

M&A activity A global overview 2009-2012



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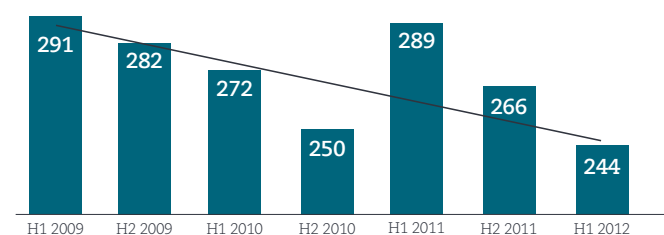
Executive summary

Welcome to our second report on mergers and acquisitions (M&A) activity in the global insurance market. Based on data supplied for completed transactions between 1 January 2009 and 30 June 2012 by Thomson Reuters, our corporate insurance specialists around the world have once again compiled a review of key trends in each of their regions.

In last year's report we commented on a pick-up in global activity during the first half of 2011 – and the deal environment remained relatively robust to the end of the year. However, transactions dropped in the first half of 2012 to the lowest level for three years, albeit with some regional variation, confirming an overall decline.

This is perhaps unsurprising as companies in every industry – not just insurance – are having to come to terms with the new 'business normal', characterised by persistent low levels of growth and market volatility. While there are undoubtedly significant barriers to getting deals done in the insurance space, including economic uncertainty in the Eurozone, stalled growth in the U.S, investment limitations in many markets and the difficulties in finding suitable targets, there is still keen interest in transactions. However, boards and investors are understandably cautious when they consider a merger or acquisition, but once an opportunity is identified that is perceived as the right strategic fit, they will look to take it.

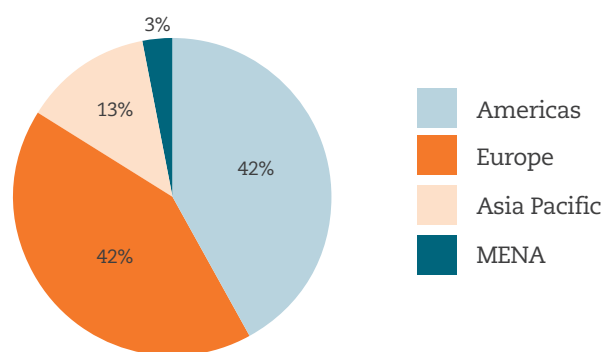
Volume of deals completed globally 2009 – 2012



Europe has seen the biggest drop in the volume of insurance M&A. Although it remains neck and neck with the Americas in terms of the number of deals completed over the last three and a half years – each accounting for 42% of transactions in the period – it has fallen back from its leadership position in 2009 and 2010, and 2011 saw a pronounced decrease in activity which has continued into the first half of 2012. There was a 21% fall in deals done between 2009 and 2010 – and a further 18% decline in 2011.

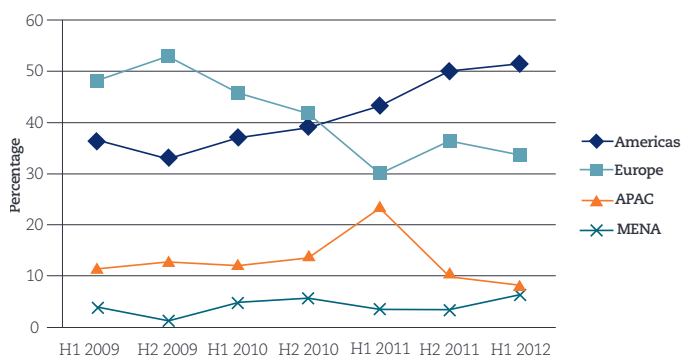
The Americas is the leading region and has accounted for 52% of global M&A activity in the insurance sector over the past 12 months. This has been driven predominantly by the US – not surprisingly given its maturity and size – as well as increased activity in Latin America.

M&A activity 2009 – 2012 by region



Asia Pacific has seen its share of global M&A activity drop from a high of 24% in the first half of 2011, when it saw 24 deals completed – including a number that had been put on hold during the global financial crisis – to 8% in the first six months of 2012.

Percentage share of global deal activity by region



Global trends

Although many of the trends driving M&A activity remain unchanged from last year – the fallout from the credit crunch resulting in the forced disposal of assets, the need for companies to acquire greater critical mass to meet the capital requirements of new regulations and the quest for growth by writing new business lines or moving into emerging markets – one key development since our last report has been the effect of the on-going European debt crisis.

This has taken its toll across the affected countries in the region both in terms of underlying businesses as well as investment portfolios. The result of this has been companies having to dispose of subsidiaries or books of business in order to improve their solvency ratios, and/or transfer their renewal rights because of ratings downgrades. There has also been a consistent move to shift the focus of their development to emerging markets to compensate for Eurozone difficulties.

Spain's Banco 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. In another example, Aviva has plans to put its globally underperforming businesses up for sale in an attempt to raise capital to protect against its Eurozone exposure.

Meanwhile, the fallout from the global financial crisis persists with re/insurers looking to repay government bailouts and shore up their balance sheets. AIG sold its Taiwanese arm, Nan Shan Life Insurance Co Ltd, and 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. The largest deal was the sale by Old Mutual plc of the Skandia businesses in Scandinavia in March 2012. In the UK, the forced sale of the insurance businesses within Royal Bank of Scotland (RBS) continues.

Many insurers are also looking to recapitalise their balance sheets in the wake of large losses sustained from a series of natural disasters. 2011 was one of the most expensive years ever in terms of catastrophe claims. 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. 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. In another notable deal Japan's Tokio Marine & Nichido Fire sought to diversify its risk portfolio through the acquisition of Delphi Financial Group Inc of the United States for US \$2.6 billion.

With growth increasingly hard to come by in the more developed economies and pricing unlikely to harden significantly in the near term, international insurers continue to look for growth opportunities in emerging markets. In Asia, Australia's IAG bought a 20% stake in China's Bohai Property Insurance as well as 30% of Vietnam's AAA Assurance. Canada's Tiger Holdings and French giant AXA both completed acquisitions to strengthen their positions in South Korea. In Latin America, another Australian insurer, QBE, completed its acquisition of HSBC's Argentina Holdings SA while the UK's RSA Insurance Group PLC completed the double acquisition of Aseguradora de Créditos and El Comercio Compañía de Seguros. In Russia, Liberty Mutual completed a deal for 99.9% of Russia's KIT Finance Insurance as a platform to enter the growing non-life market.

As the insurance industry across the emerging markets continues to develop apace, the larger domestic players are developing the capability to compete on the global stage and are starting to look beyond their borders for growth opportunities by acquisition. In the second largest deal last year Colombia's Grupo de Inversiones Suramericana acquired ING Group's Latin American insurance unit for US \$3.6 billion. We expect this to be a forerunner for other emerging market players to expand into international markets by acquisition in the future.

Widespread regulatory reform is another key driver, notably around Solvency II and equivalents elsewhere. Regulators in many markets – developed and emerging – are introducing legislation designed to create fewer, stronger and better run players in the insurance industry. The increased focus on capital requirements and the need to adapt to rapidly changing markets will precipitate a range of transactions as smaller players struggle to adapt and comply, becoming targets for larger competitors who themselves will reassess their portfolios of operations.

There is no doubt that a number of factors could have a significant effect on the M&A market in the next 12 months; making it hard to call whether activity will increase during the period. For example, a significant catastrophe creating widespread balance sheet damage

and resulting in a sharp turn in the pricing cycle may kick start new investments, while continued solvency deterioration in the Eurozone may force more asset sales or corporate transactions.


Overall however, we believe that there are sufficient reasons for the stage to be set for a range of M&A activity around the world in the coming year and beyond, as insurers everywhere reconsider their market position and evaluate the best opportunities for sustained growth.

Our regional partners, listed at the back of this report, can provide in-depth insight and perspective wherever you might be considering a corporate transaction.

