

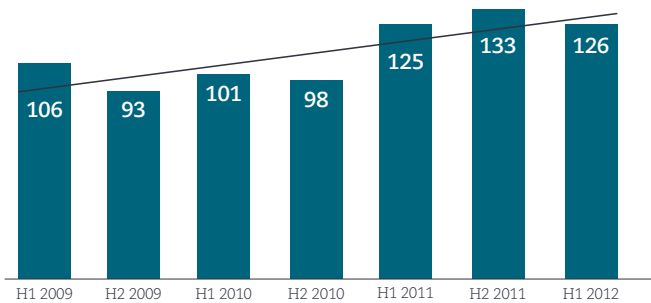
“M&A growth in the Americas will continue to be tethered to regulatory and tax certainty as well as increased capital flow and, of course, the Eurozone crisis. These factors should improve during 2012 along with the fortunes of the economic and political regions.”

Robert Ansehl, Partner
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The Americas

The overall level of M&A in the Americas from 2009 – 2012 has shown an upward trajectory with the second half of 2011 showing a peak in transactions over this period. Within the Americas, the USA is the country with by far the most activity. With 76% of all deals in the region taking place there, including some of the largest transactions of the last year such as the sale by AEGON, the Dutch insurer, of its Transamerica Reinsurance arm to the French reinsurer SCOR for \$900 million.

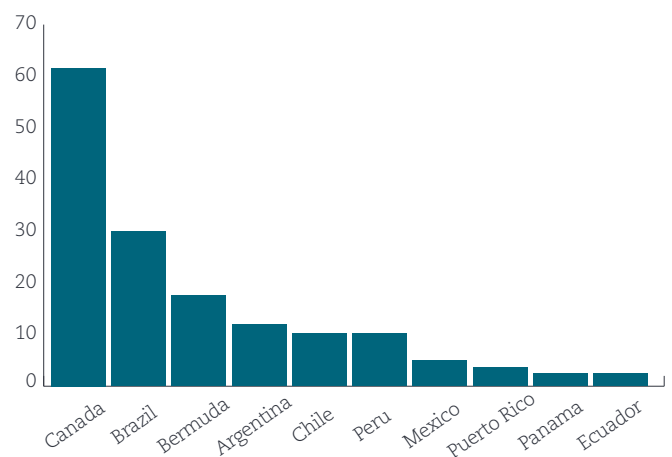
Volume of deals in the Americas



Although this US-dominant trend continued into 2012, the country represented only 63% of deals in the first half of this year, with Canada, Brazil and Bermuda all seeing some activity, albeit at a lower level than the US. There was also steady activity across other countries in Latin America, mainly in Argentine, Chile and Peru.

From 2009 to the first half of 2012, the overall trend has been upwards in terms of M&A activity in the US. It remains the most active country overall – not surprisingly given its maturity and size – and has accounted for around 32% of global M&A activity in the insurance sector over this time period.

Deals in the Americas (exc US) by country: 2009 – 2012



Canada

Many insurers view Canada as a good place to do business, which has continued to fuel competition in the marketplace. However, global and local catastrophic events have eroded the positive underwriting results of the previous three to five years, causing some insurers to start to take a much more disciplined approach to pricing – especially since investment returns are likely to remain low.

The sector is completely open to foreign competition, with the result that it has access to capital and world-class products. Conversely, however, there have also been a number of insurer mergers and reorganisations over the last year that could negatively impact available capacity going forward – and this is a trend that many expect to continue for a number of reasons.

The first is structure of the market. While the life insurance and banking sectors in Canada are highly concentrated, the property and casualty sector remains very fragmented, with more than 200 players competing for business. Many of these have been weakened by losses from Ontario's regulated auto insurance business, a high number of damaging weather events such as hail storms and floods, and ongoing poor investment returns, with the result being that consolidation is expected.

Last year's \$2.7 billion sale of AXA's multi-line operations to Intact Financial Corporation and Intact's recent acquisition of JEVCO for \$530 million are good examples of this. Although AXA's departure is partly driven by the Eurozone crisis and a desire to concentrate more heavily on emerging markets, the price achieved was indicative of the pent-up demand for quality insurance targets in Canada.

