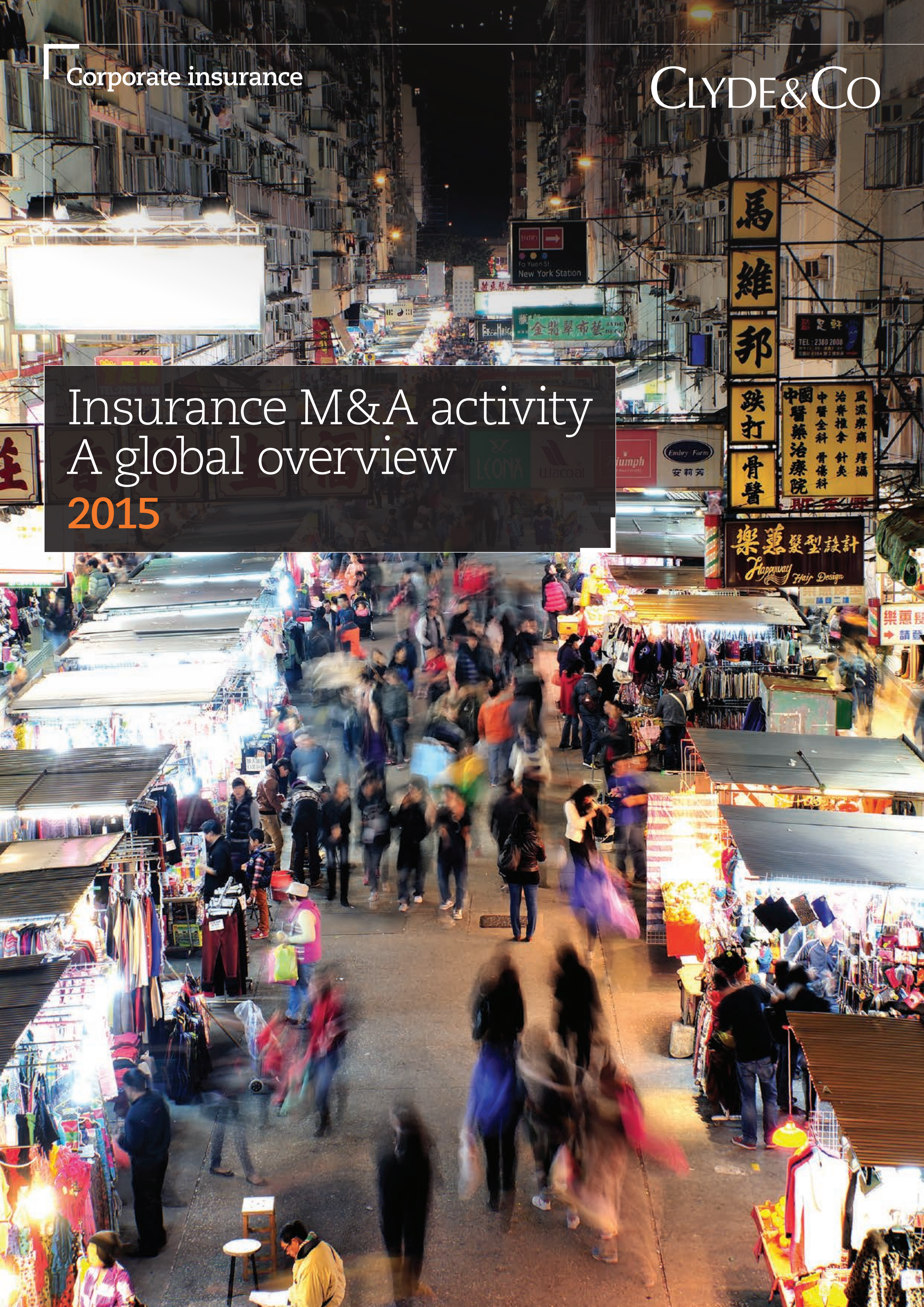
Corporate insurance

CLYDE&CO

Insurance M&A activity
A global overview
2015



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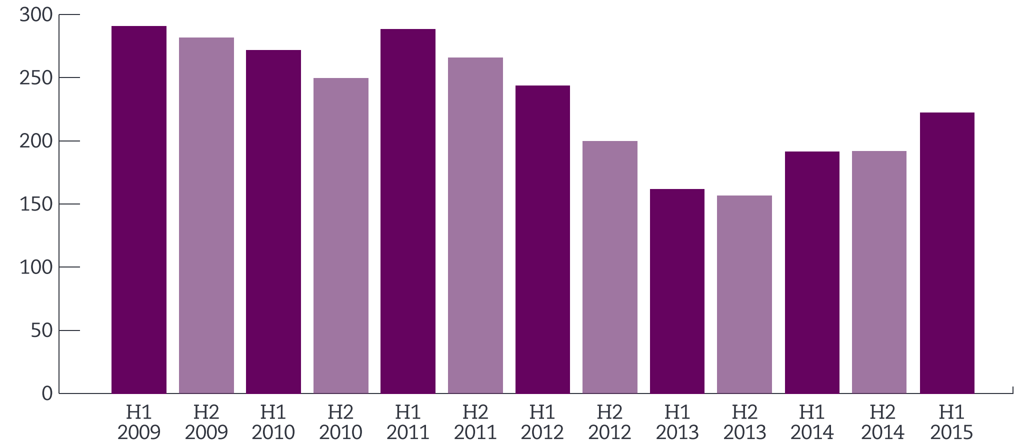
Executive summary

Welcome to our fifth annual report on mergers and acquisitions (M&A) activity in the global insurance market. At the time of writing – mid-summer 2015 – the deal environment is hot. Every day seems to bring another major announcement. In recent weeks, ACE has agreed to buy Chubb, Willis has moved for Towers Watson and Zurich has said it is considering a takeover of RSA.

Volume of deals globally: January 2009 – July 2015

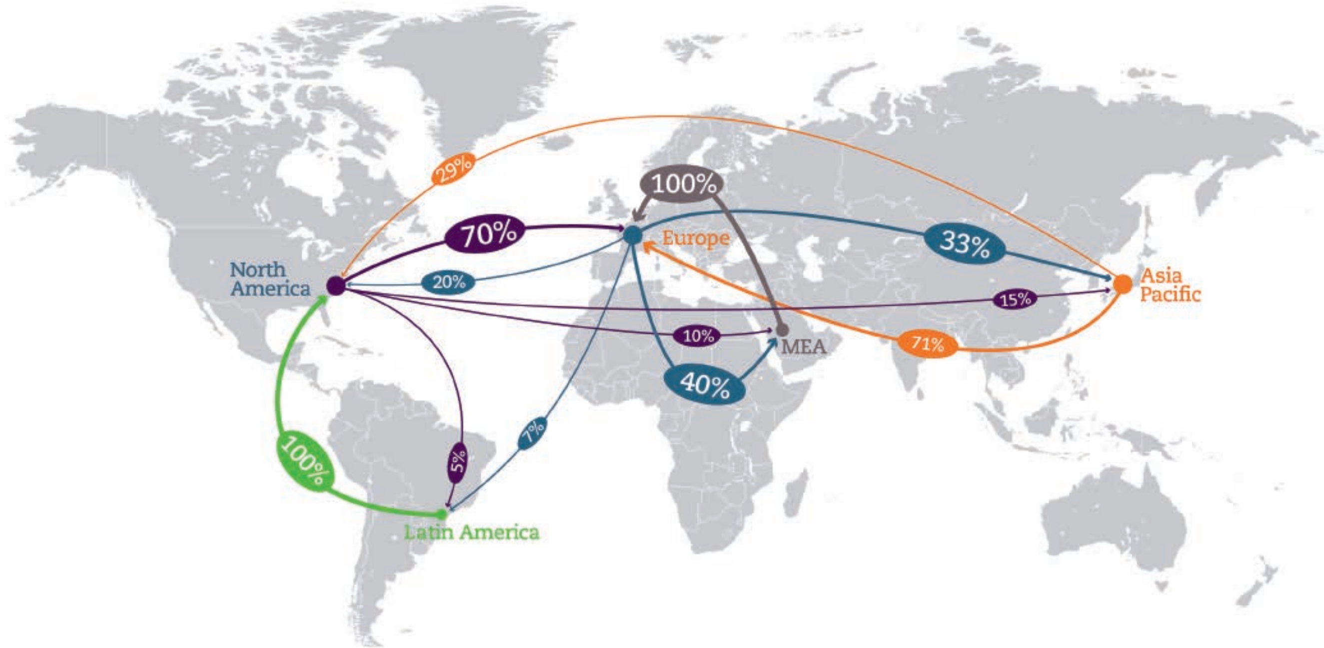


As the upturn in activity that began in the first half of 2014 has gathered momentum, a number of drivers are at play. Just as last year, the on-going low interest environment continues to impact investment returns while keeping the cost of borrowing low. Combined with an abundance of capital in the market, there is no shortage of funds with which to finance transactions. While levels of competition in the market keeping prices low and depressing return on equity has been ongoing, it seems to have reached a tipping point. Previously we have seen excess capital being deployed in share buybacks, now however there has been a shift in market sentiment towards deal activity that can deliver diversification, geographic reach and cost savings.