Andrew Holderness
Global Head of Corporate Insurance

Top ten deals by declared value: 1/07/2011 - 30/06/2012

Target Name	Nation	Acquiror Name	Nation	Value (US\$M)
Transatlantic Holdings Inc	United States	Alleghany Corp	United States	3,685.58
ING Groep-Ins, Pension Op, LatAm	Mexico	Grupo de Inversiones Suramericana	Colombia	3,614.00
Forsakrings AB Skandia	Sweden	Livforsakrings AB Skandia	Sweden	3,228.17
AXA Canada Inc	Canada	Intact Financial Corp	Canada	2,786.67
Delphi Financial Group Inc	United States	Tokio Marine & Nichido Fire	Japan	2,648.03
Nan Shan Life Insurance Co Ltd	Taiwan	Ruen Chen Invest Hldg Co Ltd	Taiwan	2,160.00
The Hartford Finl Svcs Grp Inc	United States	The Hartford Finl Svcs Grp Inc	United States	1,749.75
Harleysville Group Inc	United States	Nationwide Mutual Insurance Co	United States	1,683.76
Santander Seguros SA	Brazil	ZS Insurance America SL	Spain	1,646.55
VidaCaixa Adeslas Seguros	Spain	Mutua Madrilenas Automovilista	Spain	1,439.28



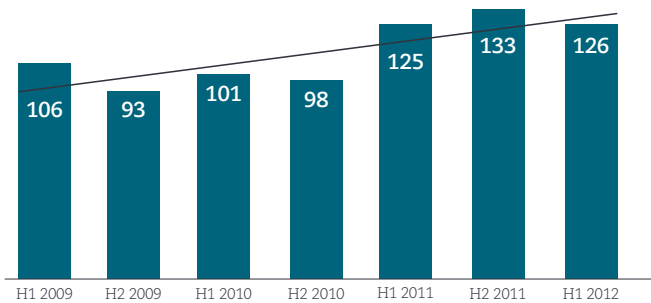
“M&A growth in the Americas will continue to be tethered to regulatory and tax certainty as well as increased capital flow and, of course, the Eurozone crisis. These factors should improve during 2012 along with the fortunes of the economic and political regions.”

Robert Ansehl, Partner
Clyde & Co, New York

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.

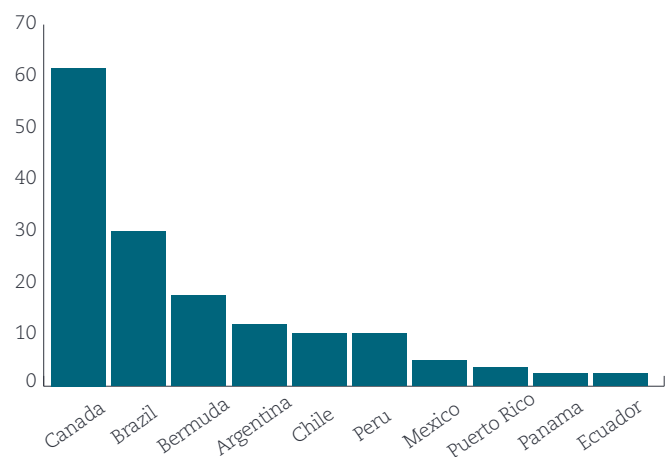
Volume of deals in the Americas



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.

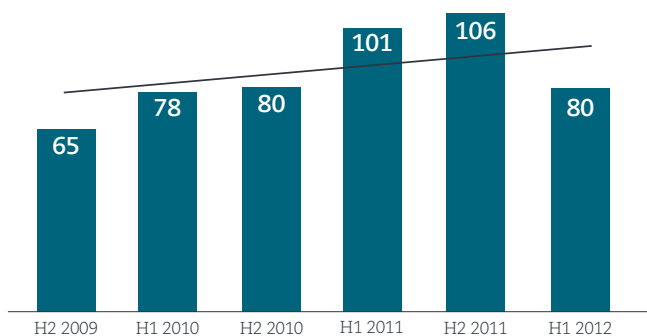


USA

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.



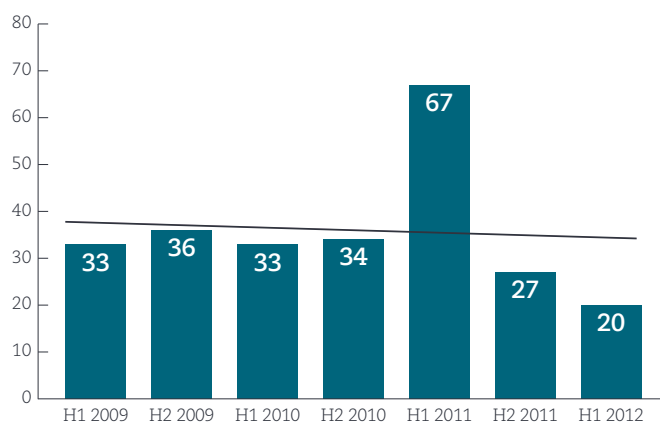
“The complexities around finding the right targets, and the limitations in many markets on investments, are slowing activity. However, interest levels in Asia Pacific remain high as market saturation and economic uncertainty in mature markets means re/insurers look further afield for development opportunities.”

Dean Carrigan, Partner
Clyde & Co, Sydney

Asia Pacific

Overall, the trend in M&A activity in Asia Pacific has moved gently downwards over the last three and a half years – albeit with a dramatic spike in activity in the first half of 2011 as a spate of transactions that were put on hold during the global financial crisis were closed.

Volume of deals in Asia Pacific



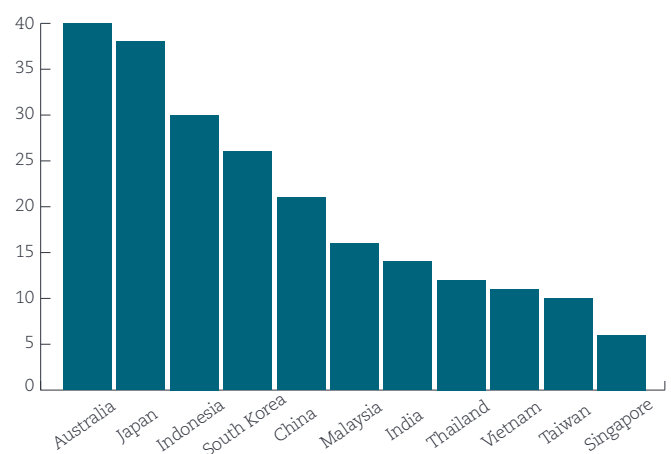
However, this is probably more a reflection of the complexities around finding the right targets, and the limitations in many markets on investments, rather than a decreasing level of interest in M&A in Asia Pacific. International insurers, whose growth in more developed economies has stalled due to a combination of market saturation and economic uncertainty, still appear keen to look further afield for development opportunities.

Primary targets appear to be in emerging market countries such as Indonesia, Vietnam and Malaysia, but insurers still have a keen focus on the more established markets such as Hong Kong and Singapore. In a number of these locations, regulators are pushing for better run, higher capitalised insurers, and are introducing new rules to deliver this. As some companies struggle to comply with the new regulations, this will likely drive an increase in M&A as the market consolidates.

In saturated markets, such as Korea and Taiwan, regulators are loosening the rules on outward investment by domestic insurers to make it easier for them to capitalise on opportunities elsewhere in the region, and, in particular, the potentially lucrative Chinese market. The fallout from the natural catastrophes in Japan and Thailand is another factor that has been driving M&A, as battered insurers look to rebuild their capital positions and diversify their risk portfolios.

Distribution remains another issue for international entrants – how do they get their products to the customer? Historically, distribution across the region has been dominated by the agency model – although greater economic sophistication and improved technology means that this may be changing. So, insurers are now looking at new distribution channels, and it is predicted that this will drive an increase in M&A in the region.

Deals in Asia Pacific by country: 2009-2012



Australia

The Australian market has seen a strong mix of both inbound and outbound activity. While Australia is very much on the radar of Asian companies with international ambitions, the market remains highly concentrated, dominated by the two biggest players: Insurance Australia Group (IAG) with around 40% of the market, and Suncorp with 34%.

The only international insurer involved in inbound M&A activity in Australia over the last 12 months was Beazley Group, which expanded its presence in the group disability market through the purchase of two managing general agencies, Australian Income Protection and Blue-GUM Special Risks, both based in Sydney. These acquisitions demonstrate the desire of international insurers to access established books of business as a way of growing their presence in the Australian market.

