.

In contrast to a buoyant level of M&A activity in recent years in terms of domestic deals, there was just one in the period, the acquisition of Protecta SA Cia de Seguros by Grupo ACP Corp SAA in May 2013. Unlike some other countries in the region, Peru has relatively few players in the industry with 28 insurers and reinsurers registered at the beginning of 2013. This, combined with the fact that the market is dominated by four large entities – Peru’s Rímac Internacional, Pacífico Vida and La Positiva, and Spain’s Mapfre – suggests that targets for future M&A activity may be limited.

However, Peruvian entities are starting to look elsewhere in the region for opportunities. In September 2012, El Pacífico Peruano Suiza Cia acquired a controlling 51 per cent stake in Bolivia’s Crediseguro SA, a possible early indicator of an emerging trend.
Mexico

Mexico is currently worth more than USD 20 billion in premium, second only in Latin America to Brazil. However, this represents just under 2% of GDP, as the country remains an underpenetrated insurance market. This potential is underpinned by a strong economic outlook, a relatively youthful population, and a rapidly growing middle class, which now comprises 50 per cent of Mexico’s population, compared with 80 per cent living in poverty in 1960.

A government drive to invest in infrastructure will create further opportunities for insurers. Under the National Infrastructure Plan for 2013-2018, the Mexican Government will spend USD 400 billion on projects in sectors including energy, tourism, transport, water and urban development. This will bring opportunities for foreign insurance and reinsurance as there is not currently sufficient capacity in the domestic market to carry the large risks that these projects will entail.

Unsurprisingly, Mexico is increasingly getting on the radar of international insurers looking to expand into emerging markets to achieve growth. Indeed, in May 2013, Mexico saw one of the largest transactions worldwide this year, when US insurer ACE bought ABA Seguros SA de CV for USD 865 million in May 2013 – the latest in a spate of Latin American acquisitions by the insurer. In April 2013, ACE also bought Mexico’s Fianzas Monterrey for USD 295 million.

Describing the rationale for these deals, Evan Greenberg, Chairman and Chief Executive Officer of ACE Limited, said: “ABA Seguros is a well-established, well-recognized, agency-based insurer with a solid service reputation and impressive creativity that can be leveraged across Mexico and the Latin American region. With ABA, combined with our existing ACE Seguros businesses and our new ACE Fianzas Monterrey business, we are extremely well positioned to take advantage of the many growth opportunities we believe will occur in this important country over the next decade and beyond.”

In terms of domestic transactions, there were only two in the period July 2012 to June 2013, both of which were restructurings, by Reaseguradora Patria SAB and General de Seguros SAB. These will have been driven in part by the announcement of a new legal and regulatory framework for insurers, created along similar lines to Solvency II in Europe. This development will likely spur further consolidation and there should be no shortage of targets. Mexico has around 100 insurers in the market and the sector is highly competitive. Although this has historically restricted growth, many insurers have improved profitability in recent years as a result of tighter control of costs and higher prices.
Asia Pacific

While the overall trend in M&A has drifted downwards over the last four years, activity in the last 12 months has been stable: there were 57 deals in total, compared to 58 the year before. This, however, is probably not an accurate reflection of interest in the region, which remains keen, but says rather more about difficulties around finding the right targets and limitations on investments in many markets.
It is difficult to talk about regional trends across an area of considerable economic and geographic diversity. However, both domestic and international insurers in Asia-Pacific are starting to benefit from the organic premium growth potential across the region, which is being delivered by increasing levels of growth and improving insurance penetration rates. The result is that there are some significant deals being done – five of the largest global insurance transactions were Asia-based last year – and there are some common trends driving activity across a number of markets.

For example, regulators in many markets are looking at the actions of the authorities to strengthen insurer solvency in Europe and the US, and are taking similar steps in this direction. The Life and General Insurance Capital framework in Australia is one good example. While the specifics may be local to each country, the overall trend to fewer, stronger insurers will undoubtedly lead to market consolidation in many places.

Insurers from developed markets such as Japan are still looking to the developing economies for growth and profitability. Primary targets appear to be in the regional emerging markets such as Indonesia and Malaysia, but they are increasingly looking to the Middle East and Eastern Europe for opportunities as well. It is also likely that some re/insurers from the more developing economies will start to look at international investment opportunities.

Another trend we are starting to see is private equity (PE) houses taking an interest in insurance targets in the region. However, this may take some time to manifest itself in deals as PE investors need to build their insurance expertise and be able to offer target companies genuine partnership, rather than just capital.
Japan

Deal activity in Japan picked up in the second half of 2012 and the first half of 2013. While there were some domestic transactions, the majority were outbound investments. The only inward investment took place in April 2013 when Swiss Re bought a 13.5% stake in Japanese insurer Lifenet Insurance Co for USD 41 million, making it the biggest shareholder.

While economic activity has picked up in Japan over the last six months, the insurance market still struggles with low investment returns, a shrinking domestic market and the losses from the earthquake and tsunami of 2011. As a result, there is a continuation of last year’s trend where domestic insurers are seeking to diversify their business beyond Japan’s borders. The result has been a spate of deals abroad – largely in developing economies in Asia, the Middle East and Central Europe.

Notable deals included Sumitomo Life Insurance Co buying a stake in Bao Viet Holdings for USD 340 million; Nippon Life Insurance Co buying a stake in India’s Reliance Capital Asset Management Ltd for USD 289 million; and Meiji Yasuda Life Insurance Co buying shares in Poland’s TUIR Warta SA for USD 285 million. Tokio Marine Holdings Inc and Tokio Marine & Nichido Fire also carried out a number of deals.