Consolidation has also been a trend in the brokerage sector as intermediaries look to expand their regional footprint. In August 2011, Western Financial Group announced that it was acquiring brokerages in Gilbert Plains and Rosetown in order to expand their exposure in south-central Saskatchewan, while Hub International Limited bought Horizon International. Of this latter acquisition the President of Hub's Canadian operation, Jim Barton, said it would provide "the infrastructure to build out the Eastern Prairies across to Northwestern Ontario".

One upcoming issue for the industry is the plan by the Canadian government to allow policyholder-owned property and casualty insurance companies to demutualise. This would allow insurers such as Economical Mutual to sell stock and raise capital, and is part of the government's effort to bolster Canada's financial sector. A similar process took place among life insurers in the late 1990s when giants such as Sun Life Financial Inc and Manulife Financial Corp went public. Opponents to the process point out that the results have not always been successful, and the recent sale by Manulife of its retrocession unit to Pacific Life to bolster its capital position may lend weight to their argument.

Brazil

Brazil is home to one of the world's most dynamic and rapidly growing insurance sectors, and therefore continues to see transaction activity. The market has experienced healthy growth over the past decade due to the country's strong economic development, the expansion of broker channels and the rise of motor, property and construction insurance lines.

A number of factors will continue to drive the development of the Brazilian insurance market in the coming years. First, the growth of the Brazilian middle class – an estimated 30 million over the last eight years – is creating demand for insurance products. Second, the country has embarked on a period of unprecedented growth and investment as it prepares to host the 2014 FIFA World Cup and the 2016 Olympics, with a number of very significant construction and infrastructure projects underway. And, third, lines with particular relevance to Brazil, such as off-shore oil and energy and even microinsurance, are evolving rapidly from small bases.

In terms of inward investment, Brazil is very much on the radar of large international insurers looking for acquisition targets to offset stagnant growth in more developed markets, while domestic consolidation is being driven by the desire from regulators to have fewer, stronger businesses serving the market. Although the insurance industry continues to face some challenges, including low efficiency, poor underwriting discipline and regulatory barriers to market competition, this will not deter the larger multinationals, many of whom have indicated an interest in opening or expanding their businesses in Brazil.

In October 2011, Swiss insurer Zurich Financial Services (ZFS) agreed to acquire a 51% stake in Spanish banking group Banco Santander's life insurance, pension and general insurance operations in Brazil, as well as Mexico, Chile, Argentina and Uruguay. Santander has been selling assets, including stakes in its Latin American insurance business and US auto loans unit, to help boost capital and absorb loan defaults. Bank distribution accounts for about 40% of all insurance sales in Brazil and, as such, is often a key to success, so ZFS has gained a powerful channel as the deal will provide it with access to over 5,600 bank branches and an additional 36 million customers in the region.

Although the Brazilian insurance market was until recently dominated by national companies, by 2010 the market share of international companies had risen to 40%. There remains a large number of smaller local companies in operation, and the period from July 2011 to June 2012 saw a number of domestic transactions, a trend that is set to continue as smaller players struggle to adapt to the rapidly changing market and become targets for larger competitors.

As the insurance industry in Brazil continues to thrive, the larger domestic players are taking active and positive steps to develop their own brands, invest in platforms and systems, improve underwriting and profitability and introduce new products. As is the case in the emerging markets of Asia Pacific, this should lead to Brazilian insurers developing the capability to compete on the global stage, and start to look beyond their borders for growth opportunities by acquisition.

Bermuda

Bermuda saw a sharp rise in deal activity in 2010, but since then levels of activity have subsided, with the first half of 2012 having returned to a lower level than the same period the previous year. While the island remains one of the largest and most important markets for re/insurance globally – supplying 40% of the US and EU market – a number of factors have conspired to make for a quieter year for mergers and acquisitions.

Despite a number of significant catastrophes in 2011, none were seen as the sort of ‘game-changing’ event that meant reinsurers’ balance sheets sustained significant damage. Although the size of the losses led some to believe that a new ‘class’ of reinsurers would emerge, there have in fact been few transactions or start-ups.

