Global insurance M&A themes, 2018

Moving from optimization to transformation

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Foreword

We expect to see a number of "Wow, that changes everything" moments in 2018, as participants or new entrants announce innovative business initiatives that fundamentally alter the role and economics of significant elements of the insurance sector.

In our 2016 review of insurance M&A deal trends we highlighted how transformation in the sector was fuelling deal activity. Then in 2017 we reflected on how global uncertainty was acting as a brake on strategic M&A. This year we assess how these two opposing forces affected M&A activity in 2017, and the outlook for 2018 and beyond.

2017 was not a stellar year for insurance M&A in terms of the overall number or value of deals — with both being broadly comparable to 2016.

However, deal activity in 2017 contained signs of the M&A trends that we expect to see accelerate as more insurers seek to transform, using business acquisitions or disposals as elements of that transformation.

The long term nature of many insurance risk types means that a process of rationalizing legacy commitments is a critical early step prior to more forward-looking transformation. During 2017 we saw many examples of such "portfolio optimization" or simplification of existing legacy businesses.

Moving beyond such activity, we have seen continuing investment into new technologies (whether via investment into "Insurtech" or the acquisition of key capabilities from incumbents), and we have also seen early signs of "convergence," with technology oriented businesses starting to invest into insurance.

In this publication we explore a number of these trends, moving on to look ahead to the potential development of new forms of M&A as insurers find ways to operate in the context of innovative and complex, technologically enabled "digital ecosystems."

We also explore how the role of M&A teams, and the range of skills required, is evolving as insurers move into emerging business models and innovative types of transactions.

We hope that you find this document informative and we would welcome the opportunity to discuss our perspectives with you.

Key takeaways

- Portfolio optimization continued through 2017, with a number of major insurers simplifying and streamlining their businesses, often as a critical step in creating future business models.
- The question of "buy or build?" has become central to many insurance M&A decisions and will continue to underpin consolidation as well as targeted acquisition of capabilities.
- Insurers continue to invest into Insurtech businesses, partly as a response to the ongoing question of buy or build, but increasingly as a way of accessing and operating in emerging "digital ecosystems."
- The drive to access and create sustainable revenue models from such ecosystems will lead to new types of partnership and joint venture arrangements.
- For insurers, new digital ecosystems are both a massive opportunity and an existential threat as such ecosystems will also be a route for sector convergence, with players from outside of the insurance sector competing for roles in the value chain.
- Such convergence may result in a number of the "wow" moments in 2018 and beyond.
- Successful M&A will come from insurers combining the talent developing in centres of innovation with the deep experience and knowledge across their existing organizations, to create diverse teams addressing fast-changing opportunities.

Methodology

- The Global insurance M&A themes 2018 publication is based on analysis of ThomsonONE.com and Mergermarket M&A data.
- We included selected additional transactions that were not in the databases.
- Deals include transactions (announced or completed) in which the target is in the insurance sector.
- Deals in which less than 20% (disclosed) of the company was acquired have been excluded from this analysis.
- Equity investments were included.
- Joint ventures were not included.
- There is no minimum disclosed value deal threshold.
- US health insurance transactions have been excluded.
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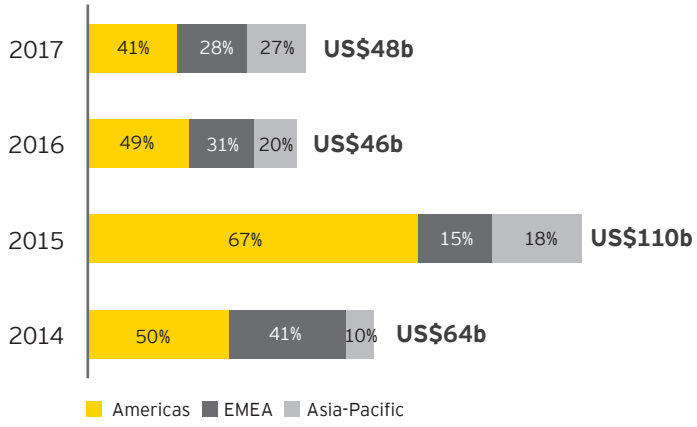
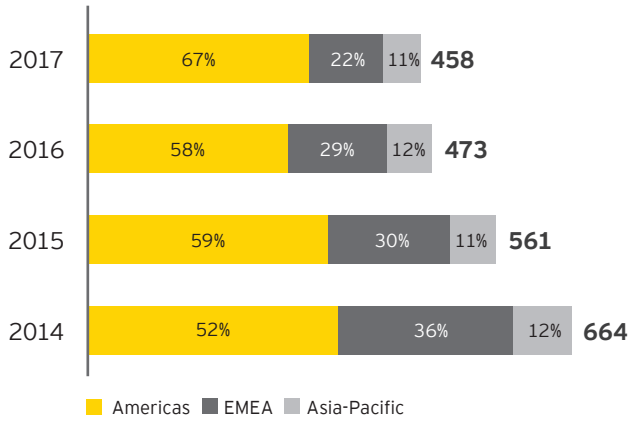
Global insurance deal activity in 2017