The unprecedented run of catastrophic losses seen in the last two years has meant that insurers in Australia and New Zealand have had to rethink their exposure and/or their reinsurance protection. This has led the biggest players to conduct a strategic review of their operations, which has sparked some deal activity.

In December 2011 Suncorp purchased AMP's General Insurance Distribution (AMP GID) as part of its strategy "to strengthen its distribution footprint and grow its business, as well as provide distribution in line with clients' preferences," according to Anthony Day, chief executive of Suncorp's commercial insurance business.

In terms of outward investments, IAG continued its expansion overseas with a number of high-profile deals. These include the acquisition of a 20% stake in China's Bohai Property Insurance in December 2011 and the purchase in May 2012 of 30% of AAA Assurance, Vietnam's sixth largest motor insurer. In the same month, IAG completed a deal to acquire AMI Insurance Ltd of New Zealand. IAG is also likely to expand its offerings in emerging markets including Thailand, Malaysia and Indonesia. IAG's CEO, Mike Wilkins, has stated that: "IAG's long term goal is to have 10% or more of its premiums come from Asia by 2016."

Japan

The domestic Japanese insurance market was static in terms of M&A in the 12 months up to July 2012, a trend that is set to continue as the country's three main insurers, Sompo Japan Insurance Inc, Mitsui Sumitomo Insurance Group Holdings and Tokio Marine, control 70% of the market between them. It was a similar story for inbound M&A since all major international insurers already have a presence in the market.

Investment returns at home are very low and Japan's domestic insurance market is shrinking because of a declining population and prolonged economic weakness. There has also been considerable fallout from the earthquake and tsunami in 2011 as insurers seek to diversify their risk portfolios.

The result is that outbound activity by Japanese companies has picked up over the last 12 months. Among a spate of deals, the most notable were Mitsui Sumitomo's acquisitions of Indonesia's Asuransi Jiwa Sinarmas PT and the Indian operations of Max New York Life Insurance, while Nippon Life Insurance Co purchased a stake in Reliance Life Insurance Co Ltd of India.

Current regulations prohibit Japanese insurers from holding more than 10% of their own total assets in an acquired entity's investment assets. This effectively prevents Japanese insurers from buying more or bigger stakes in foreign insurers. In addition, Japanese insurers' subsidiaries are not allowed to do business in areas not specified in Japan's insurance business law.

The Japan Financial Services Agency has indicated that there are deregulation plans in the pipeline which will make it easier for Japanese insurers to take advantage of the strong yen and make acquisitions in Asia's emerging markets and elsewhere. The likely result will be increased transaction activity as insurers look to diversify beyond Japan's borders to enhance their revenue, profit and stability.

Indonesia

With the number of large foreign companies establishing operations in Indonesia increasing, particularly in the natural resources sector, so the levels of employment and per capita income are rising – a situation that will undoubtedly help drive demand for insurance products.

Despite the fact that a number of insurers are looking for opportunities in Indonesia, there is a lack of attractive targets. Many local businesses are seen as weak, with insufficient business controls, and this deters potential entrants, particularly in light of growing anti-corruption legislation in developed markets in particular the UK and US.

However, the second half of 2011 and the first six months of 2012 did see a number of new entrants into the Indonesian market, with Japanese insurers Mitsui Sumitomo Insurance, Hitachi Capital Corp and Meiji Yasuda Life Insurance Co all making acquisitions.

In June 2012, ACE announced that it was continuing its Indonesian expansion with the agreement to acquire Jakarta based PT Asuransi Jaya Proteksi (JaPro) in a cash transaction worth approximately US\$130 million, which is expected to be completed within the third quarter of 2012.

JaPro is among Indonesia's top 10 general insurers and has an extensive distribution system throughout the country. Announcing the deal, the regional president of ACE Asia Pacific, Damien Sullivan, said that "there is a good strategic fit between our companies" and that "the acquisition will enable both groups to complement each other's performance, allowing ACE to diversify its current business by applying JaPro's local expertise and strong customer service record to its current strategies." The move will undoubtedly assist ACE to further its expansion in the region and we expect the market will likely see other strong players looking at ways to emulate this move.

The Indonesian regulator developed new solvency rules in 2008, which have been implemented in stages since December 2010. Looking ahead, the second stage (of three, the third being at the end of 2014) is at the end of 2012 by which time insurers should have a minimum paid up capital USD7.7 million. This will result in the non-renewal of a number of insurance licences by insurers unable to meet such minimum capital requirements. In the near term, this development is likely to be the catalyst for a flurry of M&A activity in Indonesia before 2013.

South Korea

South Korea is one of the world's most saturated and competitive insurance markets. According to a Swiss Re sigma study, the country's insurance penetration, as measured by the ratio of premiums to gross domestic product, is one of the highest in the world at 11.2% in 2010.

It, therefore, offers limited opportunities for organic growth and Korean insurers are facing tough market conditions at home, with intense competition and low profitability forecasts. The result is that many are considering expanding into new markets through M&A abroad. Overseas expansion also helps to spread risk and balance business cycles, as well as broadening client bases and, as is the case in Japan, is something that the Korean regulator is actively encouraging.

Evidence of this trend was seen in November 2011 when Korea Life Insurance announced a 50-50 joint venture insurance operation in China with Zhejiang International Business Group. The insurer, South Korea's second largest life insurance company, has also expressed an interest in ING Group's Asia Pacific insurance operations and in May 2012 was shortlisted in the bidding process for a deal that could eventually be valued above US\$7 billion.

This has been followed by plans made by their chief rival, Samsung Life, to develop operations in Thailand, India and Indonesian insurance markets in 2012.

Despite the difficulties of entering the South Korean market, many of the leading foreign insurers believe that the opportunities are too good to ignore and in May 2012 Canada's Tiger Holdings LP completed a deal to acquire Kyobo Life Insurance Co Ltd. In the same month French insurance giant AXA SA made a move to strengthen its position in South Korea's direct insurance market through the acquisition of general insurer Ergo Daum Direct in a deal that should be completed later in 2012.

AXA already have a leading presence in the South Korean motor insurance sector through its wholly-owned subsidiary AXA Direct Korea, controlling around 15% of the market. With the acquisition of Ergo Daum Direct, AXA will become the biggest player in the Korean auto insurance industry with a market share of 22% following the merger.



China

Now the world's second largest economy, China still only has an insurance penetration rate of 3.7%, compared with an average of 10.7% for other more developed markets in Asia such as Japan and South Korea. Despite this, China's insurance market now ranks as the sixth largest in the world.

So, while the scale of the opportunity in China is huge, barriers to entry for foreign players are substantial. Under current Chinese market regulations, 20% is the maximum holding a single foreign investor is allowed to have in a domestic general insurance company. This minority investment route remains the most straight-forward route into China, as those companies looking to open an office or a subsidiary in China will need to overcome a number of hurdles, mainly involving operating history and asset levels, while the application process to obtain an insurance licence can take more than three years.

The highest-profile inbound deal over the period July 2011 to June 2012 was IAG's acquisition of a 20% stake in China's Bohai Property Insurance Ltd, completed in April. Bohai is focused primarily on motor insurance, a product line in which IAG traditionally has had competitive strength. It is likely that there will be more transaction activity in this sector as the regulator has opened up the motor insurance market to foreign companies, removing minimum premiums in order to increase competition.

In conjunction with rising insurance demand, IAG also credited improvements to industry regulations in China with improving the sector's underwriting discipline and overall business forecast as drivers for the deal. These infrastructure efforts have, in turn, encouraged greater foreign investment in the country. The Chinese general insurance market, once dominated by four big state-owned players has become more open, enabling smaller companies, like Bohai, to remain commercially sound and present more profound and diverse opportunities for the international insurance industry.

Also in April, German insurance group ERGO, a subsidiary of global reinsurance giant Munich Re, announced that it had received the necessary start-up permissions from local regulators to launch a joint venture operation with Shandong's state-owned Assets Investment Holding Company (SSAIH). This new joint venture company, which yet has to be named, will primarily focus on selling life insurance and other savings-related products to retail customers across Shandong.

Announcing the deal, ERGO's Dr. Jochen Messemer acknowledged that the highly competitive nature of the Chinese market has been particularly challenging for foreign insurance entrants. However, he emphasised that, "we are confident that – based on our technical and risk management expertise and international know-how in setting-up life insurance operations – we will set strong foundations for being successful in China in the long run."