The search of growth remains paramount, especially for those whose domestic markets have stagnated. The acquisition of Protective Life Corp. of the United States by Japan's Dai-ichi Life Insurance Co. for USD 5.7 billion is just one example. European insurers too are looking beyond their own region to Asia and Africa to find the expansion opportunities that are not available at home. By contrast, businesses based in dynamic emerging markets such as China's Fosun and BTG Pactual of Brazil are making significant moves into mature markets to acquire assets that can fuel their international growth ambitions.

Regulation too remains a driver, especially in emerging markets. The raising of the foreign investment cap in India is likely to usher in a wave of M&A while new rules recently introduced in China are starting to take effect. The Middle East, long considered ripe for M&A, is set for a combination of domestic consolidation and inbound investment as a result of legislation designed to squeeze out smaller players with weaker balance sheets.

Percentage of outbound M&A deals by region



Looking ahead, although we expect M&A to continue across a range of markets, challenges remain in certain jurisdictions. Deal-making in Europe meanwhile has been patchy. A cloud of uncertainty overhangs the region, and in the UK in particular this is exacerbated by the possibility of an exit from the European Union. Many would-be deal-makers in the continent have adopted a "wait and see" attitude as a result, which is acting as a brake on transactions.

In the USA, the positive macro-economic outlook, combined with on-going fierce competition in the re/insurance marketplace and ever increasing levels of capital – including that from new and alternative sources – points to more M&A to come.

Although activity in Asia Pacific has fallen back slightly over the last 12 months, there has been an increase in the number of cross-border acquisitions; nine of the period's ten largest transactions involving Asia Pacific acquirers had foreign targets. We expect this trend to continue amid clear signs in a number of markets in the region – as elsewhere in the world – that M&A activity is set to surge.

Andrew Holderness
Global Head of Corporate Insurance

Top ten facts

225
Number of deals worldwide in H1 2015 – busiest six months for M&A for three years

90%
Of the top ten Asian deals were cross-border

-16%
Year-on-year decline in M&A in Europe

USD 53.8 bn
Anthem's hostile bid for Cigna would be the largest insurance deal ever

49%
India's new foreign direct investment limit – opening the door to more M&A

Regulation, excess capital and the search for growth = key drivers of M&A activity

USD 8.7 bn
Value of Aviva's acquisition of Friends Life, the biggest deal worldwide in last 12 months

2015
The first six months saw 20 deals valued at more than USD 1 billion

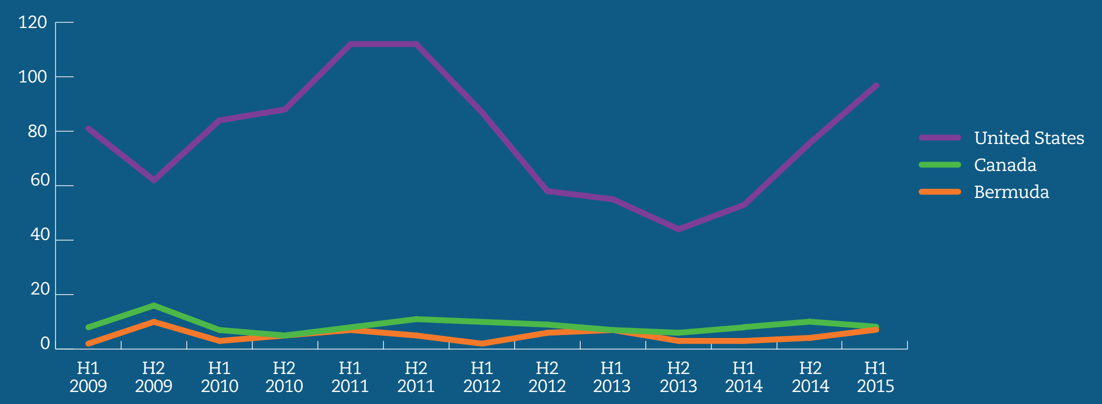
61%
Year-on-year increase in M&A in North America, the world's most active region

30 Total number of transactions involving African entities – up from 26 a year ago

North America

M&A activity in the re/insurance markets of North America has seen a 61% year-on-year increase with 217 completed transactions between July 2014 and June 2015, compared to 132 in the previous 12-month period.

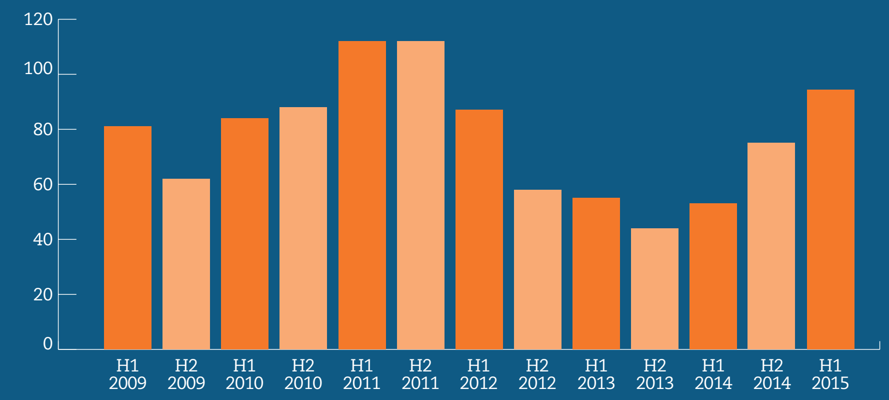
Deals by country in North America: January 2009 - July 2015



Historically, North America has dominated the global M&A scene – an entirely natural consequence of its size and maturity as the world's leading re/insurance market. However, at the time of our last report, it had lost its premiere position to Europe, with deal flow slowing in response to a combination of factors such as differing buyer/seller perceptions of company value, ongoing regulatory uncertainty and mediocre economic performance.

It has, however, now re-established itself as the overall leader in re/insurance M&A, accounting for 38% of the deals completed worldwide in the last 12 months. The announcement in the summer of 2015 of the acquisition of Chubb by ACE and HCC by Tokio Marine provides a clear indication that there is a continuing acceleration of M&A activity in the North American re/insurance market, and of larger deals in particular.

Volume of USA deals by half year



There are a number of trends that are likely to result in more deals in the coming year. These include a strengthening macro-economic outlook for the USA, ongoing fierce competition in the re/insurance marketplace, ever-increasing levels of capital in the industry (including from new and "alternate" sources), and investments into the USA by overseas players looking for diversification out of their home markets. With an increasingly robust economy, a prolonged low interest rate environment, more readily available finance and companies looking to deploy their surplus cash, it is likely that the conditions for deal-making in the USA will persist for the near-term.

Looking for growth

Despite the fact that almost every corporate statement talks about the need to grow the company's business, finding that growth, and ensuring that it is profitable, is proving elusive for many re/insurance companies.

A combination of reduced investment returns from low interest rates and fierce competition on pricing in an ongoing soft market continued to depress the return on equity for many insurers in 2014 and the first half of 2015. For many publicly-listed insurance holding groups, special dividends and share buy-backs remain frequently-used tools to address the issue of excess capital. The last few years have seen a number of insurance holding groups announce sizeable examples of this. These include Chubb Corporation's announcement of a share repurchase programme of up to USD 1.5 billion of its common stock in 2014. "Capital management continues to be an important focus for Chubb," said John D. Finnegan, Chairman, President and Chief Executive Officer, continuing: "This new share repurchase program reflects the Board's continued confidence in Chubb's strong financial condition reflecting our solid balance sheet, our conservative capital structure and our commitment to returning excess capital to our shareholders." In 2014 and 2015 Allstate also announced share buy-backs of USD 2.5 billion and USD 3 billion, respectively, based on better than expected profits and the proceeds of asset sales.

Nevertheless, many activist shareholders have increased the pressure on management and boards to actively consider M&A as a strategic tool for use of available capital and to increase the return on equity, which is now driving the increased level of transactions. These strategic acquisitions have taken a number of forms, from bolt-on buys to diversify a portfolio or scale-up in a particular line of business, to more transformational deals between domestic and international carriers. As more deals are announced the pressure to buy – or be bought – may ratchet up further.

The re/insurance M&A landscape in North America has seen a whole range of activity in both size and focus, with buyers seeking market access, diversification and/or scale. The expansion by Progressive Insurance – the fourth-largest USA auto insurer – into home coverage through the purchase of a majority stake in ARX Holding Corp is an example of the former – a business looking for growth by rounding-out its offering. "Progressive is committed to becoming the insurance destination brand for consumers," Chief Executive Officer, Glenn Renwick said in a statement when the deal was announced. "As such, we need the reliable availability of many more products than we intend to manufacture." TPG Capital Management's purchase of Warranty Group Inc, a provider of extended warranty contracts, and Alliant's expansion into crop insurance with its offer for Mary Roach, are both examples of deals in specific lines.

The completion of the acquisition of Catlin by the XL Group in May 2015 illustrated the more transformative end of the deal spectrum. Commenting on the announcement, XL Chief Executive Officer, Mike McGavick said: "After nearly two years of discussions, and several months of intense planning, we are extremely pleased to officially be one company. Starting today, we are a larger, stronger, more capable firm, with a leading presence in the global specialty insurance and reinsurance markets." McGavick added, in an update 28 days after the deal closed, that XL Catlin had been shown new business and new facilities since the deal completed.