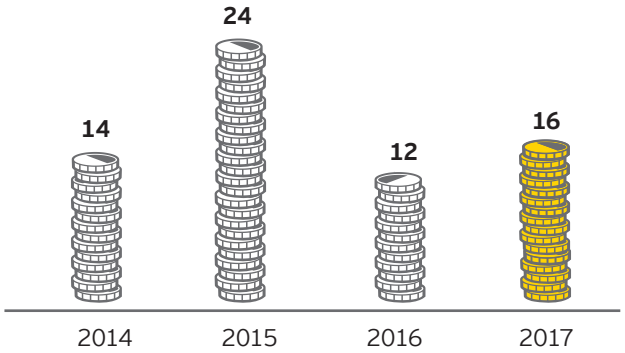
Deal value (US$b)



Deal volume



Number of deals greater than US$1b



2017 highlights

Although 2017 recorded the lowest number of deals since 2010, total value of deals grew modestly, driven mainly by an increase in US$1b+ deals compared with 2016.

▲ 4% increase in the total value of deals, compared with 2016

▼ 3% decrease in the total volume of deals, compared with 2016

▲ 16 number of deals above US$1b

A large number of major insurers carried out portfolio optimization activity. Among the larger deals was Hartford Financial's disposal of Talcott Resolution, its US-based life and annuity insurance business.

Fintech company Yunfeng's acquisition of MassMutual's business in Hong Kong is an early indication of increasing technology-driven investments in the sector.

Ongoing sector transformation continues to be a potential driver of consolidation. Intact Financial's acquisition of OneBeacon Insurance in the US reflects ongoing consolidation to achieve greater scale.

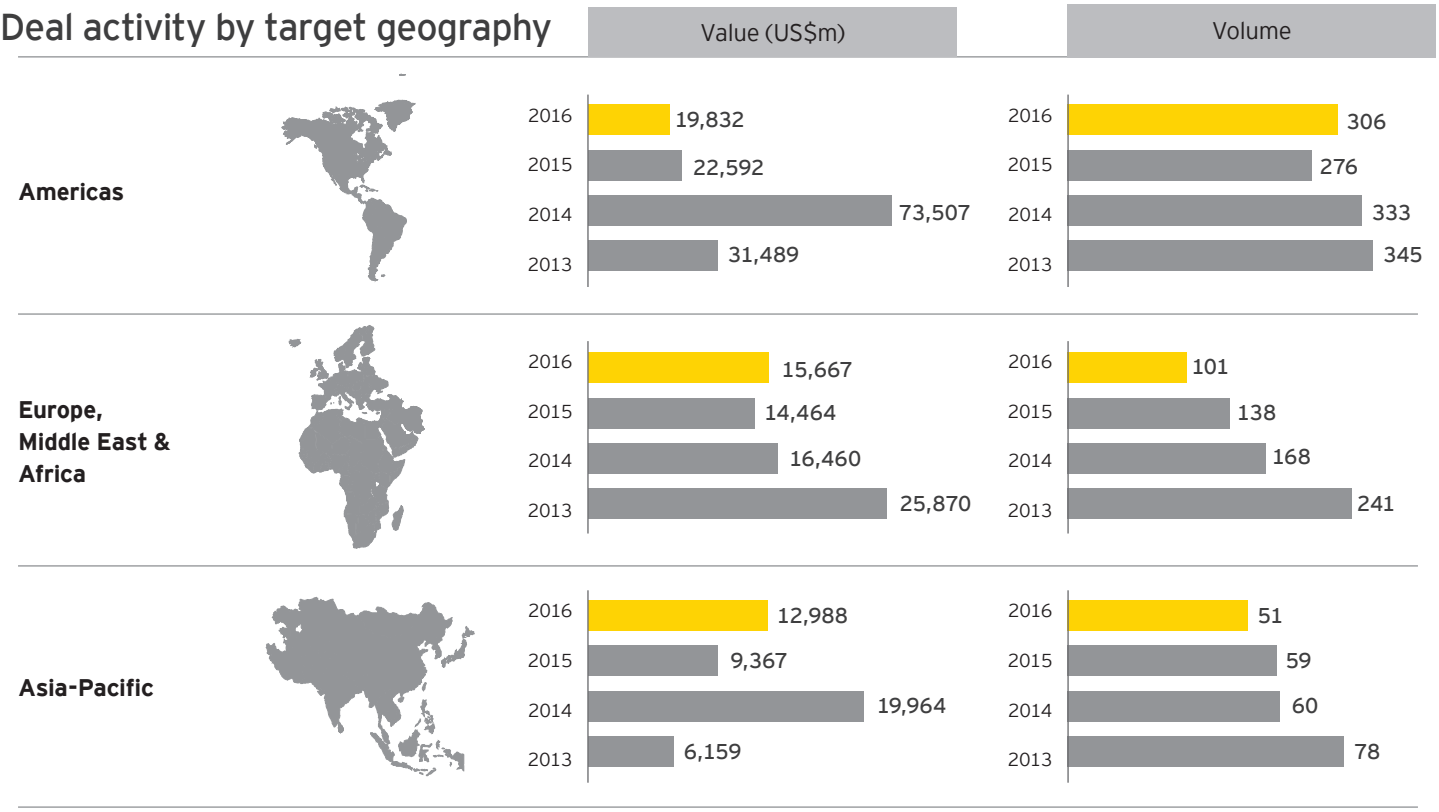
The year saw a significant increase in private equity led deals, with three of the top five deals involving PE investors. The largest deal in the period, KKR and Caisse de dépôt et placement du Québec's joint acquisition of USI Insurance for US$4.3b, was also the largest PE-led transaction in the sector since 2013.