However, one example of ongoing interest was the purchase by Goldman Sachs of Ariel Reinsurance’s Bermuda-based business. Commenting on their expanded property and casualty coverage, Tom Milligan, co-head of Goldman’s London-based P&C reinsurance business said: “The Ariel franchise adds scale, breadth and a deep talent pool”.

A significant change in the interest rate, regulatory or tax environment may also serve as a catalyst for deals. For example, there are renewed concerns about the threat posed by the Neal bill. This legislation aims to levy more US taxes from some Bermudian reinsurance groups by limiting the ability of US subsidiaries of foreign insurance groups to claim deductions for reinsurance ceded to affiliates based offshore. Although the bill has failed to gain serious support in the three years since it was originally proposed, it has now been re-introduced and for the first time has a Senate sponsor.

Although there were a number of deals in Bermuda in the last year, activity was undoubtedly hindered by many of the same factors that have created a cautious sense of ‘wait and see’ in other markets: the state of world economies, the imminent US elections and considerable regulatory uncertainty. For this reason some re/insurers there have been returning capital through share buybacks rather than devote it to M&A. Validus announced in June 2012 that it was going to buy back shares worth around \$204 million and in the first quarter of 2012 White Mountains aggressively returned capital to shareholders, buying back \$484 million of its stock.

According to a report in Insurance Insider, global legacy M&A reached \$1 billion at the half year stage of 2012, and Bermuda saw two significant deals that highlight the levels of ongoing interest in this sector. Sirius, the White Mountains subsidiary, bought Bermudian reinsurer Old Lyme’s run-off loss reserve portfolio, while Randall & Quilter Investment Holding acquired Trimac Acceptance. The latter deal demonstrated an exit solution for captive owners who have put their captives in run-off or are contemplating ceasing writing new business – a key market for Bermuda which has over 1,000 captive insurers.

Argentina

Argentina is one of the most significant markets in South America, with a number of international firms operating within the country. 2011 saw strong growth in premiums in both the non-life and life segments and interest from multinational insurers in the country has risen, as evidenced by a number of recent transactions.

In May 2012, Australia's QBE completed its acquisition of HSBC's Argentina Holdings S.A. The deal includes a ten-year bancassurance agreement enabling QBE to become the exclusive provider and underwriter of general insurance products to HSBC customers in Argentina. QBE's chief executive Frank O'Halloran described the acquisition as: "A good fit with our strategic objectives of profitable growth in the fast-growing economies of Latin America."

In the same month the UK's RSA Insurance Group plc completed the double acquisition of Aseguradora de Creditos and El Comercio Compania de Seguro, while Swiss insurer Zurich Financial Services (ZFS) acquired Spanish banking group Banco Santander's operations in Argentina as part of a wider pan-regional deal.

However, some insurers have seen their operations impacted by reforms introduced in 2011, which limit the amount of risk which companies can cede to international operations and requires firms to use local reinsurers rather than place business into the international market. The reforms represent a radical change in Argentina's attitude towards foreign reinsurers, who had operated without restriction in the country since 1992.

Speaking in March, Hannover Re chief executive, Ulrich Wallin, said his firm expected reduced volume from Argentina, where it is one of the market leaders. "We will not lose the premiums altogether, but keep some as retro business," he said. However, other companies may reconsider their position in the market and look for suitable buyers.

Structural weaknesses persist in Argentina's insurance sector, with both of the main segments under-developed by most metrics. The competitive landscape is fragmented, which may lead to some domestic consolidation, but many of the largest local groups lack scale in anything other than a purely Argentine context. One exception to this rule is Argentina's La Segunda, which, in a rare industry foray outside the domestic market, acquired Paraguay's Tajy in April 2012.

Chile

Due to a lack of regulatory barriers against foreign entrants, the Chilean insurance market is relatively open to foreign companies which now play a major role in the industry. The first half of 2012 saw a number of deals with IFC of the United States and Spain's Inversiones Magallanes SA each acquiring a stake in Aseguradora Magallanes SA. In a further transaction Inversiones Magallanes SA acquired Aseguradora de Garantia.

As Chilean companies look to comply with regulatory developments in a number of areas, including adopting International Financial Reporting Standards, changes in corporate governance and proposed moves to withhold risk based capital, more acquisition targets may emerge.