While the monetary easing policy undertaken by the government and the Bank of Japan appears to be broadly positive for economic development, it is less clear what the impact will be on insurers. However, in April of this year, Moody’s commented that it could have several negative effects on Japanese life insurers, including a reduction in economic capitalisation and an exacerbation of negative yields and reinvestment risk.

Australia

The Australian insurance industry has faced considerable challenges over the last few years, with a hardening of the property reinsurance market and large falls in interest rates that have affected insurers’ profitability and caused some to review their risk appetites. Despite this, however, the industry remains resilient and its solvency position strong.

Nevertheless, the combination of natural catastrophes and the global financial crisis proved a real test of reinsurance arrangements and – while broadly they performed well – the situation did cause the Australian Prudential Regulatory Authority (APRA) to conduct a close examination of industry practices. This included stress testing when setting reinsurance arrangements, challenging boards and senior management on
catastrophe modelling, and looking at pricing and reserving. In a market with high levels of competition and ongoing low interest rates, there is also a clear focus on disciplined underwriting.

Actual and potential counterparty risk to reinsurers is also seen by the regulator as a key risk and APRA has an ongoing interest in both the geographical spread and rating of reinsurance counterparties.

The maturity and consolidated nature of the Australian insurance industry meant that pure M&A activity was relatively quiet between July 2012 and June 2013, and there were no inbound investments. This is unsurprising given the developed nature of the market: it is likely to be only highly specialised or niche players that can find a home here going forward.

There was, however, notable activity in the legacy sector under the Insurance Act 1973 (Part III Division 3a) as businesses look to rationalise their structures and gain capital efficiencies. Suncorp, for example, rationalised its five licenses into one in this way.

Regulatory change in the form of the Life and General Insurance Capital framework (known as LAGIC) took effect in Australia in January 2013. This framework brought in requirements similar to Solvency II, but Australian insurers are largely well placed to handle them, so this is unlikely to lead to a spate of deal activity.

The focus for Australian insurers is still firmly on emerging markets, with a particular focus on bancassurance deals to achieve efficient and effective distribution in new markets. QBE Insurance Group Ltd, for example, continued its overseas expansion by buying Hang Seng Bank’s Hong Kong general insurance operations in July 2012, as well as HSBC’s Latin American insurance operations. Of the former QBE said in its annual report: “This [deal] was complemented by a 10-year bancassurance agreement wherein QBE became the exclusive provider and underwriter of bancassurance general insurance products to Hang Seng Bank’s customers in Hong Kong and mainland China. The distribution agreement provides increased penetration into the Hong Kong market and the opportunity to advance our interest in exploring mainland China through the bank’s strong operations in that country.”

South Korea

While both the life and non-life insurance markets are among the most saturated and competitive in the world, there are still growth opportunities available. In the property and casualty sector, this is being driven by the development of large-scale transport and other infrastructure projects undertaken by the South Korean government; rising consumer awareness about the benefits of non-life insurance products; and the expansion of distribution channels across the country.

Moody’s Investors Service said in February 2013 that the outlook for South Korea’s life insurance industry is stable, backed by likely steady growth in premiums, a more stringent regulatory framework and an ageing population. Moody’s said: “Korea’s stable economic growth and inflation will support steady demand for life insurance products. We expect total premiums to grow 6.0-6.5% in the next 12-18 months.”

As with a number of countries across the region, regulators are seeking to bolster consumer confidence in the insurance industry by implementing measures to increase product transparency and service standards. As a result, South Korea’s Financial Supervisory Service is now inspecting insurance sales.

Recent transactions illustrate the fact that South Korea remains attractive to inward investors. For example, a group of investors led by Hong Kong’s Affinity Equity bought a USD 1.1 billion stake in Kyobo Life Insurance Co., Ltd, the smallest of South Korea’s ‘Big Three’ life insurers, which is now thought to be heading for a stock market listing. France’s AXA SA, itself seeking growth opportunities outside mature European markets, bought Ergo Daum Direct Insurance for USD 44 million in August 2012.

With opportunities for organic growth quite limited, South Korean insurers are considering expanding into new markets abroad. In terms of outward investments in the last 12 months, South Korean insurer Hanwha General Insurance bought two Indonesian companies: Multicor Life Insurance Pt and Transpacific Mutual Capita Pt.
China

China is now the second largest economy in the world, with a GDP of USD 8.3 trillion in 2012. The OECD has predicted that China will overtake the US as the world’s largest economy around 2016, and in this year’s survey by PwC, global CEOs have rated China as the world’s top destination for foreign investment.

China’s insurance market has been developing at a phenomenal pace, growing even faster than the economy itself. The market has witnessed average annual growth of 22.2% in the last seven years, while global insurance premiums grew by 2.7%. The market started almost two decades ago with a single player, People’s Insurance Company of China (PICC), and is now the sixth largest in the world, with more than 100 market players generating direct written premium of USD 253 billion in 2012.

It is expected that the market will continue to grow across a number of areas. For example, China is currently facing a number of issues around food safety, air pollution, an ageing population, and natural disasters. The government has decided to go down a mandatory insurance route to address them, and pilot schemes on food liability and environment liability insurance have been introduced in various cities. In addition, the new Social Insurance Law has been designed to increase the coverage of pension and medical insurance. Shenzhen will be piloting a catastrophe insurance programme with support from the local government to find a suitable catastrophe insurance model for China – a country with high flooding and earthquake risks, only 1.4% of which are currently insured.