This trend for larger and larger deals looks set to continue with the announcement in July 2015 of the acquisition of Chubb by ACE, making the combined group one of the world's largest P&C insurance companies. The USD 28.3 billion deal, expected to close in the first quarter of 2016, marks the biggest acquisition in the industry since the global financial crisis. While increased competition, depressed prices and low interest rates have been quoted as the drivers behind M&A activity in North America, this is not the case for the ACE-Chubb deal, according to ACE Chief Executive Officer, Evan Greenberg. "Most of the deals I see being done are being done defensively, because of the pressures companies are feeling," he said. "This deal is being done on the offensive."

> "The USA remains of interest to foreign investors, especially those in Asia including China and Japan, who are looking for growth because their home markets are shrinking and do not offer sufficient growth or diversification opportunities.
>
> **Vikram Sidhu, Partner, New York**

Home or away?

Stagnant domestic markets are probably one of the most significant drivers of M&A activity. The result is that, while large North American insurers look to emerging markets for targets, insurers from more mature Asian markets, particularly Japan, are targeting the USA. While the USA is not considered high growth, it is the largest insurance market in the world offering a range of targets as well as growth prospects to offset the acquirers' shrinking market at home. Establishing a presence in the USA and then using this as a base for growth – either organically or by further acquisition – offers more growth potential than emerging markets where the percentage increases may be larger, but from a much smaller base.

In 2014 there were a number of acquisitions to exemplify this trend, including Dai-ichi Life's purchase of Protective Life for USD 5.7 billion. It looks set to continue with Tokio Marine announcing in June 2015 that it had agreed to buy US specialty insurer HCC Insurance for USD 7.5 billion, in what would be the biggest M&A re/insurance deal this year by a Japanese company. With insurers among the most acquisitive Japanese companies, Tokio Marine alone has spent more than USD 8 billion on international deals since 2008, including acquistions of US insurers Philadelphia Consolidated for USD 4.7 billion in 2008 and Delphi Financial for USD 2.7 billion in 2012. Tokio Marine President, Tsuyoshi Nagano told Reuters in October, 2014: "There are still possible options in the North American market. The insurance market is big, and there are many specialty companies. There are still many good targets."

There is also increasing evidence that emerging market insurers are spreading their wings and looking to broaden out their portfolios in the more developed markets. Probably the most active example of this is China's Fosun International, which has made a number of purchases in North America in the last year including Meadowbrook Insurance Company and Ironshore in Bermuda. In March 2015, in an interview with the Wall Street Journal, Fosun Chief Executive, Liang Xinjun said the group was planning to spend at least USD 2.4 billion to buy five insurers in the USA, Europe and Asia. "Insurance is the most important business segment for us – the build-out of insurance gives us a cheap and sustainable source of funding," said Mr Liang.

In February 2015 Brazil's Grupo BTG Pactual SA – the largest independent investment bank in Latin America – completed its acquisition of Bermuda-based reinsurer Ariel Re Holdings Ltd for USD 350 million in order to expand its presence in the P&C industry outside of its local market. This can be seen as part of the company's effort to broaden potential revenue and business opportunities sources as financial markets in Brazil struggle after three years of sub-par growth.

The Canadian market, by contrast, is primarily a story of domestic activity, with the second half of 2014 seeing 16 completed deals where both parties were based in Canada. Most of these transactions were valued at under USD 100 million. Growth and the desire for scale is also a driver in Canada, but another factor may be at play. Some commentators have noted that a large number of Canadian transactions involve small and medium sized entities, often in the distribution channel. Many of these – up to around 30% – are thought to be owned by baby boomers looking for an exit strategy. Private sales also look to be a popular route; if so, we should expect more to follow.

Competition and consolidation

Although the wave of M&A in the insurance industry is touching almost every sector, there is no doubt that attention this year has been more focussed on the reinsurance sector and in particular on Bermuda. In the second half of 2014 there were four completed transactions involving Bermudan entities, including the acquisition by the Canada Pension Plan Investment Board of Wilton Re Holdings Ltd. for USD 1.8 billion. 2015 has seen a continuation of the merger frenzy, with XL's deal to acquire Catlin, Endurance's purchase of Montpelier Re (after abandoning a hostile bid for Aspen), RenaissanceRe's acquisition of Platinum and the acquisition of PartnerRe by Exor. Many believe that the problem for a number of Bermuda companies is that they lack geographic diversification and are too dependent on the once profitable property catastrophe business. This narrowness of focus is out of step with an industry that has an increasing desire to diversify. Combine this with the influx of third party capital into the ILS sector and the consequent driving down of prices in these traditional sectors and you have significant pressure for consolidation.

Another factor driving this trend is so-called 'tiering' which, while not a new trend, has been growing in recent years. According to the big three brokers, there is a heavy focus on the top reinsurers, with more clients seeking to maximise their relationships with these companies. Reinsurers are therefore looking at mergers as a route to ensure that they retain their place in, or can enter, the coveted top 20.

Applying the brakes

While there is no doubt that the impetus behind M&A is growing in North America, there are some issues that might slow down that activity and the unsettled regulatory environment will probably be one of them. A range of new rules and modified requirements, including: SIFI designation, risk-based capital frameworks, principle-based reserving, and governance and risk, may create sufficient uncertainty so as to impede transactions and significantly affect how companies operate and engage in M&A.

Case study:

Dai-ichi/Protective Life

Dai-ichi Life Insurance – one of Japan's largest life insurers – acquired US insurer Protective Life in a deal valued at about USD 5.7 billion. The deal represents the largest takeover of an American insurer by a Japanese insurer to date.

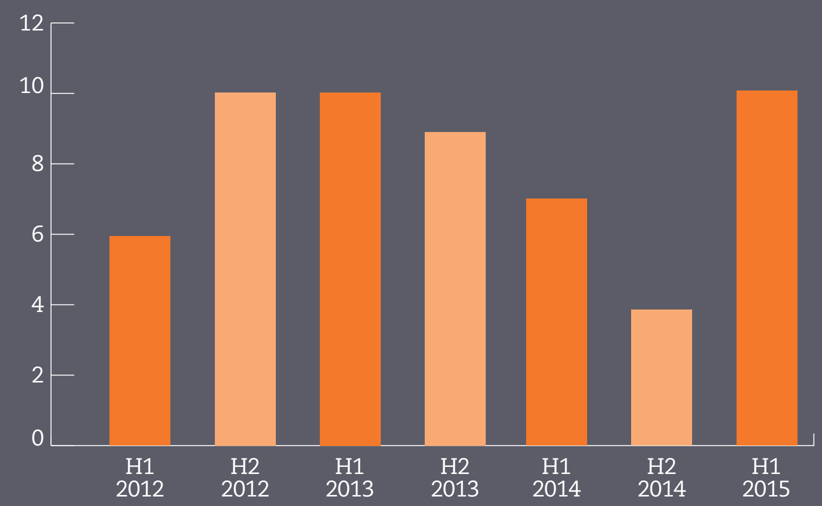
The Japanese insurance market has been stagnant, with shrinking demand from an aging and eroding population, so over the past three years, Japanese companies have been looking abroad for growth as their home market continues to slow. The USA – which represents 22% of the global insurance market – presents just such an opportunity, and has meant that some Japanese firms are willing to pay a premium for deals.

"With a strong leadership team, vibrant and growing retail franchise and long track record of profitable growth organically and through the acquisition and integration of attractive businesses, Protective is the ideal platform for expansion," said Koichiro Watanabe, President of Dai-ichi Life. "Our companies are an excellent strategic fit and share similar missions and values."

Latin America

The last year has been one of two halves for deal-making in Latin America. There were 14 completed transactions from July 2014 to June 2015, down from 16 in the previous 12-month period.

Completed deals in Latin America: January 2012 – July 2015



Economic and political factors across the region have been making investors wary of M&A activity for some time. This trend continued in the second half of 2014; there were just four deals completed between July and December. However, in the first six months of 2015 the market has seen an upturn with ten transactions completed with signs of more to come.

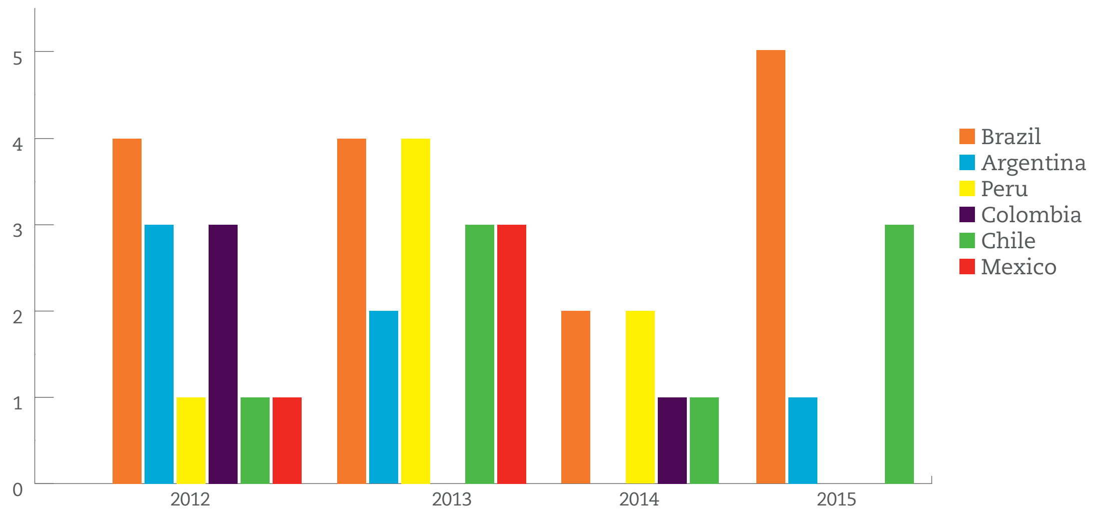
Domestic consolidation, outbound expansion

A number of factors are driving activity. There is continued regulatory pressure for fewer, stronger insurers, which is leading towards greater consolidation in the market as companies make divestments in order to comply with changing capital requirements. The majority of deals that have been completed so far this year are indicative of this trend. In Brazil, DG Participacoes Ltda bought both Fapes Administradora and Unifocus Administradora while COI Clinicas Oncologicas was acquired by Amil Assistencia Medica. Meanwhile, in Chile, Principal Institutional acquired AFP Cuprum SA and Aseguradora Magallanes was bought by Inversiones HDI Ltda, both moves that can be seen as a direct result of regulator's recently introduced new risk-based capital model.