In contrast, 2017 saw a fall in interregional capital flows, with a significant drop in value of deals from Asian bidders into Europe or the US compared with previous years. This is partly confirmation of the impact of the tightening of regulations in China on outbound M&A combined with increased scrutiny on non-core acquisitions.

Top 10 announced deals by disclosed value

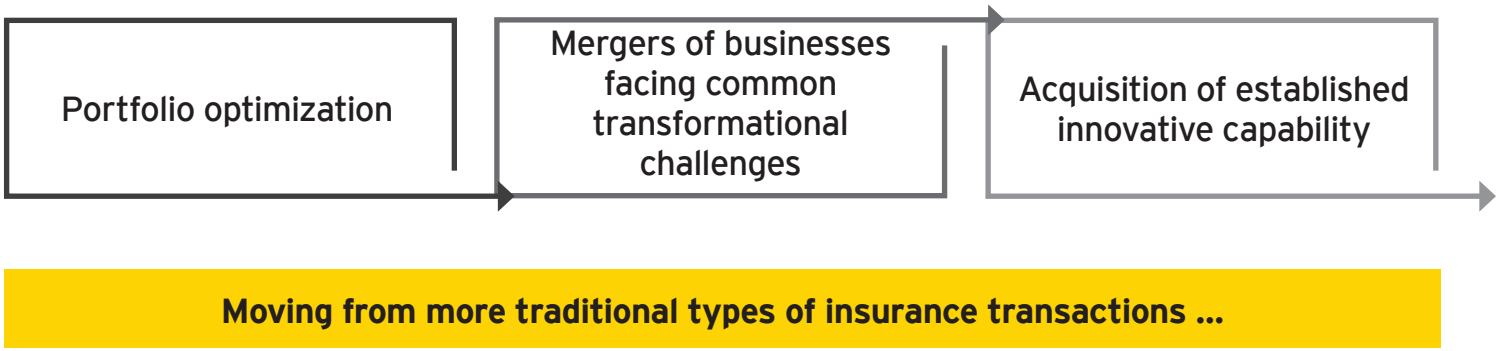
Date	Target	Target market	Acquirer	Acquirer market	Stake (%)	Value (US$m)
Mar-17	USI Insurance Services	United States	KKR & Co.; Caisse de dépôt et placement du Québec	United States	100	4,300
Sep-17	Colonial Mutual Life	Australia	AIA International	Hong Kong	100	3,051
May-17	Fidelity & Guaranty Life	United States	CF Corp	United States	100	2,240
Dec-17	Talcott Resolution	United States	Bank J. Safra Sarasin and other financial investors	Switzerland; United States	N/A	2,050
Oct-17	The Warranty Group	United States	Assurant	United States	N/A	1,906
May-17	OneBeacon Insurance Group	United States	Intact Financial	Canada	100	1,715
Aug-17	MassMutual Asia	Hong Kong	City-Scape Pte; Yunfeng Financial Group	Hong Kong	100	1,641
Aug-17	First Capital Insurance	Singapore	Mitsui Sumitomo Insurance	Japan	98	1,600
Nov-17	Euler Hermes	France	Allianz	Germany	26	1,591
Oct-17	Aetna (US Group Life & Disability)	United States	Hartford Life & Accident	United States	100	1,450