In terms of domestic consolidation, Wuhan Kaidi Hldg Invest Co Ltd acquired Zhongying Changjiang Intl in December. Other domestic deals that have received regulatory approval and are expected to close in the near future include ICBC's takeover of AXA Minmetals Assurance Co Ltd and Peiking Founder Group's equity transfer of 51% of Haier Meiji Yasuda Life Insurance Co.

Domestic transaction activity is likely to accelerate as China's insurance regulator embarks on creating the second version of its solvency requirements. Yanli Zhou, vice-chairman of the China Insurance Regulatory Commission (CIRC), said his country's new solvency requirements will reflect trends taking place internationally as well as the particular characteristics of the Chinese market and are expected to be implemented by 2016.

In terms of outbound activity the only transaction of note was the announcement in November 2011 of state-owned reinsurance giant China Re's partnership with the UK's Catlin, marking the first time a Chinese company has made a direct investment in the Lloyd's market.

Li Peiyu, chairman of China Re Group, said: "This new venture is a milestone in our international strategy. It will not only help us to gain a better knowledge of Lloyd's and benefit from its worldwide network, but it will also increase China Re's experience of international reinsurance operations and management and help build a foundation for China Re to grow into an important player in the world reinsurance market." Under the terms of the deal, China Re employees will be seconded to Catlin to gain first-hand experience working in the Lloyd's market.

As well as providing Chinese businesses with greater exposure to the London market, Catlin will be hopeful that the deal will, in turn, enable their company to increase gross premiums written in the potentially lucrative Asia-Pacific market. The deal marks a step forward in Lloyd's ambition to attract both capital and talent from growth economies like China. It also demonstrates the strength of the platform as an entrance point for Chinese insurers looking to enter the international insurance arena. There will likely be further interest in the Lloyd's platform both from other Chinese insurers, and those in other developing economies.

Hong Kong

Hong Kong remains a key insurance hub in the region, although the relatively low number of targets will always limit transaction activity. However, the territory has seen some significant deals recently. In March 2012, AXA strengthened its presence in the region when it paid US\$494 million for HSBC's general insurance businesses in Hong Kong, Singapore and Mexico. The deal will help fulfil the French insurer's goal of becoming the top general insurance player in Asia by 2015. HSBC also sold Hang Seng General Insurance, based in Hong Kong, and a similar business in Argentina to Australia's QBE Insurance for US\$420 million. For all of these acquirers, the key benefit is that they gain invaluable access to a proven distribution channel.

The fallout from the financial crisis is still being felt, with the forced sale of ING's Asia Pacific operations. It is expected that the buyer is most likely to come from North America, in part as a result of the lack of European interest due to the economic challenges in that region. The fact that the sale will also include ING's Japanese and Taiwanese business will also deter European interest due to reporting under European GAAP, which is very stringent on booking liabilities. AIA is a possible suitor, providing competition issues can be overcome, while some large Asian companies have also submitted bids.

Malaysia

Malaysia continues to attract interest from foreign investors with a number of significant deals in the second half of 2011 and the first six months of 2012. The attractive nature of the Malaysian market is further heightened by the relatively lax foreign ownership regulations; foreign owners are allowed to buy up to 70% of a domestic insurer.

In September 2011 Switzerland's Zurich Insurance Company Ltd acquired composite insurer Malaysian Assurance Alliance Berhad (MAAB). Martin Senn, Chief Executive Officer of Zurich, said: "The acquisition of MAAB is another milestone in our emerging-market strategy. It expands our presence in the Asia-Pacific region and positions us for further profitable growth. Malaysia is a highly attractive market with considerable economic potential and a young and dynamic population."

In April 2012 Australian insurer IAG's Malaysian joint venture business, AmG Insurance Bhd, entered into a conditional agreement to buy Kurnia Insurans (Malaysia) Bhd in a transaction worth US\$509.1 million, which is expected to close by the end of 2012. Kurnia is the largest motor insurer in the country and in the top four overall. The acquisition will make AmG the largest non-life insurer in Malaysia with a 13% market share.

Moving in the other direction, UK insurer Aviva has put its 49% stake in its joint venture with Malay bank, CIMB, up for sale. Aviva's imminent exit comes only five years after the firm entered the Malaysian insurance market in June 2007. Their decision to sell their Malaysian venture is part of larger plans to sell their underperforming businesses globally, including those in Sri Lanka and South Korea in an attempt to raise money to protect it against its Eurozone exposure.

Another area attracting interest from foreign players is takaful insurance, which some believe holds the key to the nation's future development and expansion of the domestic insurance market.

At present there are very low levels of insurance coverage and penetration rates across the Malaysian population, particularly in the Muslim community, so this is a sector that provides significant potential – especially when coupled with increasingly sophisticated distribution methods.

India

The insurance M&A market in India has been relatively static through 2011 and the first half of 2012. The most significant domestic deals saw Future Generali India Life Insurance acquire the Industrial Investment Trust, and the acquisition of GS Mace Holdings Ltd by Max India Ltd.

International acquisitions were limited to two Japanese companies – Nippon Life Insurance Company and Mitsui Sumitomo Insurance – acquiring Reliance Life Insurance Company Ltd and Max New York Life respectively in the aftermath of heavy catastrophe losses in recent years.

The low level of transaction activity in India, in part, is a result of the economic situation; GDP growth has slowed to around 5.3% while inflation has risen, reaching 7.3% in June 2012. Added to this, with many potential buyers' balance sheets weakened by events elsewhere in the world, deal sentiment is less than positive.

Uncertainty over government policy is another factor impacting deal activity. The foreign direct investment limit remains at 26% and the fact that the long expected increase to 49% has still not materialised – nor is likely to in the near future – remains a source of frustration for multinational companies looking to enter or increase their stake in the Indian market.

Companies looking for a capital injection may now, however, have an alternative to seeking a direct investor. The regulatory restrictions around pursuing an initial public offering were lifted with the publication of new guidelines, and companies may look at a public offering as an alternative source of raising capital. However, conditions for conducting an IPO remain rigorous and while no insurer has pursued this route, it is expected that some will try in the near future.

Thailand

The insurance market in Thailand is still getting to grips with the losses sustained during the floods of 2011, the costliest natural disaster event in south-east Asia's history, with a large number of carriers calculating their own exposures based on a total industry loss of around US\$15 billion.

Many have either dramatically reduced their catastrophe exposure in the market or, in the case of French state reinsurer, Caisse Centrale de Reassurance, pulled out entirely, as the secondary market braces itself to shoulder up to 80% of the total insured loss.

This means the capital fund capacity of international reinsurers, which Thai insurance firms have counted on for several years, is limited. Carriers need new capital, not simply to pay claims but also to meet new capital rules implemented last year.

This is a clear opportunity for international insurers to move into, or strengthen their presence in, the Thai market. In March 2012 Canadian insurer Fairfax closed a

deal to acquire a 25% interest in Thai Re for around US\$70 million in what is likely to be the first of a number of deals in the country's embattled insurance sector.

A further catalyst for increased transaction activity is the decision by the Thai regulator, the Office of Insurance Commission, to increase foreign shareholding limits in insurers to 49% (or beyond, subject to special approval, which French insurer AXA is seeking as it looks to inject more cash into its existing Thai operations) as a way of helping many of the 67 non-life carriers operating in the sector to replenish funds and raise fresh capital in the wake of the flooding.

IAG is another insurer that has said that it will take advantage of likely consolidation within the Thai insurance sector and expand its presence in the market. IAG already offers insurance coverage in Thailand through its Safety Insurance and NZI Thailand brands, having acquired a stake in Safety Insurance in the late 1990s.

Taiwan

Taiwan is a highly saturated market, and the deal trend has been for domestic mergers to create better capitalised carriers. The largest deal last year was the sale by AIG of Nan Shan Life Insurance Co Ltd to Ruen Chen Invest Holding Co Ltd for US\$2.2 billion, one of the year's biggest transactions.

Although the acquisition was driven in part by the conditions of AIG's bailout by the US government, this is the latest example of a long line of foreign insurers exiting Taiwan's 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 in the aftermath of the global economic crisis, with the market further restricted by previous business being secured at interest rates which are no longer sustainable for firms. New accounting rules that raise capital requirements on insurers, together with strict local regulators and general market volatility, have led many international insurance groups to question their continued presence in the country.