As this process of consolidation continues and markets across the region grow against a backdrop of rising wealth and a burgeoning middle class, we are starting to see Latin American players with the scale, expertise and ambition to look beyond their national borders for opportunities elsewhere in the region and beyond. In February 2015, Brazil's Grupo BTG Pactual SA – the largest independent investment bank in Latin America – completed its acquisition of Bermuda-based reinsurer Ariel Re Holdings Ltd for USD 350 million in order to expand its presence in the P&C industry outside of its local market. This can be seen as part of the company's effort to broaden potential revenue and business opportunity sources as financial markets in Brazil struggle after three years of sub-par growth.

We should certainly expect more deals of this type. In March 2015, IRB Brasil Re, Brazil's largest reinsurer, announced it was looking to raise more than USD 500 million by the end of the year either via an initial public offering or through an investment from a strategic partner to expand its presence in the international reinsurance markets. The company already has an office in Argentina and is registered to act as a reinsurer in most other Latin American markets. It owns 8% of Africa Re and has also taken small stakes, in recent years, of selected reinsurance operations in Europe and Asia. However, Leonardo Paixão, President and Chief Executive of IRB Brasil Re has said that the company's long-term goal is to become a global player in the reinsurance market, and that it would be open to acquiring stakes in other companies outside Brazil.

Volume of deals in Latin America by country: 2012 – H1 2015



The search for growth

Meanwhile, the region remains highly attractive to established international players looking for growth opportunities outside their often stagnant domestic markets; there has been double-digit life insurance premium growth in every major Latin American market over the past five years. As a result, a number of companies have set up operations or strengthened their capabilities in the region during the course of the last 12 months or so.

In one example, in December 2014, Bermuda's Armour Group Holdings Ltd bought Fidelity National Title de Mexico – the country's largest title insurer – while in Brazil, ACE acquired the insurance business of Itaú Seguros for USD 630 million in a deal which will make it the largest commercial P&C insurer in the country.

"Brazil is a large and important market to ACE's strategy in Latin America," emphasised Evan Greenberg, Chairman and Chief Executive Officer for ACE Group, in a statement announcing the deal. More recently, Juan Andrade, Chief Operating Officer for ACE Overseas General said: "In Latin America, opportunity for the insurance industry is driven by the expansion of economic activity and the emergence and expansion of the middle class. We believe there are opportunities across the board. On the industrial/commercial side, countries like Brazil and Colombia need to develop infrastructure to move goods to market more quickly. Insurance is a local business driven by local relationships. If a company wants to compete in any market, having a local presence is very important."

Although there have been no inbound acquisitions completed so far in 2015, this lull in activity is not set to continue. In March, the UK insurer RSA revealed that it had appointed Goldman Sachs to sell its Latin American arm, which is thought to be worth around GBP 500 million (USD 739 million). However, analysts have described this operation as an "attractive asset" that would likely generate a lot of interest from potential buyers – meaning the unit could fetch considerably more if a bidding war is sparked.

Routes to market

For those that go down the route of becoming an admitted insurer or reinsurer, there are high barriers of entry in terms of licensing and capital requirements. However, there are alternatives to an outright acquisition to establish a presence in the region. For example, late last year, Zurich paid around USD 350 million for a distribution agreement with Brazil's Via Varejo for the exclusive sale of extended warranty insurance through its retail network of over 1,000 stores. The deal is expected to generate premium volume of more than USD 530 million in its first year and will make Zurich the market leader in this category of business.

Others companies are using Colombia or Miami as a hub for the region in order to circumvent or delay the high costs of establishing an on-the-ground presence, while Madrid is also emerging as a centre for Latin American business. Another alternative is to utilise the Lloyd's platform. Since Lloyd's became the first international reinsurer to receive authorisation to operate in Brazil following reforms to the market in 2008, it has grown into the second largest reinsurer with a market share of 12%.

Lloyd's structure in Brazil mirrors the unique market structure of Lloyd's in London and, currently, ten managing agents have opened representative offices in Rio de Janeiro: ACE, ANV, Argo, Beazley, Catlin, Kiln, Liberty, Markel, Navigators, Starr and, most recently, Hiscox, since July 2014. Carl Day, Market Upstream Energy Line Underwriter for Hiscox London, explained the rationale behind his company's move into the country: "Going through the Lloyd's licence, there was no barrier of entry and we are able to attract business back to London through the reinsurance platform." Indeed, Hiscox is now part of a group which has reaped the benefits of being onshore in Brazil; the managing agents with an on-the-ground presence have grown faster than those without – 112% average growth per year for those in Brazil compared with a Lloyd's market overall average of 21% from 2008 to 2012.

This route to market is set to expand as Lloyd's looks to deliver on its Vision 2025. It recently opened a representative office in Mexico City, and has similar plans for Colombia. All of this is good news for those looking for opportunities in Latin America. Although we expect M&A activity in the region to continue to rise, the speed at which it does so will depend on the extent to which investors consider other alternatives.

Countries to watch

Over the next 12 months M&A activity will follow something of a mixed pattern across the region. Beset with economic problems, any deal-making in Argentina and Venezuela is unlikely, at least until after the federal election in October, which will usher in a new administration in Buenos Aires where President Cristina Fernandez de Kirchner is unable to participate, having already completed the maximum two terms.

The majority of deals that do happen will likely involve players from the Latin America's two largest insurance markets. Despite the threat of a looming recession in Brazil, which could temporarily interrupt the insurance sector's double-digit growth of recent years, the industry's longer-term prospects are positive. It enjoys a strong capital position to support future growth, and is seeing the expansion of broker channels as well as the rise of lines including motor and property.

> "Over the next 12 months M&A activity will follow something of a mixed pattern across the region.
> **Stirling Leech, Partner, Sao Paulo**

In Mexico, second only in Latin America to Brazil in terms of premium, the insurance market remains underpenetrated while the population is relatively young and increasingly well-off. The government has pledged to spend up to USD 400 million on investment projects spanning a range of sectors, which will bring opportunities for foreign insurance and reinsurance as there is not currently sufficient capacity in the domestic market to carry the large risks that these projects will entail. In addition, Mexico, like Brazil, is pushing forward with plans to implement minimum liquidity and capital base requirements as part of an initiative to meet Solvency II standards. This will likely lead to a spate of domestic consolidation as smaller entities struggle to comply with the new rules.

Finally, savvy investors are likely to be keeping an eye on Colombia, one of the most attractive markets in the region. Should the on-going peace talks result in an end to the 50-year war with Marxist rebel group FARC, GDP would increase by a further 1% above already impressive levels of growth, according to Colombia's finance minister. With the government planning to invest USD 26 million in infrastructure projects up to 2021, demand for insurance is likely to increase, attracting attention from international players looking for growth opportunities.

Case study:

BTG Pactual spreads its wings

Brazil is developing into something of a two-way street when it comes to insurance M&A. The appeal of the market to overseas investors is clear. Even as the country's economy has entered a period of stagnation, the insurance market has grown at an annual rate of 12% each year over the past five years. Insurance penetration, however, is still relatively low and the reinsurance market remains tiny.

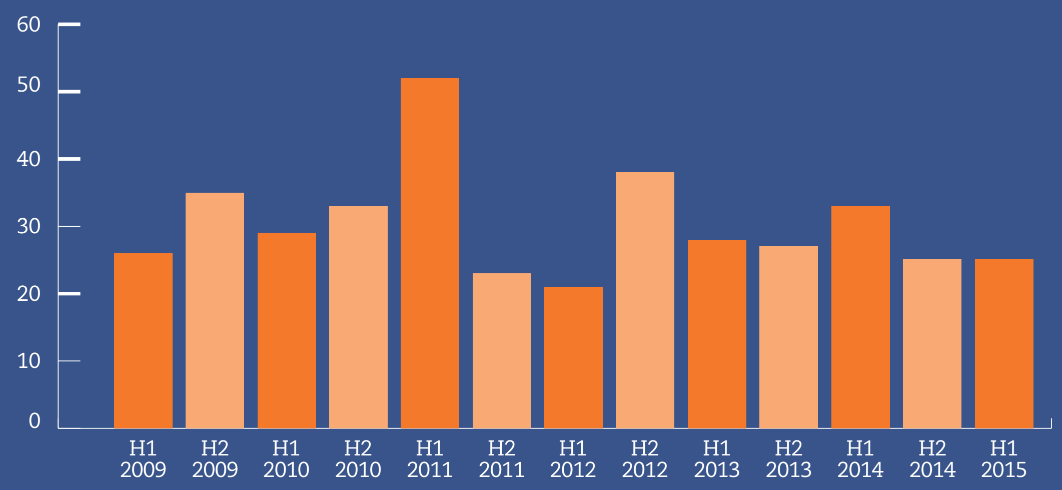
At the same time, Brazilian companies are emerging with the scale and ambition to compete on a global scale and are looking for investment opportunities in established markets. Grupo BTG Pactual, Brazil's only publicly traded independent investment bank, partnered with shareholder Abu Dhabi Investment Council to acquire Ariel Reinsurance Co Ltd in a deal worth approximately USD 350 million. The purchase represents BTG Pactual's long-term strategy to diversify away from its core Brazilian investment banking business.