Deal activity by target geography



M&A in a period of sector transformation

How will the sector shift from optimizing to transforming?



Words such as "portfolio optimization" and "simplification" appeared frequently in investor presentations through 2017, explaining the basis for a number of business disposals by major insurers looking to focus both capital and management effort on critical forward-looking business initiatives.

For many insurers, such streamlining of their businesses is a critical step in the journey towards creating new target operating models and propositions, generally centered around digital capabilities.

The Insurance sector, like so many sectors, is going through a period of clear and rapid transformation. Indeed, the industry is facing up to the reality that its products, customer engagement and overall propositions need to change radically while operations and costs need to be fundamentally streamlined.

Sector transformation has driven M&A activity in 2017 in a number of ways and we believe that there is a clear likelihood that transformational deal activity will continue through 2018 and beyond.

As set out in the graphic above, we see a range of likely M&A activity forming part of the overall transformation of the sector in the short-to-medium term. We have sought to distinguish between more "traditional" insurance transaction types to the left hand side of the graphic, compared with the types of innovative deals that will be required in the future.

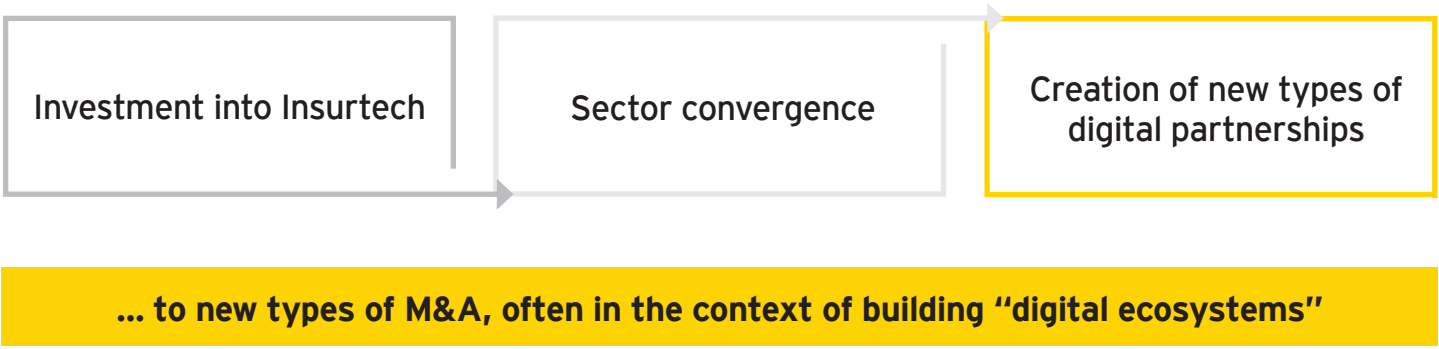
The majority of recent M&A activity has been in respect of traditional deal types – portfolio optimization as well as mergers aimed at accessing or sharing the cost of development of key capabilities.

Private Equity is a key participant as the sector transforms

PE investors are participating in the overall transformation of the insurance sector with ever-increasing sophistication and confidence. A number of large PE houses are at the forefront of the market solutions to legacy risk – Closed Life and Non-Life run-off – and we are seeing a series of very large transactions in North America, Europe and elsewhere. We are also seeing PE activity across many other areas of insurance, including participating in the extensive consolidation and reshaping of distribution businesses, which are themselves fundamentally affected by technology changes.