The opening of the motor third-party liability insurance market in 2012 represents a major opportunity, as does any possible opening up by the regulator of other key areas of the market. For example, on the life side, changes around pensions, retirement products, tax incentives and health insurance could allow foreign insurers to leverage their knowledge and expertise. All of this means that China remains a very attractive destination for international underwriting businesses.

The market started to open up to foreign investment on China’s accession to the World Trade Organisation in 2001, and is now almost fully open. There are currently 55 foreign insurers in the market and 100% foreign shareholding is permitted for property and casualty insurance companies, reinsurance companies and insurance intermediaries. However, in 2012, foreign life and property and casualty players only held 4.3% and 1.2% respectively of the Chinese insurance market.

This is partly because barriers to entry for foreign players remain substantial. Under current rules, 25% is the maximum holding a single foreign investor is allowed to have in a domestic general insurance company. However, this option remains the most straightforward route as those companies looking to open an office or subsidiary in China need to overcome a number of hurdles – and the application process for an insurance licence can take more than three years.

Nevertheless, the biggest deal of the 12-month period was Thailand’s Charoen Pokphand Group’s purchase of a minority stake in Ping An Insurance for USD 9.38 billion from HSBC, which is divesting holdings to improve profitability. Founded in 1988 as China’s first joint-stock insurer, Ping An has grown into one of the world’s largest, with 74 million clients and more than 175,000 employees.

The other inward investments involved Hong Kong’s China Taiping Insurance Holdings Co Ltd increasing its ownership in subsidiaries Taiping Pension Co Ltd and Taiping Asset Management Co Ltd.

The remaining spate of deals were domestic, with notable instances including Agricultural Bank Of China Ltd buying a stake JIAHE Life Insurance Co Ltd buying a stake JIAHE Life Insurance Co Ltd for USD 393 million; and Sino Life Insurance Co Ltd buying Gemdale Corp for USD 266 million. Bancassurance continues to play a very significant role in the Chinese market. China’s five largest state-owned banks are all participants in the insurance market, and for life insurers in China, banks are now the most important distribution channel. In another key deal in 2012, ICBC bought shares in AXA Minmetals Assurance Co Ltd for USD 179 million. In the aftermath of the deal, ICBC-AXA Life reported a 2,472% increase in bancassurance sales, according to Asia Insurance Review.

Despite 2011 seeing the first direct investment by a Chinese insurer in the Lloyd’s market – China Re’s partnership with Catlin – there were no similar deals this year. Chinese domestic insurers are facing a more challenging regulatory environment, with increasing capital adequacy pressures, significant shifts in distribution and a shortage of local talent. This will
mean that, while their longer-term goals might include international expansion, in the shorter term their focus will remain domestic. However, Lloyd’s is likely to remain of interest to Chinese companies in the coming years.

**Indonesia**

In a region that offers promising growth for the insurance industry, Indonesia is widely held to be a stand-out market with some staggering metrics. Premiums are increasing 11% year-on-year – five times the growth rate of Europe or the US. Life products reported a 37% annual rise in early 2012, and one major European insurer recently reported a 100% annual growth rate in premiums. Although these numbers can only be achieved from a low base – penetration rates are around just 5% – they remain impressive.

There are of course challenges for insurers looking to establish themselves in this market – not least of which are the physical size of the country and the lack of infrastructure, which make it difficult to reach parts of the population. In addition, for those seeking to enter through acquisition, there has been a lack of attractive targets, with many local insurers being under-capitalised and badly managed.

In the last year, the government has taken some key steps to tighten up regulation significantly, with new rules including a 250% increase in capital requirements for insurers by the end of 2014. With many small companies unlikely to be able to fulfil this, there could be a flurry of M&A activity. This will be helped by the fact that the foreign ownership limit in Indonesia is 80% – much higher than many other markets in the region.

The second half of 2012 and the first half of 2013 saw a spate of deals – all of them involving overseas insurers investing in Indonesia. There is particular interest from insurers from mature markets who are looking outside their borders for growth. Two of this year’s deals involved South Korean company Hanwha General Insurance, while Japan’s Tokio Marine Holdings Inc also made two acquisitions. ACE continued its Indonesian expansion with the acquisition of 80% of PT Asuransi Jaya Proteksi in a transaction worth approximately USD 130 million.

In other trends, some PE investors have started showing an interest in Indonesia, but Indonesian insurers tend to look for strategic partners and are unlikely to want to partner with PE companies until they are more experienced in the sector.

Finally, takaful – where members contribute money into a pooling system in order to guarantee each other against loss or damage – remains a very significant opportunity in Indonesia as it is the largest Muslim country in the world, and the insurance market is still largely untapped. In fact, a number of insurers are appraising Indonesia purely for the takaful opportunities it represents.

**Malaysia**

Compared to other countries in the region, the Malaysian insurance market saw a high level of M&A activity between July 2012 and June 2013. Part of its attraction is the relatively relaxed foreign ownership regulations – foreign investors can buy up to 70% of a domestic insurer – combined with strong economic potential and a growing population. Another area of interest is takaful insurance. At present there are very low levels of insurance coverage, particularly in the Muslim community, so this is a sector that provides significant potential – especially when coupled with increasingly sophisticated distribution methods, such as bancassurance.

One of the most significant deals was the purchase by Hong Kong’s AIA International Limited of ING Management Holdings (Malaysia) for USD1.7 billion. AIA Group CEO and president Mark Tucker said: “With a combined customer base of over 2.6 million people, approximately 16,600 agents and an exclusive bancassurance relationship with one of Malaysia’s leading banks, our business in Malaysia represents a very powerful proposition that will result in a positive outcome for our shareholders, customers, employees and agents.”