Vietnam

As manufacturing and other businesses look for an alternative to China for low-cost production, Vietnam is seeing an increase in foreign direct investment. Insurers are also maintaining a keen interest in the country, which has seen its general insurance market grow at a compound rate of 25% per annum since 2009 and is expected to continue at similar levels in the next three to five years.

In May 2012 IAG completed its acquisition of a 30% stake in Vietnam-based AAA Assurance Corporation (AAA). IAG managing director and CEO, Mike Wilkins, described the investment as a strategic stake that will deliver an exposure to the rapidly growing Vietnamese insurance market via an established participant.

In another significant move into Vietnam, driven by similar motives, Sun Life Financial Inc, a subsidiary of Sun Life Assurance Co of Canada, signed a joint venture agreement with PVI Holdings to form PVI Sun Life Insurance Co Ltd.

Vietnam is poised for more M&A activity in the coming years as large multi-national players seek to strengthen their presence in a market which still has a degree of over capacity; this may lead to the withdrawal of less successful businesses, or merger activity to create fewer, stronger players.





“The European insurance industry is more cautious in its approach to M&A as the developing Eurozone crisis – combined with widespread regulatory reform, prolonged soft pricing and reserve inadequacy – means that boards and investors are scrutinising potential targets much more closely before transactions are authorised.”

Ivor Edwards, Partner
Clyde & Co, London

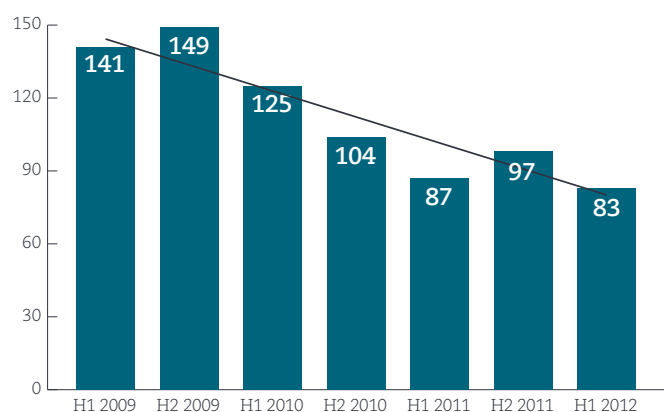
Europe

Overall, there has been a downward trend for M&A in Europe in the last three years. In general, activity was limited by the high levels of global economic uncertainty – especially around the Eurozone crisis – combined with widespread regulatory reform, notably around Solvency II and concerns around prolonged soft pricing and reserve inadequacy. When economies and markets are more buoyant, senior management is more willing to take greater risks in corporate deals. While, when times are tougher, there is greater uncertainty surrounding target businesses and future returns leading to increased scrutiny by boards and higher thresholds before transactions are authorised.

Although Europe was the region with the highest volume of insurance M&A in 2009 and 2010, 2011 saw a pronounced decrease in activity which has continued into the first half of 2012. There was a 21% fall in deals done between 2009 and 2010 – and a further 18% decline in 2011. 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 suggested that activity would increase.

Despite the reduced number of deals, the region has retained its position as the second most active globally, after the US, at 38% of the total – still some way short of the 51% of global deals it attained in 2009. Europe's increased share has come as Asia Pacific and the Middle East have been relatively quiet.

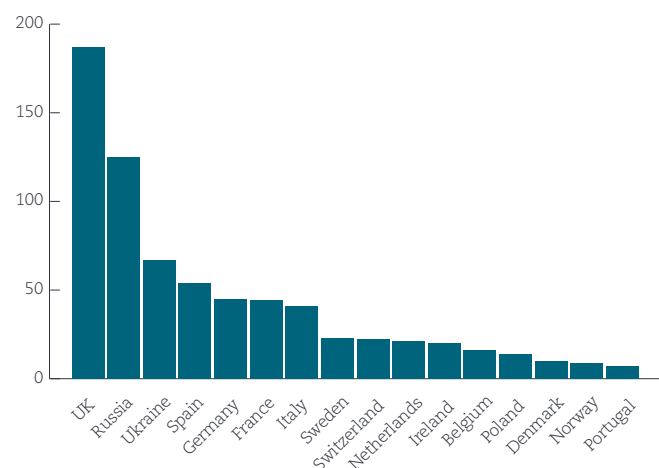
Volume of deals in Europe



The UK and Russia remain the two largest markets accounting for 40% of the deals taking place in the period. The Eurozone countries of Spain, France, Germany and Italy were also active, while the Ukraine (which had ranked third in last year's report) saw a sharp decline.

The Russian insurance industry saw premium growth in 2011 in excess of 10% and so continues to offer attractive long term growth opportunities. As such, it is not surprising that there is renewed interest from foreign players as well as an upward trend in domestic M&A activity as leading insurers continue to absorb market share. For example, in March 2012, Liberty Mutual announced the acquisition of 99.9% of KIT Finance Insurance as a platform to enter the growing non-life market, while, in August 2011, Res-Garantia agreed to purchase a 25% stake in VSK.

Deals in Europe by country 2009-2012



In many cases, the drivers for corporate activity that underpinned the M&A market in the previous report remain valid 12 months later. In terms of notable transactions, the fall-out from the financial crisis is still a key component. The largest deal was the sale by Old Mutual plc of the Skandia businesses in Sweden, Norway and Denmark to Skandia Liv in March 2012 – separately it also sold its Finnish business to OP-Pohjola osk.

According to a statement from the London-based insurer “the transaction is part of Old Mutual’s commitment to streamlining its business,” and to paying down debt after it was hit hard by the financial crisis, particularly in its US and Bermudan units. In the UK, the forced sale of the insurance businesses within Royal Bank of Scotland continues. Over the last 12 months RBS has undergone considerable re-structuring to streamline its operations ahead of a planned flotation. However, there are a number of buy-out groups reportedly interested (either alone or in consortia) in RBS’ Direct Line, which owns leading insurance brands such as Churchill and Green Flag in the UK. The business – Britain’s biggest personal motor insurer by number of policies – is valued by analysts at about £4 billion. There is no guarantee that RBS will listen to the approaches given that advanced plans for an initial public offering of at least part of the business are underway.

Despite 2011 having seen two of the most expensive natural catastrophes in the history of the insured world – the Japanese earthquake and severe floods in Thailand – as well as a succession of less severe claims, the pricing cycle remains depressed with few signs of improvement, although the market perseveres in trying to talk rates higher! Pricing, therefore, remains an important catalyst for corporate transactions of all kinds as an on-going lack of profitability causes investors to take a hard look at their business model. In addition, the effects of further progress by insurers to meet the Solvency II requirements, as well as the deterioration of economic conditions within the Eurozone, have also meant that businesses are either very carefully scrutinising the component parts of their business or are being compelled to consider disposing of less efficient capital. While this means that there may be more assets up for disposal, it is also likely that these same conditions will make buyers much more cautious.

Consequences of Euro crisis

One key change since the last report has been the effect of the on-going European debt crisis, which has taken its toll across the affected countries in the region – both in terms of underlying businesses as well as investment portfolios. This has had a number of consequences with companies having to dispose of subsidiaries or books of business in order to improve their solvency ratios, and/or transfer their renewal rights because of ratings downgrades.

There are a number of examples of these transactions in the last 12 months. In July 2011, Mutua Madrileña and “la Caixa” completed the sale of Criteria’s 50% stake in VidaCaixa Adeslas Seguros Generales to the Madrid-based insurance company – a transaction driven by Criteria’s need to reduce its debt and increase cash reserves. Banco Popular, Spain’s third largest listed bank, and German insurer Allianz, finalised the creation of a joint insurance company to manage over 11 billion euros in assets. Banco Popular booked a capital gain of 490 million euros which was used to strengthen its balance sheet. In another example, Liberty Mutual Group and Anglo Irish Bank completed the acquisition of Quinn Insurance in November 2011; the Irish insurance company was placed in administration by the Irish financial regulator in April 2010 citing “serious and persistent breaches” of solvency rules as the reason.