While Insurtech is largely perceived as a space for venture capital rather than PE, we need to be careful about generalizations. PE investment will be a key part of the development and monetization of new technologies supporting the sector. PE houses are looking to invest into current IT service providers, with a view to helping them to significantly enhance their propositions, and will also be looking to acquire new disruptive businesses as they start to prove their ability to scale and generate cash flows.

David Lambert – EY Global Insurance Transactions Leader



If insurers are to operate effectively in a world of rapid technology innovation, convergence between sectors and the growth of emerging digital ecosystems then we expect to see a corresponding shift in the nature of M&A.

Insurance M&A markets and solutions are evolving rapidly

We are seeing the creation of ever more sophisticated insurance M&A markets in response to ongoing sector transformation.

Every seller needs a buyer, and the sale of non-core legacy businesses by major insurers has been facilitated by the increasing scale and complexity of the Closed Life and Non-Life markets.

Such legacy consolidation is further facilitated by effective reinsurance markets which enable selective de-risking as well as by sophisticated investment allocation strategies.

Given the long-term nature of insurance risks, cost efficiency becomes a critical element of valuation. Advances in IT, particularly in areas such as robotics, provide hope that the insurance sector can finally address the key issue of managing down the cost of administering old legacy insurance products. This will add a vital further component in the ongoing evolution of the Closed Life and Non-Life consolidation model.

Tax Reform will provide yet another catalyst for M&A

US reform is a great example of how tax law changes can stimulate (or nullify) the deal market. The US rule changes are wide ranging. Changes such as the reduction in headline rate will make the US a more attractive place to invest. The ability for US companies to repatriate previously trapped offshore profits will put more acquisition funding into the market and changes to the way a US company interacts with its foreign subsidiaries should stimulate US investment overseas. On the flip side the changes to some of the rules around investments in what appear to be "passive" companies may limit investor choices and the US base erosion anti-avoidance rules could make cross-border trade and capital provision uneconomic.

Tax is never, and should never be, the driver for a deal but we are starting to see a few transactions where US tax reform is cited as a contributing factor. I suspect we will see many more.

Jeff Soar – EY Global Insurance Tax Leader

Insurtech and other emerging transactions

Will insurers partner effectively with Insurtechs to build and rapidly scale innovative propositions?

The growing size and complexity of Insurtech

The population of Insurtech companies continues to expand rapidly. Indeed, the definition of "Insurtech" is proving to be fluid as a number of innovators are finding insurance-related use cases as one of the many potential applications of their technology.

Verticals demonstrating real traction include:

- Machine learning and data augmentation (e.g., AI-enabled automated claims assessment in auto insurance);
- Drones and aerial intelligence (e.g., visual satellite imagery for property damage assessment);
- Telematics and Internet of Things (e.g., sensor data for usage-based insurance and risk prevention); and
- Blockchain (e.g., simplifying data collection and automatic updates for policies in specialty insurance).

In 2018, Insurtechs will continue to move from proof of concept to proof of scalability, demonstrating the ability to achieve scale across multiple insurance lines, components of the insurance value chain and geographies. Emerging winners can be expected to be the target of M&A interest from a range of potential investor types (including incumbent insurers, large technology companies, and institutional and retail investors).

Investment in Insurtech disruptions (such as sensors, AI, wearables, analytics) will increasingly be a medium to build and access emerging consumer-centric digital ecosystems. This will in turn accelerate convergence through business partnerships between innovative companies in very different sectors.

How incumbent insurers are investing into Insurtech

We have seen continuing investment into emerging Insurtech businesses, often via venture fund structures established by major insurers.

The use of dedicated venture funds goes part of the way to addressing a number of the challenges that insurers face when investing into (and partnering with) emerging and startup businesses:

- The investment approach to innovative companies requires very different skills to "traditional M&A" by major institutions.
- The funds can apply metrics that may be very different from classic return on equity type models, recognising the strategic value of an investment as opposed to the short term financial return.
- The venture funds can apply a variety of different investment structures. Many Insurtech businesses do not want to be fully acquired by a single financial institution, as that would limit the number of industry counterparties with which they can interact. Insurers can use venture funds to take strategic stakes in innovative companies (perhaps combined with wider commercial arrangements) as a way of strengthening long term collaboration and alignment of interest.

The challenges require ongoing flexibility and innovation on the part of the insurer. Simply setting up a venture fund does not create innovation, so it is critical that the venture fund is supported as part of the wider approach to innovation and transformation.