The only other foreign investment involved South Africa’s Sanlam Emerging Markets buying a 49% stake in Pacific & Orient Insurance for USD 88 million. Sanlam Emerging Markets Chief Executive Heinie Werth said: “This transaction is our first foray into the South East Asia region. We believe that this transaction will provide us with a platform to gain an understanding of the region and a footprint on which to expand … We are confident that the company offers us a relatively low risk entry into the market and a platform for growth.”

There were seven domestic deals during the year, with the biggest being AmG Insurance Bhd buying Kurnia Insurans (Malaysia) for USD 514 million in September. Further consolidation in the sector is expected.
India
While the Indian insurance industry struggles to overcome the challenges and uncertainties of the last few years, there can be little doubt that the fundamentals that underpin future growth remain strong. However, India is somewhat out of favour with foreign investors at present, and a number of companies are contemplating exiting or have put their entry or expansion in India on the backburner.
This is partly because of the slowdown in growth; after registering impressive growth of around 8-9% in the last decade, the economy has visibly slowed in the last two years. For the insurance sector in particular, the foreign direct investment limit remains at 26%, and the fact that the long expected increase to 49% has still not materialised remains a source of frustration. In addition, some companies have been in India for up to 10 years and feel that a disproportionate amount of value is being captured by their joint venture partners. Finally, India is perceived by some as a drain on capital that is much-needed elsewhere.
Despite a sense of gloom, the Indian insurance market saw a number of domestic deals between July 2012 and June 2013, the most significant of which involved Exide Industries Ltd buying ING Vysya Life Insurance Co for USD 102 million. Newspaper reports indicate that Indian property developer DLF Ltd has agreed to sell its 74% stake in a life insurance joint venture with U.S.-based Prudential International Insurance Holdings Ltd to Dewan Housing Finance Corp, an Indian housing finance company.
International acquisitions were limited to Japan’s Nippon Life Insurance Co buying a 26% stake in Reliance Capital Asset Management for USD 289 million. For Japanese investors – whose cost of borrowing is far lower than for companies operating in countries like the UK, and who have a real need to look internationally for growth – there is a much greater willingness to play a long game and patiently await the returns they are confident the Indian market will one day deliver.
While deal activity is likely to remain fairly stagnant until the government opens up the insurance sector, longer term, India is still a huge market with lots of potential, so it should stay on the radar of insurers.

Taiwan
Taiwan is a mature, highly saturated insurance market. According to Ernst & Young, Taiwan had a non-life insurance penetration rate of 3.1% in 2011, and a life insurance penetration rate of 13.9% – relatively very high for the region.
Recent years have seen Taiwan’s popularity with outside investors decline, with many exiting its insurance market due to the high level of product guarantees and the downward pressure this places on margins. Taiwan’s insurance trade has remained sluggish since the global economic crisis, and changes to accounting rules that raised capital requirements for insurers, as well as strict local regulators and market volatility, have led to many international groups questioning their continued presence in the country.
Unsurprisingly in light of that, there were no inward investments in Taiwan during the period from July 2012 to June 2013. There were, however, several domestic transactions, continuing the trend for domestic mergers to create better-capitalised carriers.

Thailand
Thailand is South-East Asia’s second largest economy and, while the effects of the devastating floods in 2011 are still being felt, there are a number of factors that make it an attractive destination for multinational insurers looking to expand into emerging markets. For example, as well as strong economic fundamentals and a growing middle class, there is a regulator that is keen to encourage growth.
In March 2012, the Office of Insurance Commission (OIC) nearly doubled the limit on the percentage of a Thai insurer that a foreign company could own, from 25% to 49%. In addition, the OIC can authorise a higher than 49% ownership, if a joint venture encounters financial difficulties. Risk-based capital benchmarks have also been put in place to increase transparency and bolster capital strength: in January 2013, the minimum capital adequacy ratio was increased to 140%. The OIC is also planning to amend Thailand’s insurance licensing rules to streamline the merger process and facilitate consolidation.
Nevertheless, many companies seem to be operating a ‘wait and see’ approach. The second half of 2012 and the first half of 2013 saw three acquisitions by Thai companies, two of which were domestic. The most significant was Prudential Life Assurance completing its purchase of Thanachart Life Assurance Co for USD 568 million. In an interesting add-on, considering the rising popularity of bancassurance in Asia Pacific, Prudential Thailand and Thanachart Bank announced a 15-year partnership to develop their bancassurance business in Thailand.

The major story of the year concerned an outward investment. In the biggest deal of the period, Charoen Pokphand Group (CP Group), a conglomerate controlled by Thailand’s richest man, bought a 15.6% stake in China’s Ping An Insurance from HSBC for USD 9.38 billion. This was a major departure from its core food business, although CP Group has a long history in China.

**Hong Kong**

Hong Kong is one of the most dynamic insurance markets in the region, if not the world. The combination of its location; its effective regulatory framework; and its credible legal system have all contributed to it establishing itself as a leading insurance centre in Asia.

2013 is expected to see the introduction of legislation that will make significant changes to the regulatory environment in Hong Kong. Like other sectors of the economy, insurance in Hong Kong has traditionally been subject to the principle of minimum intervention. However, while positive, the introduction of the proposed new Independent Insurance Authority will significantly increase the costs to insurers and insurance intermediaries of meeting more stringent regulation. All of this – plus new privacy and personal data obligations – will place a high, and increasingly costly, administrative burden on the insurance industry over the coming year.