"Ariel Re is an exceptional business with a strong track record, experienced people, market-leading technology and an innovative structure, including a Lloyd's syndicate. While current market conditions are clearly challenging, the opportunity to buy a best-in-class business with proven risk-discipline was too good to miss, as it offers an exceptional opportunity to expand our presence in the P&C industry outside of our local market," said Andre Esteves, Chief Executive Officer of BTG Pactual.

Asia Pacific

Activity in Asia Pacific has fallen back over the last 12 months. In the period July 2014 to June 2015 there were 52 deals, down from 60 in the preceding year. However, transactions have continued to be completed and there are clear signs in a number of markets that activity is set to rebound through the remainder of this year and into 2016.

Volume of deals in APAC: January 2009 – July 2015



We are seeing a range of factors driving M&A in the region. While intra-country deals continue, especially in markets with a large number of smaller insurers struggling to comply with risk-based capital requirements, there has been an increase in the number of cross-border acquisitions; nine of the period's ten largest transactions involving Asia Pacific acquirers had foreign targets. Rule changes in China, the overhaul of the insurance laws in India and the imminent arrival of the ASEAN Economic Community, are other developments likely to drive an increase in M&A.

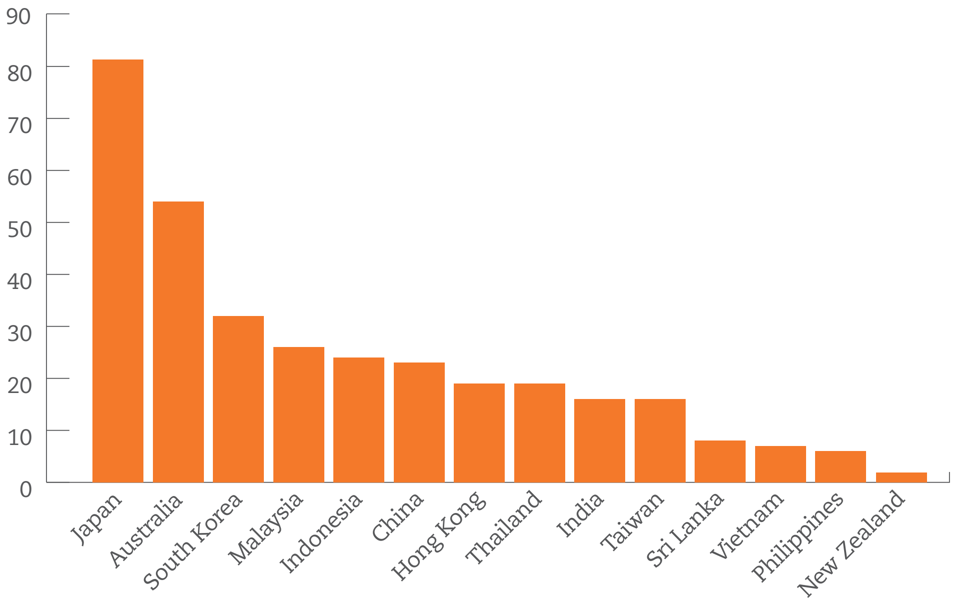
Activity in developed markets

Japanese insurers retained the top spot in Asia Pacific in terms of deal volume over the last 12 months with 12 transactions. The majority of the deals were domestic, principally in the life sector, including the acquisition of Hartford Life Insurance by ORIX Life Insurance Corp for USD 963 million. In terms of cross-border activity, two notable transactions involved Nippon Life Insurance Co Ltd – the acquisition of a USD 424 million stake in Indonesia's Asuransi Jiwa Sequis Life PT and the purchase of a 35% share of India's Reliance Capital Asset Management.

The main trend, however, is Japanese insurers looking to expand overseas as they face a shrinking market at home, and to diversify their portfolios. Japan also saw the world's second largest deal of the period, the USD 5.7 billion acquisition of Protective Life Corp of the United States by Dai-ichi Life Insurance Co. Further M&A involving Japanese entities is expected; Dai-ichi has stated it will continue to look for acquisition opportunities in the USA.

Despite spending more than USD 7 billion to buy insurance companies in the USA in the last six years, Tokio Marine – Japan's largest insurer by market capitalisation – still sees M&A opportunities and has ample access to funds for deals. In an interview with Reuters, Chief Executive Officer and President Tsuyoshi Nagano said the company is also looking for acquisition opportunities in Brazil and Mexico, while closer to home Thailand and Indonesia are markets of interest for acquisitions, although he cautioned there are few potential deals in the region and prices have become very high.

Deals in APAC by country: January 2009 – July 2015



Interest in Australia

Deal numbers in Australia have held steady for the past 18 months. There were six completed deals in the period July 2014 to June 2015. Three of these were domestic and one was outbound – Insurance Australia Group (IAG) taking a stake in Asuransi Parolamas of Indonesia. Meanwhile, German giant Allianz strengthened its presence in Australia with the acquisition of the general insurance business of the government-owned Territory Insurance Office (TIO).

Despite the fact that Australia is already a very competitive and mature marketplace, we are seeing an uptick in interest with a number of foreign investors trying to come into the market by virtue of acquisition or start-up. This was clearly demonstrated in April 2015 when Berkshire Hathaway Specialty Insurance opened an office in Sydney with the intention of what the head of the business, Chris Colahan, describes as "playing in the large corporate segment" of Australia's insurance market, which is dominated by players such as IAG, Suncorp Group, and QBE Insurance Group.

Barely two months later, in June, Berkshire Hathaway entered into a strategic relationship with IAG, taking a 3.7% stake in IAG via a USD 500 million placement. The agreement will see the two companies form a ten-year, 20% quota arrangement across IAG's consolidated insurance business. That an operator of this size and reputation should make such a significant move demonstrates a commitment to the country based on an underlying confidence that is likely to serve as a catalyst for others to follow.

There is considerable potential both for further M&A and start-up activity. It is relatively straightforward for a new business to get up and running in Australia; the application process takes around nine to 12 months, but follows a predictable path. Although we have not seen the arrival of any new life insurers for a number of years after the market was badly hit by disability claims, it is starting to stabilise and become more rational in terms of pricing, which may attract the attention of foreign investors.

In terms of deal-making, we expect some intra-group reorganisations as re/insurers look to streamline the number of licenses they have for capital efficiency purposes. This will mainly be driven by entities in run-off. In addition, buyers will continue to look to acquire distribution channels or partner with intermediaries. The Allianz/TIO deal was driven in part by this, as was the acquisition of Calliden Insurance by Munich Holdings Australasia at the end of 2014.

> In Australia there is considerable potential both for further M&A and start-up activity.
>
> **Dean Carrigan, Partner, Sydney**

Deal surge in China

It is not just the more developed economies in the region that are seeing deals. One market very much in the midst of a flurry of M&A activity is China. Transactions involving Chinese entities have risen in the last 12 months. There were eight deals in the period July 2014 to June 2015, up from five the prior year.

Anbang Insurance Group Co Ltd provides evidence of a strong trend for outbound deals, with Chinese insurers moving into mature markets. Indeed, the majority of Chinese transactions over the last 12 months have been outbound. Anbang demonstrated its international growth ambitions with a deal to acquire Belgium's Fidea Assurances, expected to complete in the middle of 2015, which will mark the first time a Chinese insurance company has gained 100% ownership of a European insurance company. Also in Belgium, Anbang agreed to purchase the banking operations of Delta Lloyd NV in December last year, while in February it won Dutch government approval to purchase and recapitalise Vivat, the former insurance arm of seized bank SNS Reaal NV.

Other Chinese firms have also been actively seeking the acquisition of overseas insurance assets, demonstrating their financial muscle as well as the ambition to become genuinely global players. Acquisitions have been driven by the desire to access to low-cost insurance funds in the world's low-interest markets and establish funding vehicles to help deliver on overseas investment strategies. In December, Chinese conglomerate Fosun International – the country's largest private equity group with a focus on overseas markets – acquired North American insurer Meadowbrook for approximately USD 433 million, in a deal scheduled to close in the second half of this year. In June 2015, Fosun further expanded its portfolio of insurance assets, announcing the acquisition of a 52% stake in Phoenix Holdings of Israel for USD 450 million.