Ratings agencies have been keeping a close eye on the effect of the Eurozone debt crisis, evaluating investment risk exposure and assessing financial strength and creditworthiness. In an example of the difficult rating environment, French mutual insurer Groupama went from an A- rating in May 2011 to BBB- in December of the same year based on weak capital adequacy and regulatory solvency levels. One result of this was that Groupama began a sale of assets in order to boost solvency, including its domestic marine business, UK business and a recently launched Polish direct insurance unit.

Other companies are looking at international alliances and acquisitions to overcome difficulties in Europe. For example, Zurich's international markets division contributed \$1.3 billion in gross written premium in the first quarter of 2012, an increase of \$240 million compared with the same period last year – the difference coming from a range of emerging market initiatives. For example, in April 2012, Zurich began to provide wealth insurance products to HSBC clients in Bahrain, Qatar and the United Arab Emirates after signing a ten year distribution agreement. It has also recently acquired Banco Santander's insurance business which is providing significant growth in Latin America – particularly Brazil.

Limited stock at Lloyd's

Over the last three years, eight London Stock Exchange-listed Lloyd's businesses have been bought and this process has accelerated and widened to encompass non-quoted businesses over the last 12 months. The principal stimulus to this trend has not changed; for a domestic insurer from outside Europe, a Lloyd's business means immediate access to a global network of licenses for a moderately sized capital investment. The demand created by this attractive investment proposition has been fuelled by the very stringent demands of the Franchise Board in terms of new entrants – if creating a syndicate is out of the question, then acquisition is the only route. The sale of Chaucer Insurance to the US group, Hanover Insurance, illustrates this ongoing appeal – with the deal being described by Chaucer as “a great complementary fit with Hanover”. Hanover had no UK presence and was looking for greater exposure to specialty insurance lines.

So, while interest in Lloyd's remains strong, supply is diminishing rapidly, with available targets becoming much harder to find. The majority of Lloyd's businesses are now part of multi-platform corporate insurers and the assumption is that they are not for sale. In terms of listed Lloyd's vehicles, among the small caps, the period from 2005 to 2009 saw the likes of Cox, Wellington, Kiln, Atrium, Heritage and Advent taken over. This left Chaucer, Hardy, Omega and Novae. Chaucer went in 2011 and Omega and Hardy have been acquired in 2012. Michael Watson,

executive chairman of Canopi is quoted as saying that “an increasing scarcity value” is a significant factor underlying Lloyd's deals.

So what is left? Amlin, Beazley, Catlin and Hiscox are now large businesses and are not regarded as acquisition targets. There is a view that in a tough market buyers are reluctant to invest more than ten per cent of their market capital in an acquisition. There are private-equity backed vehicles where the owners have perhaps not yet seen the return they envisaged (Ark, Cathedral, Antares and Barbican) or those owned by overseas insurers already (Ariel, Equity, Marketform and Sagicor) but these are also not without their challenges. There is also still a real striving for scale, with recently announced deals being explicit in welcoming new investors to go for growth. It is felt that certain scale is required to allow management costs and expenses to be better utilised. Others see the increased regulatory burden in terms of the demands of Solvency II, and staying competitive in terms of technical sophistication around subjects such as modelling, as meaning that smaller players are disadvantaged.

Significant legacy activity

Activity in the legacy market has undergone significant change in the last several years as the focus has shifted away from dealing solely with the historic issues of APH claims. The more traditional retrospective view of legacy has been replaced by a focus on active liability management, and this includes looking at more recent underwritten risks as well as those going back some years.

While Solvency II has long been cited as a potential driver of legacy deals, the ongoing uncertainty in capital markets and depressed investment conditions are putting even greater pressure on insurers to explore all possible options for releasing and managing capital. Management is scrutinising the returns generated by every ounce of capital they have deployed, and the result is that legacy activity is being driven as much by live business as run-off, and is now being more closely integrated into the overall management of an insurance business.

The level of corporate activity for either insurance companies in run-off, or run-off portfolios, appeared to slow in 2011 following a period of prolonged activity starting in 2008. However, this reduced activity should not be viewed as an indicator that the sector is currently inactive, or that it is not restructuring and responding to market and regulatory developments. As well as more formal M&A activity, there has also been a rising number of portfolio transfers and reinsurance deals to free up capital as debt markets remain broadly closed and equity raising difficult. According to a report in Insurance Insider, legacy M&A reached \$1 billion at the half year stage of 2012 – providing real evidence that there is life in the run-off market.

For example, having acquired very large run-off books from Zurich and Ageas last year, Swiss Re became a seller in May 2012, disposing of its US life and health legacy in Admin Re. It cited redeployment of capital to more profitable parts of the business, such as its live P&C lines, as the reason. Brit Insurance has also re-focused its business as a specialty carrier underwriting solely on its Lloyd's platform and sold its UK run-off arm to Riverstone – a subsidiary of Fairfax Financial. Brit group chief executive called the sale “a significant milestone” in the firm's restructure.

There has also been considerable consolidation in terms of the number of specialist buyers in the market. Those who remain are highly experienced in the legacy markets, and are committing considerable funds to acquisitions in this sector. Enstar recently described itself as the biggest standalone legacy company in the world, having completed 35 company acquisitions and 17 portfolio transfers since it was founded in 2001. It has articulated a keen appetite for further deals saying at its annual investor meeting in March 2012 that it had “significant financial resources”, including \$1.4 billion of shareholders' equity and over \$300 million of capital and financial resources, to deploy in future deals.

The last 18 months has also seen a spate of major group re-organisations across Europe ahead of Solvency II – often using Part VII transfers. Euler Hermes and Chartis – to name but two – consolidated their European operations to facilitate a more efficient use of their capital. This type of internal restructuring inevitably causes these groups to look more closely at the composition of their businesses – in particular their run-off business – as well as its on-going structure and management. It remains to be seen, however, whether books of business which are considered to be a restraint on the efficient use of a group's resources are being put into run-off or sold.

In one of the larger European transactions of the last 12 months in the life sector, Cinven bought Guardian life insurance in a \$453 million deal. The UK private equity group purchased the 190-year-old Lancashire-based company from AEGON, as a basis for further acquisitions in a sector where banks and insurance groups are looking to sell assets to unlock capital. Caspar Berendsen, a Cinven partner, said: “Guardian is an ideal entry point for us into the market and provides us with a strong platform from which to deploy further capital to create a leading closed life consolidator”.

The other developing trend is the blurring of the line between legacy and live business. This is being demonstrated in several ways; the first being the number of businesses more traditionally associated with run-off who have bid for live carriers with a view to putting live entities into run-off and disposing of renewal rights. Hand in hand with this trend is the creation of specialist central divisions within businesses to take a holistic view of legacy business – compared to previously rather fragmented structures with claims handlers in different profit centres – and using the transferable skills from legacy to live business in terms of chasing commutations.



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Despite the positive levels of recent activity, there are worries that the severity of catastrophic losses in 2011, concerns over the European debt crisis and ongoing delays with Solvency II are likely to slow down European run-off solutions and divestments. However, the European legacy market is estimated to be worth around \$200 billion and the pace of regulatory change is not slowing, so while there may be peaks and troughs in activity, it is unlikely that the long term trend will decline.



“Although the Middle East seems poised for consolidation, and foreign insurers are still looking to enter the market, this does not appear to be happening. Companies who believe it is strategically critical to be in the region need to be realistic about the time it can take to achieve the right structural solution.”

James O’Shea, Partner
Clyde & Co, Dubai

MENA & Sub-Saharan Africa

The Middle East is a key growth area for insurance businesses with many of the countries in the region, particularly those in the Gulf Co-operation Council, presenting exciting opportunities for the industry as a result of continuing GDP growth, a youthful and expanding population and low insurance penetration rates for both personal and commercial lines.

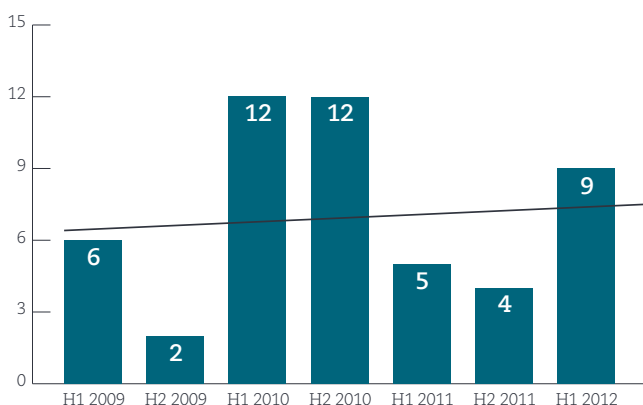
Despite much publicity surrounding the economic difficulties of Dubai, the region has recovered strongly from the worst of the global financial crisis, and, while the Arab Spring has been disruptive, it is expected to create opportunities in the medium-term as new markets open up for international insurers.