In terms of M&A activity, the relatively low number of targets in Hong Kong will always limit transaction activity. However, last year saw the purchase of ING Groep’s Southeast Asian life insurance, general insurance, pension and financial planning units in Hong Kong and Macau by Pacific Century Group, as well as the life insurance operation in Thailand, for USD 2.14 billion. The opportunity became available as part of the ongoing sell-off of several of ING’s business units demanded by the Dutch government after providing a USD 12.9 billion bailout during the financial crisis. The acquisition marks the first step in Pacific Century’s plan to develop a world-class pan-Asian insurer to capitalise on the long-term potential of the insurance sector.

There were a number of other transactions – all within Asia Pacific – that also aimed to increase the regional footprint of the acquirer. The most sizeable was AIA International Limited buying ING Management Holdings (Malaysia) for USD 1.718 billion in December 2012 – a deal that will make AIA the leading life assurer in that country. AIA also acquired two businesses in Sri Lanka.

HSBC sold its profit-making general insurance business in Asia to France’s AXA SA, and the sale included a 10-year bancassurance agreement. Stuart Gulliver, HSBC Group Chief Executive, said: “[This] will enable us to focus our capital and resources on the growth of our core businesses, including the building of our broader wealth management capabilities. These long-term collaborations with AXA will broaden and strengthen the suite of general insurance products available to our retail banking and commercial banking customers in Hong Kong, Mainland China, Singapore, India, [and] Indonesia.”
Europe

The downward drift in deal activity in Europe has continued over the last 12 months, with deal volume falling by almost 30% year on year between 2009 and 2013. This would suggest that the European insurance industry is growing more cautious in its approach to M&A despite a number of trends that might have indicated that activity would increase.
There is no doubt that some of the triggers for an increase in the number of transactions – such as hardening rates, an improvement in economic conditions or the final form and date of Solvency II – has left the management of European re/insurers in something of a quandary as to the shape and size of their businesses going forward.

Breakdown of deal flow by half year in Europe

Europe does however remain the second most active region, after the Americas, both over the entire four-year period and in the last 12 months. Although Europe was the region with the highest volume of insurance M&A between 2009 and 2011, this has fallen away sharply.

The UK and Russia remain the two largest markets accounting for 43% of the deals taking place in Europe in the five years to 2013. That said, while the number of deals in the UK has increased year on year, in Russia it has remained stable. The Ukraine is in third position, while the Eurozone countries of Spain, France, Germany and Italy have also been active.

The Russian insurance industry has emerged as one of the fastest growing in the world with an impressive CAGR of just over 12% predicted between 2011-2014. This growth has come on the back of the introduction of compulsory insurance policies (primarily, motor TPL and medical insurance). In addition, insurance for firms handling hazardous materials became compulsory in 2012 and mandatory insurance for carriers such as bus companies will be introduced in 2013. This rapid development provides a huge opportunity for foreign insurers, with more compulsory lines being added every year.

As such, it is not surprising that there is ongoing interest from foreign investors looking for growth opportunities outside their own static domestic markets, as well as consolidation amongst domestic players who are looking to gain market share.

From an international perspective, Russia’s entry to the World Trade Organisation on 22 August 2012 should increase the opportunities for foreign investors. The environment for insurance companies operating in Russia has traditionally been quite limited, but as part of its accession commitments, Russia has agreed to increase foreign investment limits in life companies to 50% and will allow 100% foreign ownership of non-life insurance companies.
companies. The prohibition of foreign participation in mandatory insurance lines, as well as restraints on the number of licences granted to foreign life insurance firms, is also likely to be phased out.

**Eurozone difficulties rumble on**

The ongoing Eurozone crisis and fall out from the global financial crisis remain key drivers for M&A activity. For example, Generali has continued to sell off the firm’s non-core and sub-scale assets as part of its turnaround programme. By June 2013, disposal proceeds to the group had reached EUR 2.2 billion, more than half the EUR 4 billion target set for 2015. Commenting on the sale of its US life reinsurance business to SCOR, chief executive Marco Greco said that the deal was a further step in “delivering against the goal of refocusing on our core insurance business”.

Acquisitions were also part of that strategy. In one of the ten largest deals in the last year, Generali took full control of Generali PPF (GPH) – a successful joint venture in the CEE region – in a two stage deal to be completed by the end of 2014. This will increase its exposure to this fast-growing region, which is Generali’s fourth-largest market. Also in Italy, the Cassa Depositi e Prestiti (CDP) – Italy’s state investment holding company – acquired state-owned credit export insurer SACE to create an Italian hub for export finance and support for Italian business looking to expand internationally.

Another significant merger last year was between the Dutch and Belgian arms of Belgian insurer Ageas – the remains of bailed-out financial services group Fortis. All assets of the Dutch entity, Ageas NV, are to be transferred to Belgian entity Ageas SA/NV and Ageas NV shareholders would receive shares in Ageas SA/NV. Ageas said the move reflected the fact that the focus of Ageas’s insurance activities was Belgium, Britain, continental Europe and Asia, but no longer the Netherlands, and a desire to simplify its regulatory and accounting structure.

**Return of the IPO**

Quoted insurers have generally been trading below book value during the Eurozone sovereign debt crisis as investors are concerned about the potential impact on the value of the government bonds in which insurers invest, as well as the long-term drag on performance from globally low interest rates.

Nevertheless, the last 12 months has seen an increase in IPO activity in the insurance sector albeit that a trend is hard to discern since each flotation was driven by a different agenda. October 2012 saw the successful flotation of Direct Line – a sale forced on RBS as part of the conditions of its bail out. Almost a third of the shares in the business were sold to raise around GBP 787 million, with further sales planned for 2013 and 2014.