Cross-border and domestic activity

While there are no indications that this outbound acquisition spree is set to abate any time soon, there are strong signals that domestic M&A is about to ramp up. Some of these are resulting from measures put in place by the regulator to drive consolidation in order to achieve its aim of fewer, stronger insurers in the market. In the second half of 2014 China Life Insurance Co Ltd and Anbang Insurance Group Co Ltd both acquired smaller players in the industry. A number of sizeable deals remain in the planning stages, but are expected to be announced in the coming months. In addition, inbound activity is also set to increase as international players take advantage of rule changes introduced last year.

Perhaps most significant for the future volume of transactions was the rule brought in from 1 June 2014 that allows insurers in China – including Chinese-based foreign insurers and domestic insurers – for the first time to buy shares in more than one company operating in competing lines of business. This brings it in line with other competition laws now in place in the country. In addition, the way in which capital can be contributed has also changed; under the new rules companies are permitted to use external debt to fund acquisitions, up to a limit of 50% of the overall price, subject to approval from the China Insurance Regulatory Commission.

These new rules have allowed people to think a lot more creatively about how to structure their operations in China. A number of insurers are looking to do deals with Chinese mutuals or MGAs. Meanwhile, there is a growing sense of dissatisfaction among some international insurers with their arrangements with Chinese joint venture partners; they would like to increase their equity closer to 49% but are being thwarted in this desire to enter a more equal partnership. As such, foreign players may be re-evaluating their position and looking at other options.

Lloyd's China is set to enter a period of rapid growth as it becomes increasingly attractive to overseas companies, in particular those looking to write specialty lines. Setting up at Lloyd's is relatively straightforward in comparison to other routes to market such as launching a standalone entity. In addition, for international insurers the arrival of new rules on risk-based capital under the China Risk Oriented Solvency System (C-ROSS) is crucially demanding on assets – and having a presence at Lloyd's makes it easier to comply.

> New rules have allowed people to think a lot more creatively about how to structure their operations in China.
>
> **Michael Cripps, Partner, Shanghai**

India opens up

The region's other dominant market in terms of size and population – India – has been stuck for some years in a political quagmire, which has acted as a brake on M&A. In the last 12 months the country has seen just two relatively modest deals. The Life Insurance Corporation of India bought its compatriot Credit Analysis & Research Ltd for around USD 66 million, while Japan's Nippon Life Insurance Co Ltd took a USD 106 million stake in Reliance Capital Asset Management.

However, this deal may be the first of many such moves by international players looking to tap into the newly opened Indian market. In March, the government managed to squeeze the Insurance Laws (Amendment) Bill 2015 through both houses of parliament.

The main change brought in by the Bill is to increase the Foreign Direct Investment (FDI) limit in the insurance sector from 26% to 49%. In doing so it has opened up to foreign investment a market with huge potential. From USD 66.4 billion in 2013 the total market size of India's insurance sector is projected to touch USD 350-400 billion by 2020. This will provide Indian insurance companies with a platform to readily access new capital, increase competition and attract fresh investment. In addition, an increase in FDI will help ensure innovations on product design, distribution, better risk management and improved solvency standards.

As a result of the higher FDI cap foreign joint venture partners are looking to increase their investment in domestic partners. The foreign partners of Bharti AXA and Max Bhupa have already committed to raising their stakes up to 49%. It is also possible that an influx of capital will see some insurance companies consider initial public offerings. For example, in May, HDFC Life – in which the UK's Standard Life owns a 26% stake – announced plans to go public within a year.

The other significant change brought in by the Bill allows foreign re-insurers to open branches in India, clearing the way for Berkshire Hathaway, Hannover Re, Munich Re and others to finally enter the market. In addition, the Bill amends the definition of a "foreign company" which will facilitate the entry of Lloyd's of London into the Indian insurance market.

South East Asia sees temporary lull

M&A activity in South East Asia has hit a bump in the road in the last 12 months. After a couple of years of solid deal making, insurance M&A hit its lowest point in six years in the first half of 2015. This is all the more surprising given the region has seen some huge deals in other industries, which is not being reflected in the insurance space for a number of reasons, of which political uncertainty is one.

Thailand remains under military control and the arrival of a new government in Indonesia will be giving investors pause for thought. The single deal in Thailand over the last 12 months was domestic: the acquisition of Thai Cardif Life Assurance PCL by Thai Life Insurance Co Ltd. During the same period, Indonesia has seen two deals, both involving foreign acquirers: Japan's Nippon Life Insurance Co Ltd taking a USD 424 million stake in Asuransi Jiwa Sequis Life PT and International Australia Group buying into Asuransi Parolamas PT for an undisclosed amount.

Inbound transactions may continue at a lower level for the short-term. Although a number of regulators in the region have made it clear that their ultimate aim is for fewer, larger insurers in the market, and they have introduced legislation designed to drive consolidation, making regulatory uncertainty a major issue.

In Indonesia – a fragmented market with strong growth prospects and a myriad of insurers, seemingly ripe for M&A – the authorities have completely re-written the insurance laws. Anecdotal evidence suggests that these changes have introduced a note of caution among some of those looking to enter or strengthen a presence in the market, especially as there is on-going speculation that in addition to the announced regulatory changes there could be a reduction in foreign ownership limits.

Furthermore, although it would appear that the region has an abundance of targets, many companies may not be sufficiently attractive, especially in terms of price. This does not necessarily reflect either a lack of interest nor activity on the part of investors. In today's sellers' market, an emerging trend is the decision by a number of entrants that it is more cost effective to enter the market by setting up operations rather than acquiring an existing business. Singapore, where there are no restrictions on start-ups – compared to other less developed markets in the region such as Indonesia – is an obvious destination to set up a regional HQ from which to make a play into neighbouring markets. China Life is one insurer to follow this path and, more significantly, so too is global giant Berkshire Hathaway.

> "The ASEAN Economic Community will usher in a new era of closer cross-border collaboration.
>
> **Ian Stewart, Partner, Singapore**

Pick-up in M&A expected

Looking ahead, the prospects for a pick-up in M&A activity in South East Asia are very good. The market fundamentals remain strong: most countries in the region are characterised by a growing middle class increasingly concerned with protection of their wealth. The size of this opportunity should not be underestimated. In the broader Asia Pacific region, the number of people who qualify as middle class is greater than the total population of the EU. Furthermore, the region is the world's most exposed to natural catastrophes, another key driver of insurance growth. According to a UN report, 88% of the people affected by natural disasters worldwide in the past 45 years live in the Asia Pacific region, where economic losses resulting from earthquakes, floods and other catastrophes have surged significantly from USD 5 billion per year in the 1970s to around USD 75 billion in recent years.

The launch of the ASEAN Economic Community (AEC) in December 2015 will usher in a new era of closer cross-border collaboration and facilitate business in the region. Although there are clear distinctions between the different countries within ASEAN, and the paths they are following to development are very different, there is a common optimism that the AEC will present opportunities for insurers in the region which will serve as a spur for transaction activity.

In addition, we expect new regulations on risk-based capital (RBC) will push consolidation activity. China is rolling out its version of Europe's Solvency II and Hong Kong is moving to a RBC model. While Singapore adopted an RBC framework more than a decade ago, it is currently considering a raft of further reforms.

Markets on the radar of those looking for international growth opportunities include the Philippines which, despite seeing little in the way of M&A to date, is maturing rapidly and may likely result in deals in the relatively near future. Meanwhile, after a number of difficult years characterised by economic challenges including rampant inflation and currency devaluation, interest is returning to Vietnam.

Finally, the region's last frontier, Myanmar, is continuing to open its markets in a number of industries, albeit gradually. Although the country remains essentially closed to international insurance, in May 2015 the government issued a licence to Japan's Tokio Marine to operate in the Thilawa special economic zone; we expect further licences to be issued in the coming years.

Case study:

Anbang's aggressive investment strategy

Following new insurance rules in China that permit companies to take a stake in more than one peer and the lifting of restrictions on the yuan being used for foreign investment, Anbang Insurance Group has extended its M&A drive at home and across the globe.

In a flurry of deals, Anbang's acquisitions represent a broader trend: Chinese firms' desire to target assets outside of China for growth. Anbang's notable acquisitions abroad include the purchase of the iconic Waldorf Astoria Hotel in New York City and Singapore's Blackstone Re Partners Asia LP. It has bought Belgian insurer Fidea Assurances, was the sole bidder for Woori – the second-biggest bank in South Korea – and is now looking at the London market.

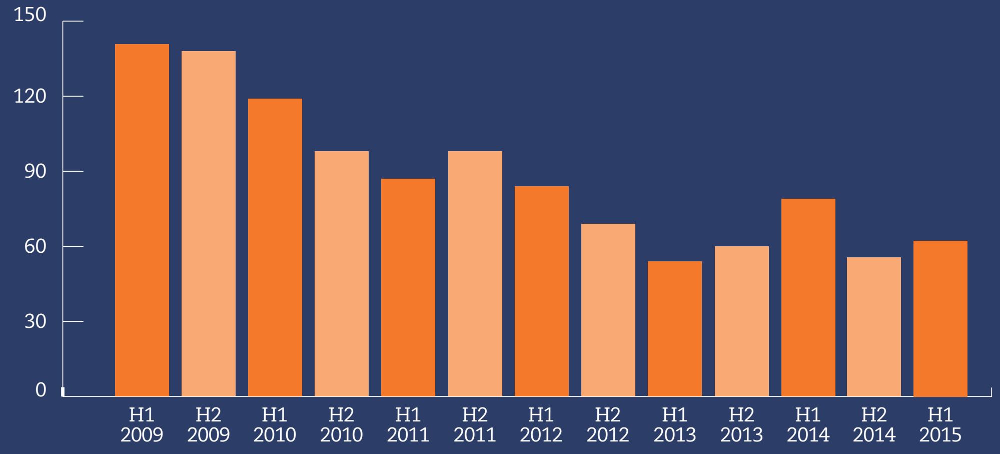
Moving forward, Anbang expects to increase the share of its overseas assets in asset allocation, making North America and Europe priority regions. "In ten years, Anbang will have companies on all the world's continents," said the company's Chairman, Wu Xiaohui.