Peru

The outlook for the industry is positive with strong growth expected across all business lines due to a good macroeconomic outlook and industry players' growing managerial sophistication, with premium volume expected to grow across most lines, including surety, cargo and homeowners, automobile, and life insurance, annuities and pensions, according to a report published by Moody's. Peru's insurers have remained well capitalised after the 2008 financial crisis, a trend that is set to continue, reflecting the improvement in financial markets, good profitability and a strengthening of underwriting conditions.

These upbeat market conditions have contributed to a buoyant level of M&A activity, with a spate of recent domestic deals, despite the market being dominated by four large players, Peru's Rímac Internacional, Pacífico Vida and La Positiva, and Spain's Mapfre.

Looking forward, there are several challenges for the industry, including high market concentration, low penetration of insurance products relative to regional peers and Peru's geographical vulnerability to natural disasters, which could impact future M&A activity in the country.

Columbia

Columbia's insurance market is still relatively small, ranking in sixth place against neighbouring countries in the region, and representing only 2% of the country's GDP. Nevertheless, with numerous new potential sources of business development for foreign investors, there is, it seems, ample room for growth among local and international insurers.

Colombia allows 100% foreign ownership of insurance firm subsidiaries; however, firms must have a commercial presence to sell policies other than those for international travel or reinsurance and, as such, one way foreign companies are increasing their market penetration is by acquiring local companies. However, with high levels of competition, several dominant local insurers, and most of the large international players already present in the region, a significant entry of inbound transactions is not expected.

Conversely, there may be M&A in the opposite direction. Last year Colombia's Grupo de Inversiones Suramericana's acquired ING Group's Latin American insurance unit for \$3.9 billion, the arrival of a Latin American insurer on to a larger stage for the first time, a potential forerunner for other emerging market players to expand into international markets.

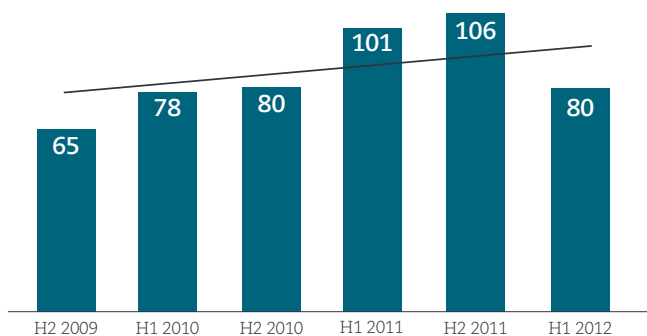


USA

While seeing low activity levels by historic standards, 2011 saw more deals than recent years. Previously, while the US economy struggled, prices bumped along the bottom of the cycle and valuations further deteriorated. There were fewer deals being driven by the consequences of the financial crisis – although there were some. Other deals that were undertaken tended to fall in a few key categories; buyers looking to acquire some specific capability in terms of product or distribution, seeking growth in new markets (rather than trying to gain scale in associated economies) or making alternative use of capital.

One of the bigger transactions in 2011 was a direct fall-out from the financial crisis – the sale by AEGON, the Dutch insurer, of its Transamerica Reinsurance arm to the French reinsurer SCOR for \$900 million. AEGON said that the deal would provide funds to repay the aid it received from the Dutch state, while for SCOR the deal adds considerable scale and makes it the second largest life reinsurer in the world.

Volume of US deals by half year



In terms of adding specific capabilities, the merger of Nationwide Mutual and Harleysville in early 2012 was driven by a desire to add depth and breadth to their distribution platform to create genuine national reach.

Nationwide CEO, Steve Rasmussen commented on the deal, saying “the completion of the transaction sets Nationwide apart from the competition as a top independent agency partner in the United States”. Later in 2012 wholesale broker AmWINS agreed a \$1.3 billion recapitalisation with New Mountain Capital. AmWINS has seen a number of acquisitions both at home and abroad in recent years and is looking to be a clear leader in the specialty insurance distribution market.