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**Breakdown of deal flow by country 2009 – June 2013**

[Graph showing deal flow by country]
Growth in the motor insurance market was part of the appeal in the IPO of esure – another retail player in early 2013 – which raised money to pay down debt and realise value for the founders.

The final part of the UK-based trio was Partnership Assurance Company which floated on the London Stock Exchange in June 2013. This transaction was primarily driven by the desire of its private equity owner (Cinven) to realise value. Having bought Partnership in June 2008 for around EUR 200 million (GBP 172 million), it had seen the company’s value increase by 800% in the last five years. The success of the Partnership flotation may encourage others – such as Just Retirement, another private equity backed life insurer – to pursue the same route.

Talanx, Germany’s third-biggest insurer, made their Frankfurt stock market debut in October 2012 despite the generally fragile state of Europe’s IPO market. Owned by mutual insurer HDI, Talanx had first announced its IPO only to then cancel it. It was then revived again within days after investors convinced the company that they would buy the shares after all, after a pick-up in global equity markets.

Life at Lloyd’s

Lloyd’s remains an attractive proposition for investment with a number of different parties seeking acquisitions or wanting to create start-ups including private equity, existing businesses seeking greater scale, and capital from emerging markets. The principal reasons for this remain relatively constant; for a domestic insurer from outside Europe, a Lloyd’s business means immediate access to a global network of licenses, a pool of business and a rating – all for a moderately sized capital investment. The demand created by this attractive investment proposition has been constrained by the very stringent demands of the Franchise Board in terms of new entrants – so, if creating a Lloyd’s business is out of the question, then acquisition is the only route.

Over the last 18 months there has been some churn in the market but not a great deal, so overall it is very much business as usual. Transactions in 2012 – of which there were four – included buyers seeking risk diversification as well as scale and access to new platforms – all recognising that organic growth alone in a highly competitive marketplace is hard to achieve.

Increasing regulatory costs and compliance costs - as well as rating agency models seeking to penalise insurers that do not have wide product and geographical diversification – have put downward pressure on the valuations of smaller Lloyd’s business. The need to achieve greater scale is therefore a key rationale behind deals such as the sale of Dore and Sagicor to AmTrust.

The pricing of the completed Lloyd’s transactions illustrates both the appeal and rarity value of acquiring an existing entity. CNA’s acquisition of Hardy for GBP 142 million, a multiple of more than 1.5 times book value, highlighted the price of the right kind of asset. ANV’s acquisition of Flagstone Re’s London operations for 1.3 times book value shows that even a recently loss-making Lloyd’s business can command attention.

There are still a number of agencies that are backed by private equity, representing an approximate total of GBP 3 billion in GWP. A number of entities are more than five years old and, if valuations remain strong, then there may be a strong rationale for PE investors to take an exit if offered. The recent sale of Cathedral Underwriting in the summer of 2013 may mark the start of a trend.

The unveiling of Lloyd’s long term strategy – Vision 2025 – focussed very clearly on growth both in and from emerging markets. As well as growing premium income from new markets, there was an articulation of the desire for a more diversified capital base with a greater contribution from high growth economies. Given the advantages of the Lloyd’s network of licenses and the single rating, it is easy to see why Lloyd’s might be a first port of call for an emerging market re/insurer looking to develop their business. The landmark partnership between Catlin and China Re looked to be a leading example for this sort of activity but the absence of any further activity since then suggests that this might be a slow burn.

Almost every underwriting business in the Lloyd’s and London market has talked about significant growth ambitions. With pricing still under pressure and competition fierce, the number of possible routes to grow top line income is limited. Increasingly therefore re/insurers are looking to move into products they have not underwritten before, or entirely new products such as cyber risk. The key to this appears to be recruiting key
underwriters and their team, rather than acquiring entire businesses with possibly messy run-off. The last year has seen more movement in this regard than for some time.

**Legacy meets live**

Last year, this report highlighted the shift that the legacy market was undergoing as its traditional mainstay of asbestos, pollution and health liabilities ebbs away. The result is two emerging trends: the first is the search for potential business from the run-off portfolios in large groups (rather than buying the entire entity), and the second is the rise of the ‘buy to kill’ market, where the renewal rights are sold on while the rest is run-off. Legacy players have also become less self-contained with a blurring of the lines between the live and run-off markets.

One example of this change is Enstar Group, which has changed its business strategy by bolting on a number of live businesses to its leading run-off acquisition operation. Most recently, it bought the under-performing insurer Torus for USD 692 million and entered into an agreement to acquire Atrium Underwriting Group, adding to the list of transactions that have taken the company away from its long-standing core run-off acquisition business.

CEO Dominic Silvester explained that Enstar’s lack of a live underwriting platform was proving a “significant impediment” in some transactions when competing with its largest rivals in the run-off space, such as Fairfax, Berkshire Hathaway, White Mountains and Swiss Re. With that in mind, Silvester explained that the acquisition of Torus and Lloyd’s platform Atrium should be viewed as adding “another weapon in our acquisition armoury” rather than a wholesale change in strategy.

The market may also be adapting to new opportunities. The last several years have seen a lot of new capital – particularly from private equity and hedge funds – coming into the market. There will come a time when they may want to exit with the same speed and that is not as easy to do from re/insurance. Legacy players may offer a very compelling alternative to a sale of the entirety of the business – for example the private equity might continue with the renewals and ongoing business, while a legacy partner acquires the run-off book.