However, there is a danger of viewing the region as homogenous, when in fact it has significant differences within the region and is not without its challenges. The regulatory environment is in a state of flux in many places as attempts are made to establish and enhance the legislative framework for the industry. There remains a shortage of qualified insurance professionals, and a need for new products tailored to the requirements of the region. In addition, there are a large number of players in the region creating a highly competitive marketplace. Many of these players lack scale, both geographically and within the individual countries. Although this should be creating ideal conditions for consolidation, as well as acquisition opportunities for foreign insurers looking to enter the market, so far this does not appear to be happening in practice.

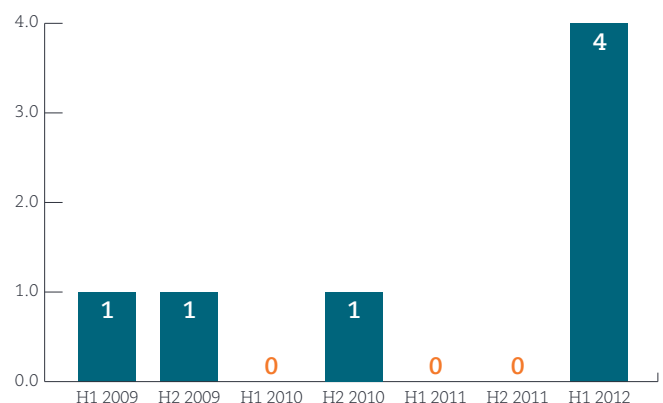
In the Middle East, Jordan continues to lead the pack in terms of M&A deal volume but overall, deals are few and mostly intra-regional. Two of the largest deals done were acquisitions in Lebanon, where the insurance industry is set for a shake-out driven by new regulatory capital requirements which favour insurers with stronger balance sheets. The government of the late Prime Minister Rafik Hariri set the minimum capital levels for insurers at \$1.5 million – a figure seen as far too low.

Kuwait-based Gulf Insurance Company (GIC) also made two significant acquisitions in the last year, including the completion of a \$3.4 million takeover of Iraq's Dar Assalam Insurance Company. Like most Gulf states, Kuwait suffers from overcapacity – it has 34 insurance companies servicing a population of 2.8 million. Against this backdrop, GIC has a clear, sound strategy for growth; to slowly acquire local operations with sound books of business across the region. It announced plans to move into Algeria and Dubai in mid-2012.

Volume of deals in the Middle East



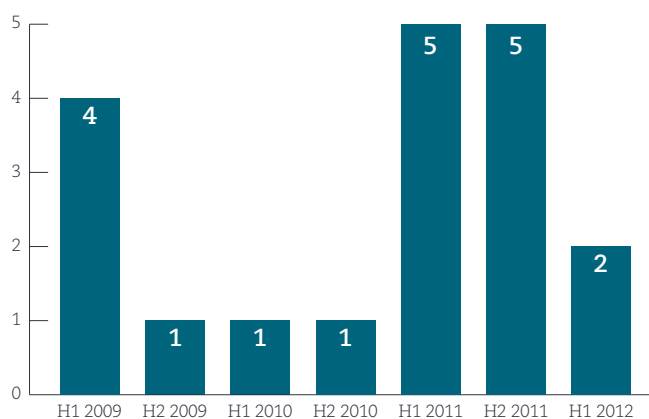
Volume of deals in North Africa



Increasing promise is turning into increasing deal volume in North Africa, where recent unrest brought about by the Arab Spring has turned into opportunity and, some believe, will usher in a fresh round of insurance sector M&A. The largest deals in the last year were in Morocco where Saham Finances, an insurance holding company, secured investment from private equity firms to support its ambitious growth and integration targets through planned acquisitions in the high growth markets of Africa and the Middle East. Moulay Hafid Elalamy, founder and chairman of Saham Finances, said: “The African insurance sector represents an extremely attractive investment opportunity.”

Elsewhere on the African continent, South Africa continues to dominate the Sub-Saharan market, though Nigeria & Kenya continue to make progress toward more stable business environments and will surely feature in the longer-term M&A picture.

Volume of deals in Sub-Saharan Africa



Optimism tempered by caution

By 2030, it is predicted that the members of the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE) – collectively will achieve the world’s sixth largest GDP, overtaking Russia, and their insurance markets are estimated to grow 20% annually over the next five years. This growth has largely been driven by government regulators introducing new compulsory lines of insurance in the motor and health sectors. However, increasing penetration has seen increased demand in lines of business that had no traction in the MENA market previously.

Take health insurance, where mandatory schemes have been introduced in Saudi Arabia and Abu Dhabi and the rest of the GCC states are proceeding at pace with plans for their own reforms. The opportunities are obvious and are drawing the attention of a number of international players including Munich Re, Bupa, Cigna, Aetna and Zurich, among others. Growth is also being driven by state-funded infrastructure projects. For example, having won the rights to host the World Cup in 2022, Qatar has embarked on a \$150 billion investment programme of complex public works projects including new airports, community regeneration and the building of roads and bridges.

The global financial crisis has also provided a new incentive for insurance purchasers. A rise in contentious disputes, coupled with the regulators’ increasing focus on corporate governance, for example, has led to greater demand professional indemnity and directors & officers insurance coverage; a development that has seen international insurers such as Zurich and Chartis launch new products in these areas.

However, despite expectations of new investment from overseas and local market consolidation, this has not been reflected in the deal flow in the last several years – and indeed the last 12 months has seen a decrease in activity. There are a number of reasons for this, including concerns around political instability, ripple effects from the Eurozone crisis and continuing legal and regulatory obstacles.

The Arab Spring

No one predicted or expected a solo protest in Tunisia to spark a wave of protest across North Africa and into the Middle East. Today there is relative stability in most of the region and cause for optimism, particularly within the insurance sector, with a recent survey of top insurance executives showing that 75% of respondents were as confident, or more confident about opportunities in the region post the Arab Spring.

For example, Middle East regional reinsurer Gulf Re recently expanded its reach to include Algeria, Tunisia, Morocco, Egypt, Iraq and eventually Libya citing the “strong capital base” as a reason, adding that the Arab Spring had created “an increased need for construction policies”. Ace has also been in discussions with regulators in Tunisia around plans to open a hub for North Africa there by the end of 2012.

Legal and regulatory obstacles

One of the key issues hindering deal flow is regulatory and legal issues which mean that M&A is often seen as just “too difficult”. The legal infrastructure in the region is still in its infancy and therefore may not satisfy the changing needs of the regional insurance industry. Considerable reform is required before consolidation is likely to happen in any meaningful and structured way. That sort of reform is neither simple nor quick.

A recent example of regulatory flux is the dissolution of the Board of the UAE Insurance Authority in September 2011. Pending the appointment of a new Board, M&A activity is restricted as it is challenging to obtain the necessary regulatory permissions. In addition, there has been extension in the UAE, for another three years, of the deadline by which composite insurers must segregate their businesses into life and non life. This coincides with efforts to revamp solvency rules for the UAE insurance industry, which are also on hold at present. Once the new regulatory regime is in place it is likely to trigger movements of books of business and corporate acquisitions and disposals. However, in the interim, uncertainty will tend to seriously hinder transactional activity.

Another long-standing issue arises from the difference in the laws and regulations across the region. Due to prohibitions on non-admitted insurance and a lack of any EU-style passporting of insurance products, it is necessary for insurers to establish branches and/or capitalise subsidiaries in each country in order to access the different markets. Inevitably, this increases cost and complexity and is clearly a deterrent to those looking to enter new markets and establish regional businesses whether by way of acquisition or a new start up.

For insurers and reinsurers seeking to establish regional operations in the Middle East complex legal issues can arise. The decision to centralise aspects of their operations, utilising a ‘hub and spoke’ model, gives rise to questions regarding the best jurisdiction for such a hub and the extent to which operational functions can be outsourced by the local operation in each country to the hub.