Anbang's aggressive investment strategy is mirrored in the domestic market. In late 2014, it acquired Jiaxing Minfeng Group and it has built up a 20% stake in Minsheng Bank – China's biggest private lender – as well as sizeable holdings in other banks and property developers. Last year the firm raised around USD 8 billion through two private financing rounds, quintupling its registered capital in the process. With reports in the Chinese media suggesting Anbang is adopting a "Warren Buffett model", further acquisitions are likely to follow.

Europe

After a four-year slide, insurance deal-making in Europe saw a modest improvement in 2014 with 134 transactions completed, up from 114 in 2013, an 18% increase. However, despite the announcement of some major deals in other regions, activity in Europe has been patchy since 2014, and only 61 deals were closed in the first half of 2015, perhaps suggesting a potential decline in activity.

Volume of deals in Europe January 2009 – July 2015



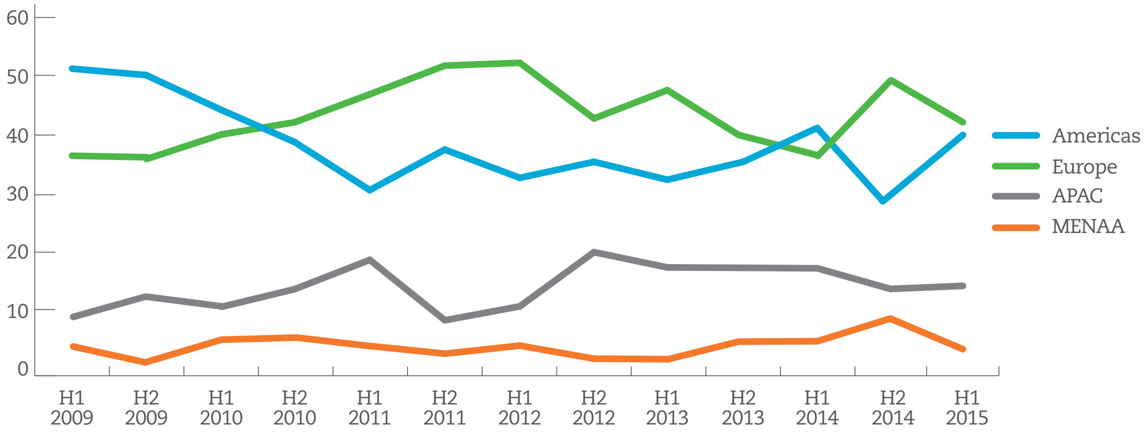
There have been some sizeable deals in Europe, for example the sale of UK-listed Catlin to XL for USD 4.2 billion – creating the world's eighth largest group in the reinsurance industry – and the purchase of Friends Life by Aviva for USD 8.7 billion. Nevertheless, these may prove to be an exception rather than the shape of things to come. Even the UK, where the majority of deals in the region are done, faces considerable ongoing uncertainty ahead of the referendum in 2017 as to whether it should stay in the European Union – this will undoubtedly affect corporate decision-making going forward.

However, the decline in M&A activity may be the result of the fact that Europe – particularly mainland Europe – is still beset with a number of uncertainties around issues such as regulation (e.g. Solvency II (SII)) and the overall economic picture in many Eurozone countries. While the first half of 2014 saw key economies in Europe start to show signs of sustained recovery, more recent events – for example in Greece and Russia – may have undermined that forward impetus. This cloud of uncertainty has delivered a strong "wait and see" attitude in many countries and has contributed to the lower number of deals.

Some of the recent M&A activity in Europe has been disposals in difficult circumstances. Some deals are still hangovers from the global financial crisis, but others are driven by problems that have occurred during normal operations. In France for example, the mutual-dominated health sector has become increasingly concentrated in anticipation of increased market and regulatory pressure and, in particular, the challenges of SII in terms of both capital requirements and governance. Other strategic imperatives included international expansion by foreign investors looking for growth opportunities outside their own, often stagnant, domestic markets.

> "A cloud of uncertainty has delivered a strong "wait and see" attitude across Europe.
>
> **Ivor Edwards, Partner, London**

Percentage of deals by region



Responding to change

Ongoing changes to legislation and regulation can both encourage and inhibit M&A activity. Most significantly in terms of change, however, the long, drawn-out introduction of SII has generated considerable debate about whether changing capital requirements will prompt the sale of assets. With the current start date of January 2016, it is likely that businesses will have to give this more serious consideration in the very near future and a spate of transactions may follow.

The area in which most SII-related activity was predicted was the legacy sector, where market participants anticipated that there would be significant potential. It was expected that 2015 would mark the year in which companies finally acted to reconsider their business models ahead of the imminent capital and regulatory burdens of SII. Although in some areas deal-making has been slow to get going, there is a sense that the impending legislation is driving interest in run-off solutions, particularly in mainland Europe, and the last six months have seen a noticeable increase in activity. Nevertheless, many feel that the real opportunities will only come once SII is actually in force and companies – especially medium or smaller insurers – are able to assess what it means for their business.

As with other sectors of the re/insurance industry, the entrance of new sources of capital is also adding an additional dynamic. Private equity has been no stranger to the legacy market in recent years – Stone Point is a shareholder in Enstar and Apollo Global Management in Catalina. In one example, in June 2014, UK-based legacy carrier Compre secured a private equity backer to replace Milestone Capital, which had put its stake up for sale, and in February 2015 CBPE Capital announced that it would acquire a majority share in the carrier from its management and Milestone.

The geographic focus of the legacy market is also widening. Activity is expanding from the mature legacy market in London, not just into mainland Europe, but also further afield. The recent announcement by Chinese investment giant, Fosun International that it is to invest in run-off portfolios as it seeks to expand its insurance asset portfolio is evidence of an increasingly global marketplace.

> The real legacy opportunities will only come once SII is actually in force.
>
> **Yannis Samothrakis, Partner, Paris**

Meanwhile, the US run-off market is expanding in terms of the number of acquisitions being carried out, and this may have an impact on future activity in Europe. According to Carolyn Fahey, Executive Director at AIRROC: "The tightening of the UK Prudential Regulation Authority's rules around schemes of arrangement and capital extraction is likely to further dampen run-off activity in London, increasing the attraction of doing deals in the USA." In addition, the Legacy Insurance Management Act introduced last year in Vermont to attract run-off business to that state mirrors many of the aspects of Part VII transfer rules used in the UK and could further fuel market appetite for North American run-off acquisitions, which can offer bigger books, bigger returns and more insurers with legacy book in a younger market.

There are also a number of developments on the horizon as alternative capital looks for opportunities to write legacy reinsurance deals, a trend that may be given further impetus by the current wave of consolidation of reinsurance companies. For example, one development might see private equity-funded shell companies write 100% retrocession policies for prior-year risks, providing a stop-gap to allow the liabilities in some books to crystallise and mature ahead of a potential sale. It may also give investors a guaranteed coupon period.

An unexpected change to the UK pension rules in 2014 caused disruption in the UK life sector. This saw the purchase by Aviva – the UK's largest insurer – of Friends Life for USD 8.7 billion – the biggest UK acquisition by value in the last 12 months. Changes were made to UK pensions to allow retirees to use their pension pots as they choose, rather than being forced to buy an annuity, a change which triggered a collapse in the annuity market. Friends Life for example reported a 15% drop in annuity sales following the announcement of the changes.

Building scale

The largest deal in Europe during the second half of 2014 was in Switzerland, with Helvetia acquiring compatriot Nationale Suisse for around USD 1.5 billion, creating a new insurance group with a leading position in the domestic market. In announcing the deal, the Chairmen of both companies alluded to the increased opportunities that the additional scale of the new combined entity would offer. This is further evidence of an on-going trend we have witnessed in Europe and other regions where deals are being driven by the desire to reach an optimal scale. Size appears to be becoming increasingly important, and balance sheet strength is seen as being critical to clients. Indeed, the second and third largest deals of the period – the acquisition in Portugal of Espirito Santo Saude for USD 809 million by Fidelidade-Companhia de Seguros SA and the purchase of CityLife SpA by Assicurazioni Generali SpA for USD 639 million in Italy – would seem to be further examples of this trend.

Seeking growth abroad

With many domestic markets stagnant, potential targets for M&A activity are currently in the developing economies where the middle classes are growing, and insurance buying is being driven by the need to insure increasingly valuable assets. Some of this activity is in the less mature but faster growing European markets, while Asia remains popular and Africa is seeing increased interest. Better capitalised firms in Europe are continuing to follow established routes such as acquisition or joint ventures into these emerging markets and they will seek to take advantage of their peers' withdrawals from the same markets. More specifically, insurance companies are looking at the best entry model, assessing which markets are core for their business and the benefits of taking on a local partner.