Insurers are adapting to execute on innovative transactions

Insurance groups investing into Insurtechs is about far more than simply access to emerging technology.

We see the most progressive insurers increasingly looking at transactions through the lens of innovation. The challenge is to avoid the erosion of innovation value post acquisition i.e., how to achieve an "infusion" of innovation into the mature parent without stifling the smaller entity.

Dustin Ball — EY Asia-Pacific Insurance Transactions Leader

Challenges for insurers in assessing Insurtech investments

Nascent and ill-defined markets and niches	Many Insurtechs play in, or have helped to create, relatively new product markets and market niches. Such addressable markets may currently be ill-defined.
New and unfamiliar business models	New and innovative business models may be unfamiliar to investment committees and boards, or be considered unproven. Targets may sometimes be reliant on the insurer for a significant share of revenue, which will complicate stand-alone valuation discussions.
Limited financial records and controls	Many Insurtechs are relatively young. They may not have large volumes of financial information evidencing a financial track record and may have relatively limited internal financial control functions or frameworks.
Limited familiarity with due diligence	Investee Insurtechs may have limited familiarity or exposure to the typical due diligence process and investor information requirements.
Changing regulation and compliance regimes	Regulation and compliance regimes in most Insurtech subsectors and jurisdictions are changing as the sector develops globally. Some Insurtechs may still be undergoing approval processes or face heightened regulatory uncertainty (both at a national and state level in the case of the US). This may impact growth projections, expansion plans, the transaction timeline and exit potential.
IT security and compatibility	Compatibility with insurers' systems is obviously key, as is the need for controls set at the very high standards required by financial institutions, particularly in areas such as client data and cyber risk.

Proof of scalability will be a key test in 2018. A critical question as Insurtechs move from early-stage funding is whether solutions can be scaled to meet projected demand.

Thomas Korte — EY EMEIA Insurance Transactions Leader

Investing into digital ecosystems

How can M&A enable insurers to position themselves for success in rapidly evolving digital ecosystems?

Insurance business models are being redefined through the use of technology and the fundamental redesign of traditional value chains.

Insurers are grappling with how to enter into new types of partnership arrangements, often within the context of newly developing, digitally-connected business ecosystems.

The concept of partnerships is obviously not new for insurers – bancassurance has been a key distribution route for decades and the insurance value chain has historically required extensive relationships between insurers, distributors and other service providers.

However, participating in digitally-connected ecosystem "partnerships," whether contractual or not, requires very different behaviours and commercial approaches.

Diversity is at the heart of successful digital M&A strategies

Insurers recognize that specific skill sets are required for traditional strategy and M&A activity and that different skills can be developed in structures such as venture funds and innovation labs.

All of these skills are rare and extremely valuable. Ultimately success will depend upon the insurers' ability to combine new and innovative skills and approaches with the deep sector experience and skill sets that exist across their organizations, to develop diverse teams that work together to successful execute upon digital strategies.

Shaun Crawford – EY Global Insurance Leader

What do we mean by a digital ecosystem?

The phrase "digital ecosystem" has been used in many different contexts. In this article we are applying a wide definition, applying to the combination of systems, businesses and services that insurers develop themselves as well as the wider ecosystems in which the insurers will operate. Such overall ecosystems will include a wide array of potential business partners and competitors.

Businesses are assessing digital ecosystems in order to find new ways to access customers and monetize on capabilities. We would define a digital ecosystem as having a number of critical features:

1. Purpose: Most ecosystems link to a purpose that is of common interest to the participants.

The most progressive insurers are exploring a new sense of purpose for meaningfully engaging with their customers. In many cases this moves beyond being the traditional insurance purpose of managing risk.

2. Diversity: Ecosystem participants can play a wide range of roles representing value-adding services.

Insurers increasingly recognize that they cannot do it all themselves and are seeking third parties to provide a far wider range of services that are critical to the customer. This diversity of potential business partners requires insurers to look at the diversity of their own talent pools.