There is still no single hub for the industry in the Middle East. The primary contenders being Bahrain, the Dubai International Financial Centre and the Qatar Financial Centre. However, each has its own pros and cons – there is no one size fits all solution and the decision should be based upon the requirements of each individual player.

Looking at the alternatives

The result of the legal difficulties facing M&A in the region has been that insurance companies are looking creatively at non-traditional options to establish and expand operations in the Middle East & North Africa (MENA). In order to avoid the difficult and often costly exercise of M&A international players are partnering with established and licensed businesses already operating in the market.

These models have evolved from the longstanding use of fronting arrangements with a locally licensed insurer which have been prevalent in the region. The ‘fronting plus’ models are designed to enable the local insurer to benefit from the expertise and brand of the international player. They involve intellectual property licenses and administration services arrangements which are used to enable the co-branding of the local insurance products and the supply of trained staff and specialist systems and procedures from non-local entity. This approach was pioneered in the region by Aviva in its relationship with a UAE insurer, NGI, prior to Aviva’s restructuring of its business.

Joint ventures with established businesses to enter the market are also popular. The health insurance sector provides numerous examples of such arrangements such as the Abu Dhabi government's partnership with Munich Health to form Daman. Formed in 2005 as the UAE's first specialist national health insurance company, Daman has recently established Daman Qatar in order to expand its regional operations.

Distribution arrangements are also integral to the growth of the insurance industry. The recent boom in bancassurance is illustrated by Zurich's 10-year exclusive partnership deal with HSBC's Middle East banking operations for the distribution of insurance products across UAE, Qatar and Bahrain, with other MENA markets to be considered in the future.

Thorsten Kocherscheidt, CEO of Zurich's Global Life business in Middle East and Africa, comments, "Zurich and HSBC already have an extensive relationship in the Middle East and I am delighted that this has been formalized into a long-term exclusive arrangement in UAE, Qatar and Bahrain. This agreement also underlines Zurich's commitment to grow in emerging markets."

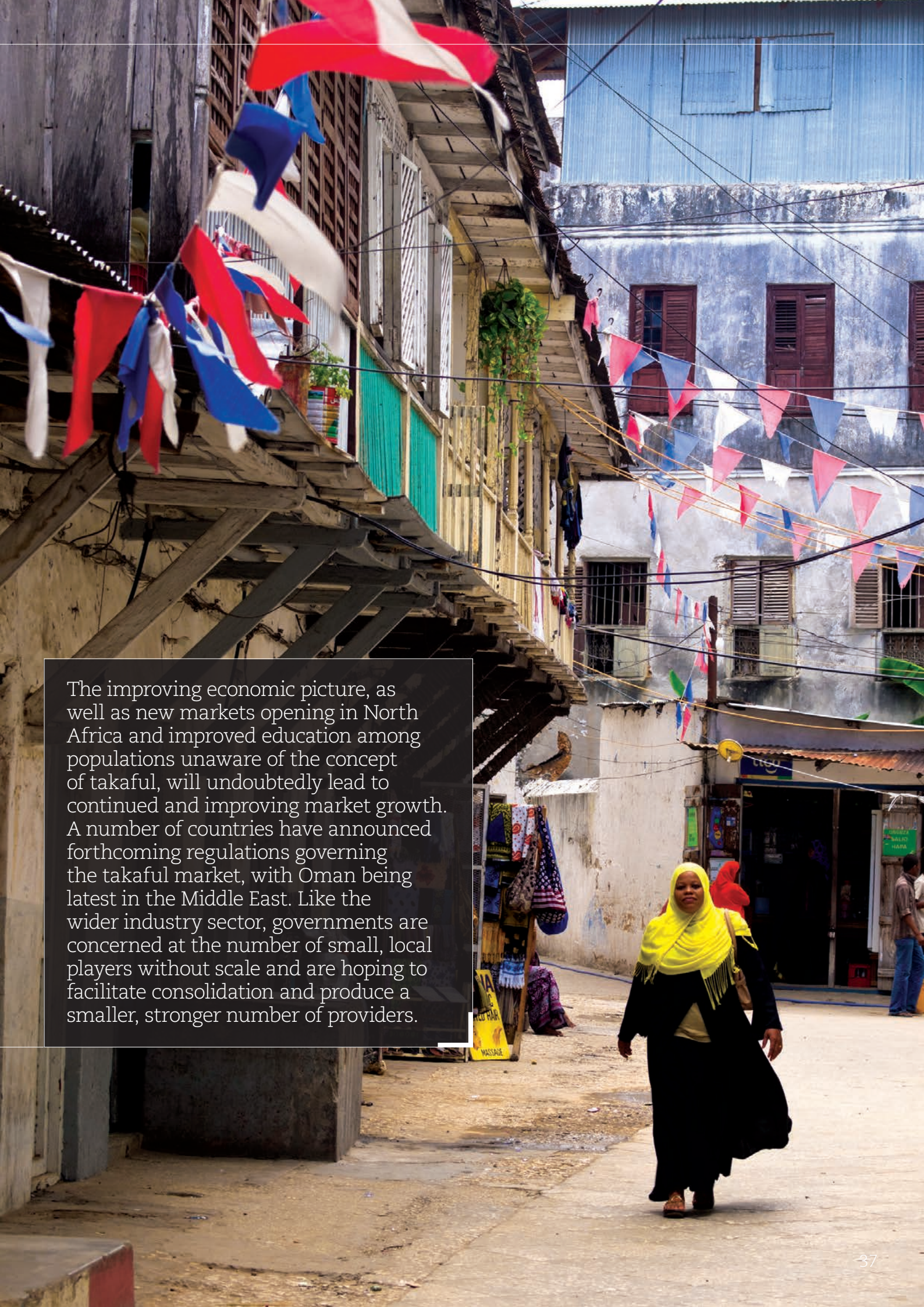
One final trend, which is emerging globally, is the idea of Financial Interest Coverage (FInC) as a way of facilitating global insurance programmes for multinational groups. FInC is part of an extensive insurance rationalising exercise whereby multinationals find ways of insuring various subsidiaries with a single insurance provider. Traditionally, this has involved global insurers utilising fronting arrangements with their subsidiaries and local insurers, non-admitted insurance (where permitted) and Difference in Conditions/Difference in Limits clauses.

FInC adds one additional option for insurers of such global insurance programmes by restating the subject matter of the policy to be the parent/holding company's interest in its subsidiary/affiliate it eliminates the need to have insurance for each country written locally.

Takaful

Like the insurance market generally, takaful continues to hold great promise and continues to report exceptional growth figures; albeit, growth rates have slowed from previous years. The Ernst & Young, World Takaful Report 2012 states that global Takaful contributions grew by 19% to US\$8.3b in 2010. Of these, the GCC contributed US\$5.68b and South East Asia contributions were US\$2b. In 2010, growth in the GCC slowed to 16%, from a CAGR of 41% in 2005–2009. However, strong growth is still predicted, particularly in the family takaful (life insurance) market due to the rising affluence of populations in Muslim countries across MENA and southeast Asia.

However, there is a growing chorus of insurers suggesting takaful products are falling short of expectations, with a significant minority terming their performance "disappointing" in the GCC survey. This comes as industry insiders are looking at the wider question of whether Sharia-structured products in general are as profitable as their conventional counterparts. The growing consensus is that such structures are complex and time-consuming to set-up and thus require a higher level of upfront investment. However, once established, the market should see rates of returns on par with traditional insurance products in the medium- to long-term, but this is dependent upon the takaful operators achieving sufficient scale. There are signs that the industry is in a waiting game, moreover it is a game that has been prolonged by the global economic downturn.



The improving economic picture, as well as new markets opening in North Africa and improved education among populations unaware of the concept of takaful, will undoubtedly lead to continued and improving market growth. A number of countries have announced forthcoming regulations governing the takaful market, with Oman being latest in the Middle East. Like the wider industry sector, governments are concerned at the number of small, local players without scale and are hoping to facilitate consolidation and produce a smaller, stronger number of providers.

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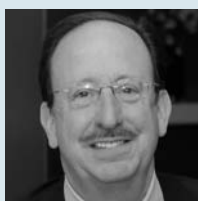
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