**Capital efficiency**

Another key to this is a growing impetus to gain the greatest possible efficiencies in capital and organisational structure. The changes required by Solvency II, as well as depressed investment conditions, mean increasing pressure on insurers to explore all possible options for releasing and managing capital. The delay in the final form and effective date of Solvency II has probably slowed some players gaining a full understanding of the implications of it on their balance sheets but, nevertheless, many have simplified their European structures to free up capital to support underwriting activity.

The first stage has been internal, intra group initiatives – tidying up rather than things coming to market. The next step in the UK is likely to be businesses looking externally and this is already happening in Europe, where the size of the prize is still considerable.

An example is the estimated size of the run-off market in German speaking countries – this alone is around EUR 103 billion according to Professor Martin Eling, director of the Institute of Insurance Economics at the University of St Gallen. Of this, he estimates that nearly 30% is accessible for active management and carriers in the region are showing increased interest in proactively managing their run-off portfolios.

In April 2013, London-listed Randall & Quilter (R&Q) and German run-off (re)insurer Darag both raised GBP 25 million and EUR 60 million respectively to power acquisitions in the legacy space. In the case of the latter, Darag CEO Arndt Gossman said his firm was evaluating 10 portfolios containing about EUR 219 million in technical liabilities and expects to close up to six deals in 2013. While, for the former, this has been part of a strategy of piecemeal run-off acquisitions with two recent deals in Finland. Commenting on the announcement, R&Q’s founding CEO Ken Randall said: “This is another example that demonstrates that the group can provide a variety of solutions for companies wishing to dispose of their legacy run-off business and we look forward to further similar opportunities across Europe.”

The Nordic countries have seen a flow of run-off as low investment yields have pushed insurers operating in the region to focus more on insurance risk. Several acquisitions of run-off portfolios in the region were announced in 2012 as insurers looked to hedge capital-intensive legacy lines. Freeing capital and reducing complexity will likely continue to be desirable resulting in more instances of runoff, spinoff or shedding non-core operations.
MENA

The economic prospects for the Middle East remain bright with the Gulf Co-operation Council (GCC) dominating the IMF rankings with an average of 4% GDP growth across the region.
Many GCC markets continued to perform well through the global financial crisis, not least bolstered by the sustained high oil prices that have helped governments to build revenues. Demographic trends also confer an advantage on the Middle East. There is a youthful, educated and increasingly affluent population. Indeed, the average age in the region is less than 30, and with around just one to one-and-a-half per cent currently aged 60 or over.

Governments across the region have continued to make significant investments – to the value of an estimated USD 1.9 trillion – in governmental projects. These are in part a natural effect of the region’s on-going growth and healthy government finances, but other factors are at play. The football World Cup to be held in Qatar in 2022 is demanding significant preparation and across the Middle East governments are investing heavily in infrastructure and social welfare projects prompted, in part, by a desire to address the issues underlying the Arab Spring. The final factor is also the continuing development of mandatory health insurance being rolled out across the region.

These factors underpin what we consider to be a positive picture for the future for the insurance industry’s medium to long term future. As levels of wealth continue to rise, there is a corresponding increase in the awareness of and the need for insurance. In the GCC in 2012 combined gross written premium (GWP) in both life and non-life amounted to USD 16.3 billion, having grown at a CAGR of 11.8% since 2008. Projected growth for the period 2012-2017 is estimated at 18.1% per annum – a level outstripping the traditional developed: economies. However, this growth is from a low starting point. Insurance penetration, calculated as GWP as a proportion of GDP, was at 1.1% in the GCC in 2012 against a global average of 6.5%. In the
levels of penetration in the GCC are almost non-existent, at a meagre 0.4%, so it is unsurprising therefore that there is a lot of interest in the sector.

Despite this positive background, the insurance industry in the Middle East needs to overcome some fundamental challenges. Domestic markets are suffering from over-supply, a lack of skilled staff and expertise. The growth potential is attracting considerable foreign interest – all of which should be leading to a growing number of transactions in the region. However, as the data above illustrates very clearly this is not the case.

**Industry consolidation**

Over the last decade the number of insurance companies has grown considerably but, despite high levels of competition and, in some lines, low profitability, industry consolidation is yet to gain momentum. Across the region, there are countries with too many insurers for the size of the market. For example, the UAE has 67 insurance companies writing USD 7.2 billion in GWP and Saudi Arabia has 35 companies writing USD 5.5 billion. Many insurers in the Middle East lack sufficient scale and expertise to endure in the medium-to-long term. This means that a situation has arisen whereby, if consolidation in the market fails to materialise, the result will be business failures. The regional regulators are unlikely to allow such failures due to the impact on the nascent insurance market in the region, and we anticipate that they will seek to encourage consolidation as a mechanism to alleviate this risk.

**Inbound investment**

The transactions that have taken place in recent years have been led by international players looking to establish a presence in growth markets to compensate for slow/non-existent growth in their domestic markets. For example, between July 2012 and June 2013, there were two significant acquisitions by Japanese insurers – ORIX Corporation acquired Bahrain’s MEDGULF, while Tokio Marine & Nichido Fire bought Egypt’s Nile Family Takaful Co SAE.

Indeed, overseas transactions involving Japanese insurers have increased in the last couple of years on the back of a strengthening economy, a saturated market at home and the need to diversify risk portfolios in the fallout from the tsunami. The Middle East is a logical location for acquisitions as Japan has significant trading relationships across the region. For example, Japan recently overtook the US as Saudi Arabia’s largest trading partner. Where Japanese businesses go, so do expatriate employees, presenting Japan’s insurance companies with the opportunity to enter a new market via domestic relationships and gain access to a new customer base.