3. Fair value exchange: New commercial models beyond traditional fees and commissions.

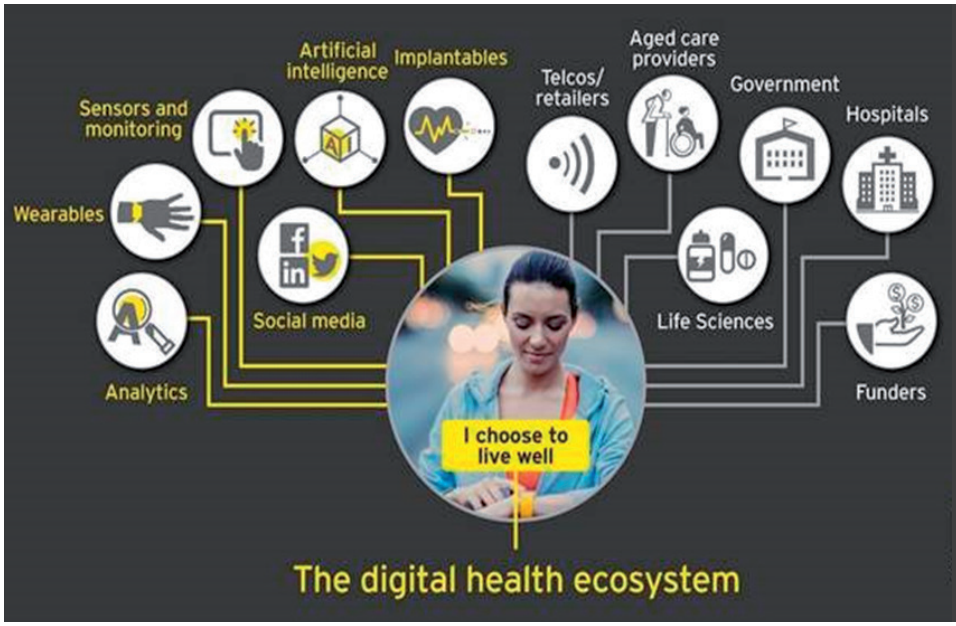
New partnership ecosystems need to be economically sustainable for the participants. Accordingly, we are seeing the development of new commercial models. In broad terms, the value that any participant can extract from the ecosystem must be reflective of the value that they are able to put in.

4. Modern Customer Experience: Customers enjoy a seamlessly connected ecosystem of services.

Customers increasingly carry their expectations from one sector to another; with ease of experience in one situation lifting the level of expectation for everything else. The most progressive insurers are therefore seeking partners who have modern digital customer experience built into their DNA and who will help accelerate the digital transformation of insurers' own customer facing processes.

5. Ease: Modern digital services and pricing models minimize hurdles to set-up.

The newest technologies can now be accessed in ways that significantly lower the barriers to entry, enabling startups and new disruptors to enter web-based ecosystems as they develop. This ease of access is clearly a critical factor to insurers seeking sustainable revenue models.



An example ecosystem showing a diverse range of participants offering a range of health & wellbeing-related services to a digitally connected consumer. The consumer has "opted into" a menu of timely, personalized, relevant and trusted services that support their personal health & wellbeing values.

In the image, insurers fall into the "Funders" category, but they can embed and enhance their position by connecting across the ecosystem.

How will insurers create effective partnership models within digital ecosystems?

In the illustration above we have set out one potential digital ecosystem. There are numerous other such ecosystems for every potential type of insurance.

Considering the digital health ecosystem, there are multiple participants that coalesce around a critical consumer requirement – in this case centered around the clear consumer statement that "I choose to live well."

The purpose of all participants in the ecosystem is to help the consumer to achieve that need, and the strength of the consumer proposition in every element of the digital health ecosystem will be based upon responsiveness to that purpose.

What does this mean for M&A?

Operating in digital ecosystems raises an array of new questions and challenges for insurers, including:

- Do we acquire capabilities across the ecosystem in order to increase our customer access and relevance?
- How do we develop capabilities to effectively acquire and manage businesses that are far outside the typical core competence of an insurer?
- How do we assess (and monetize) the key assets in our business? For example, is our customer data of critical value to other participants in the ecosystem?
- Do we need to invest in order to secure a longer term role in this ecosystem? This might include a combination of partnership arrangements or joint ventures with other participants, or extensive acquisition of participants in order to "control" the ecosystem (if that is possible)?
- Do we create new, less traditional and potentially less permanent business structures to operate in multiple digital ecosystems?

Digital ecosystems open the prospect of access to new markets and solutions. For insurers this is both a massive opportunity and an existential threat as digital ecosystems will also be a route for sector convergence, with players from outside of the insurance sector competing for roles in the value chain.

> The most progressive insurers are undertaking transaction activities through a number of new lenses including access to innovation, new sources of non-insurance revenue and new data monetization models.
>
> **Rob Webb** – EY Global Insurance Transactions Resident

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