Potential deals are being judged much more stringently on strategic fit. The key criteria are how close to the core business is the acquisition, whether the deal will be accretive to earnings per share, make a return on invested capital and the ease with which planned synergies will be achieved. For example, the acquisition of Delphi, a US based insurer, by Tokio Marine was one such match – the meeting and filling of an immediate need. The deal provides Japan’s largest non-life insurance group with the ability to expand its presence outside its home insurance market where premiums have been on the decline as society has aged and changing lifestyles have hit the auto insurance markets.

The hesitancy in the market to transact unless the margin for error is very small is another factor driving companies to look at alternative uses for capital. This, combined with recent low returns on equity means that shareholders are putting pressure on management and boards to return capital rather than devote it to mergers and acquisitions. As a result, many insurance companies are engaging in share buy-backs rather than reinvesting excess capital in their core business. For example, in late 2011 Allstate Corporation’s board of directors approved a \$1 billion share repurchase scheme which is expected to be completed in March 2013. Meanwhile, Prudential Financial announced in June 2012 that it would buy back \$1 billion in stock over the next 12 months.

There is no doubt that the US has become a slow premium growth market and, as a result, foreign insurers have less interest in the US insurance markets – with a lot of deal activity being outbound not inbound.

2011 was one of the most expensive years in catastrophe claims ever. As well as the Japanese earthquake and tsunami, Thai floods and New Zealand earthquake, the US saw more weather catastrophes that cost at least \$1 billion in damage than it had since the 1980s. P&C companies’ income statements have had to absorb some large losses, and as a result are looking for reinsurers with strongly capitalised balance sheets.

This was one of the key drivers behind the largest deal of the last 12 months – the sale of Transatlantic Holdings for \$3.4 billion to US insurer Alleghany. Weston Hicks, Alleghany chief executive described the deal as “transformational” and said that it would allow them to diversify both geographically and by risk. He commented: “Clearly as the customers of insurance companies get larger, you need a large pool of capital to be relevant to them.”

Looking forward

Despite the significant size of the Alleghany / Transatlantic deal, the first half of 2012 has been relatively inactive – with fewer deals being completed than in any six month period since late 2009. Despite this relatively sluggish start, recent investor relations calls by insurers have been much more upbeat about M&A prospects. There are a number of indicators that suggest that corporate transactions could pick up as the year progresses.

Pricing

Despite the fact that soft pricing has shifted in some lines of business and rates are at least stable – if not rising – it is not likely that organic growth is going to be easy to achieve in the current economic environment, so acquisition may be a more practical solution.

Many market commentators suggest that – absent a capital destroying catastrophe – pricing is unlikely to harden significantly. As a result, some insurers are looking to control distribution in a number of ways from e-commerce through to vertical acquisitions of managing general agents and underwriters.

Capital requirements

A number of pieces of legislation from Solvency II in Europe to the Dodd-Frank Wall St and Consumer Protection Act in the US will affect how much capital re/insurers have to hold to underwrite certain lines of business. This may result in certain activities becoming less attractive and therefore open to disposal.

It is most likely that this will mean more ‘bolt-on’ transactions, sales of duplicative operations or sales of non-core activities.

Valuations

The insurance industry continues to see historically low valuations in property & casualty, life and health and reinsurance companies – with many trading at a discount to book value. While this tends to deter some sellers because they perceive the business to be worth more, buyers see this as an opportunity. Currently, the mis-match of pricing expectations is preventing many deals being consummated, however it could be that other pressures (possibly regulatory) will impel activity.

More negatively, legislative changes of various types are still casting a long shadow over the US M&A market, whether it is tax reform, federal legislation or capital requirements. Tax reform typically creates M&A uncertainty as taxes can have a significant impact on deal values. In the last year there has been a number of suggested changes in the taxation of life insurance products, offshore re/insurance companies, as well as taxation issues resulting from health care reform.

Another potential brake on deal activity is the issue of reserving. The second quarter of 2012 saw a number of P&C companies take reserving charges. For example, Tower strengthened prior accident year reserves by \$65 million on a pre-tax basis following an analysis of recent loss emergence and Mercury General recorded \$23 million of unfavorable reserve development on prior accident years and \$29 million for the first quarter of 2012. A trend towards deteriorating reserves will deter potential buyers who will be nervous about acquiring a business that then has to take a large reserve charge.