**Regional M&A**

Jordan, in recent years something of an anomaly in the region in terms of its high level of M&A in the insurance industry, saw just one small transaction in the period, suggesting a natural slow down.

Takaful has long been highlighted as an area with significant potential for growth, albeit from a low base. The industry fared better during the global financial crisis than its traditional counterpart due to the nature of its investments being less volatile. However, as equity markets have recovered, takaful operations have not benefited to the same extent as their conventional counterparts for the same reason. An additional challenge is the fact that Islamic investment portfolios are inherently difficult to manage effectively; not least due to the lack of availability and diversity of Sharia-compliant instruments (especially in the life insurance sector, family takaful, which suffers from a dearth of medium – long-term fixed income securities). Recent studies also suggest that shareholders in takaful operators on average receive a lower return on equity than with traditional insurance. It remains to be seen if this is an inherent aspect of the takaful structure or a reflection of the relative youth of the industry. Whether or not future growth will allow takaful operators to offset their initial start-up costs, it is a factor which is currently exerting additional pressure on the management of these operators.

Despite these challenges, there have been a number of transactions. In Syria, Al Aqeelah Takaful Insurance was acquired by its compatriot, Hamed Mohammed Abbas Hajeya, while in another development in the Sharia sector Oman National Investment Corporation announced the acquisition of a 7.5% stake in Takaful Oman, the country’s first takaful company, in June 2013. While these have been relatively small in terms of value, they are essentially longer-term strategic plays on the part of the purchasers.
Barriers to transactions

There are a number of factors stifling transaction activity in the insurance industry across the region:

The business landscape across the region is characterized by the proliferation of family businesses, many of which are large conglomerates with operations spanning a range of diverse industries. Inevitably, a level of rivalry exists, with any one family business reluctant to enter into a transaction with another that may result in, or be perceived as, conferring a potential advantage or being otherwise harmful to their reputation.

Another issue is whether any vendor is prepared to agree to a realistic valuation for their shares in a local insurer. In some markets, notably the United Arab Emirates (UAE) and Saudi Arabia (SA) as the two largest insurance markets in the GCC, the insurance legislation requires that all domestic insurance companies have to be publicly listed. Start-up insurance companies are required to conduct an IPO prior to commencing trading as part of the establishment process. As each new insurer listed, its share price initially surged but typically there has been an absence of on-going trading in its stock. The result has been a misalignment between the market value of the business – and what a buyer thinks is appropriate to pay based on the book of business written – and what the vendor thinks it is worth. This makes it difficult to reach an agreement on price.

Should the pricing issue be overcome, an additional hurdle is the difficulty of obtaining meaningful due diligence necessary for a successful transaction. The information that companies provide is generally of poor quality, which presents potential buyers with a challenge as they attempt to accurately gauge the risk profile of a target company.

In addition, the regulatory regimes in the region require further development to facilitate such transactions if they are to occur on a meaningful scale.
Breaking the log jam

Regulators across the region are aware of the issues and in many cases are taking positive steps to address this issue. In Saudi Arabia for example, up until 2004 the market was monopolised by a single state owned insurance company. A change in the law saw the market take off around 2007, with the creation of dozens of insurance companies. The regulator is now seeking to avoid over-saturating the market and is putting pressure on potential new entrants to the insurance market to do so via acquisition, rather than through the creation of a start-up business. In addition, capital requirements are expected to go up – putting further pressure on smaller insurers to consolidate.

In May 2013, nearly a decade after it was first discussed, the UAE’s Federal National Council passed a new companies law bill that should go some way towards clarifying and simplifying transactional processes. In addition, the UAE has seen capital requirements rise for brokers and in 2015 new legislation will come into place that will mandate the segregation of composite insurance companies, splitting out life and non-life operations into separate entities. It is anticipated that this will lead to an increase in M&A as many local composite insurers may not have the necessary expertise, experience or desire to meaningfully grow stand-alone life insurance businesses.

With domestic consolidation remaining tricky due to the political complexities of dealings between large families, many of these transactions will be cross-border in nature. Indeed, a number of international life companies are hovering in the wings, poised to enter the market, with joint ventures likely to be the most popular route. Others, for example in India, are looking to pre-empt the legislation by getting in early to seize a stake and gain first-mover advantage.

Elsewhere in the region, the Capital Market Authority in Oman is in the process of updating the country’s insurance regulatory framework and new regulations for the conventional insurance and takaful markets are likely to be implemented in the near future. This is expected to have a positive impact on the overall market structure, and bring the legislative environment closer to international standards, clarifying the process for transactions.

In addition, there have been positive regulatory developments in Qatar with new legislation passed in December 2012 establishing the Qatar Central Bank as the single regulator for all banking, insurance, and financial services companies located within Qatar (other than those established in the Qatar Financial Centre). The details on the new regulatory structure for the insurance industry are in the process of being developed and are expected to be published shortly.

Reinsurance

While these regulatory developments may take some time to impact the M&A market, international players looking for opportunities in the region may choose to establish a foothold via fronting arrangements with local insurers. There are clear benefits for doing so. Fewer restrictions are in place for fronting arrangements and the regional financial centres offer hubs for foreign companies looking to set up regional operations. In contrast, in order to write insurance business, a separate licence is needed for each individual country in the region due to the absence of any passporting arrangements – a costly and time consuming process. Fronting arrangements can, if properly structured, offer a way into the market and allow the international player to second staff, develop products for regional markets and build regional brand recognition.
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