Aviva, for example, has focused on Poland in the last few years. In September, 2014 it bought 17% of the shares in the two joint ventures it has with BZ WBK in the insurance sector. The Polish economy boasts that it was the only member of the EU to avoid recession during the recent financial crisis, and its GDP is still expected by the International Monetary Fund to grow at a healthy 3.2% this year.

Meanwhile, in Asia, in August 2014 Allied World agreed to buy the Hong Kong and Singapore operations of RSA Insurance Group Plc for USD 215 million to expand its operations, especially in lines such as casualty, construction and marine.

> With each acquisition the choice among the remaining acquirable Lloyd's businesses becomes smaller and smaller.
>
> **Andrew Holderness, Partner, London**

"This transaction will significantly deepen and broaden our presence in Asia," said Scott Carmilani, Chairman, Chief Executive and President of Allied World, in a statement. These businesses were divested by RSA as part of its programme to regain investor confidence after an accounting scandal. In Malaysia, Generali acquired a 49% stake in Multi-Purpose Insurans Berhad for USD 103 million, a move that put it amongst the top ten P&C insurers of the country. The Group Chief Executive Officer of Generali, Mario Greco, commented: "Our entry into the Malaysian market marks an important step for Generali's development in Asia, an important area for the Group's future growth and where we are already investing. Malaysia is a market which is significantly growing and offers great opportunities, especially in the P&C segment."

There has also been a rise in acquisitions involving African targets, suggesting that the international insurance industry may finally be waking up to the continent's latent promise. In the second half of 2014 Swiss Re and the UK's Prudential both made acquisitions in Kenya, while French company AXA paid around USD 250 million for Assur Africa Holding Ltd in Nigeria and acquired 7% of Africa Re, the leading reinsurer in Africa for USD 61 million.

Testing the waters

If transactional activity is not high on the corporate agenda in the current economic circumstances, some European insurers are putting their toe in the waters of some different markets to look for growth. Chubb, for example, has recently started to look at the high net worth market in France – looking to build on its brand in the personal lines space. Another example is the partnership between AXA and BlaBlaCar to launch a first-of-its-kind ridesharing insurance product. With ridesharing moving from niche market to a more mainstream activity, this product – bought in addition to drivers' existing insurance – shows insurers responding to new trends.

Ever-reducing choice

The last 12 months have seen rather less transactional activity in the Lloyd's market than in previous years. The reason being that with each acquisition the choice among the remaining acquirable Lloyd's businesses becomes smaller and smaller. Anyone looking for opportunities therefore needs to consider a significant investment to buy one of the larger players, persuade private equity investors to exit at an acceptable price or acquire operations that might be considered sub-optimal.

An example of the first two categories was the purchase in February 2015 of Brit Insurance – the Lloyd's re/insurer – by Fairfax Financial Holdings for USD 1.88 billion, 1.6 times net tangible assets. Brit was 73% owned by the private equity arms of Apollo and CVC, who it is estimated made a 2.5 times cash return on their original investment. At the other end of the scale was the acquisition by Hamilton Insurance Group of Lloyd's insurer Sportscover Underwriting for a price estimated at between USD 10-15 million. Hamilton has announced plans to build-out its newly acquired Lloyd's platform with diversifying lines of business and scaled-up underwriting resources for a 2016 start, according to Chief Strategy Officer, Bob Deutsch.

There are however other routes available for businesses that are looking for a more gradual introduction to the Lloyd's market – and this includes the use of Lloyd's special purpose syndicates (SPS). For example, in February 2015 Beazley's SPS in partnership with Korean Re was given in-principle approval by the Lloyd's Franchise Board. This SPS will represent the first step in a longer-term strategic relationship between the two carriers and give each party access to business that it would not be able to source independently. Indian state-owned carrier GIC Re and Malaysian carrier Labuan Re have also established SPSs at Lloyd's, partnering with Catlin and Barbican respectively.

Case study:
Aviva/Friends Life

UK insurer Aviva PLC acquired insurer Friends Life in a deal valued at USD 8.7 billion. The merger represented the largest deal between UK insurance companies in more than six years.

The combined group will have 16 million customers in the UK, or a customer base of approximately one in four households. Contributing factors to the deal were the impending Solvency II requirements as well as the UK's new pension rules which led to a sharp drop in the sale of annuities. The government reforms put substantial pressure on pension providers and insurance companies like Friends Life and other smaller operators.

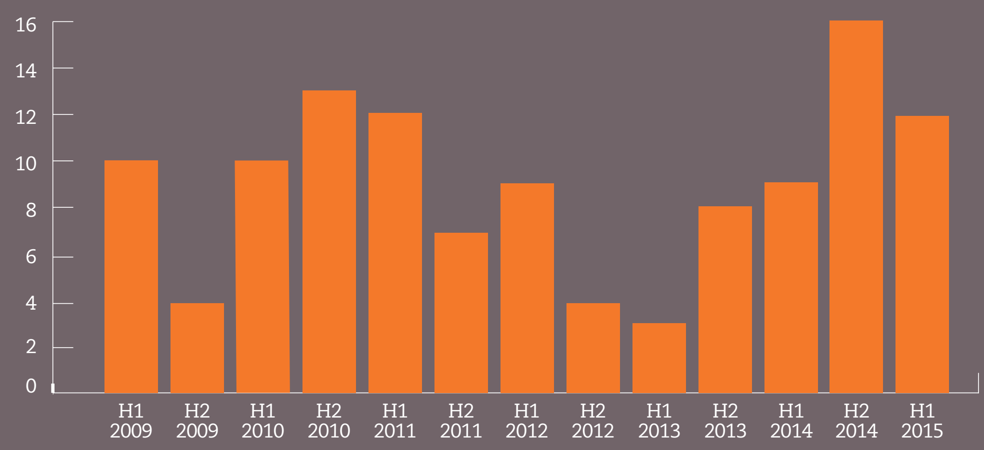
"We welcome shareholders' endorsement of the financial and strategic logic of this acquisition. This is the right deal at the right time for Aviva," said Group Chief Executive Officer, Mark Wilson. "The enlarged UK life business, to be led by Andy Briggs, will be an industry leader, well-positioned to serve customers in the vibrant UK life and pensions sector."

Middle East & Africa

M&A activity in Africa has continued to build over the last 12 months as the insurance industry wakes up to the continent's huge potential. Meanwhile, in the Middle East – long recognised as ripe for both domestic consolidation and foreign investment – recent developments suggest that green shoots are appearing in the transaction market.

There were 28 deals over the entire region in the period July 2014 to June 2015, up from 17 in the same period of the prior year. This comprised a healthy mixture of local, inbound and cross-border deals. With many insurance markets in the region offering significant opportunities, the search for growth via acquisition remains a key transaction driver. Regulatory developments too are helping to attract foreign investors while also driving domestic consolidation among smaller, less capitalised insurers. With new legislation recently introduced or pending in a number of jurisdictions, we expect more M&A to follow.

Volume of deals in MENAA: January 2009 – July 2015



Winds of change

After a relatively quiet second half to 2014, in the first part of 2015 there have been a number of deals involving entities located in the Middle East. Bahrain Kuwait Insurance Co acquired its compatriot Takaful International Co and, in Jordan, Yarmouk Insurance Co was bought by First Insurance Co. In another takaful deal, Dimah Capital Investment Co of Kuwait bought Bahrain's Tazur Co BSC.

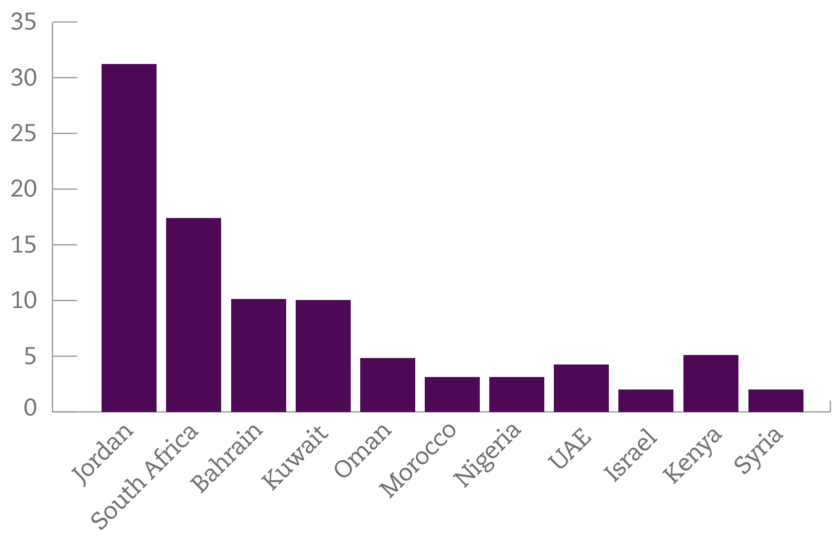
That deals are taking place is unsurprising. Economies in the Middle East are financially strong, underpinned by youthful populations and rising levels of wealth. Insurance markets remain over-crowded yet under-penetrated, with a proliferation of players. The larger businesses are looking to improve their returns on equity, while medium-sized operators are looking to protect market share and smaller insurers typically struggle with profitability, owing to their high expense bases.

However, a number of barriers to transactions exist, including structural issues as well as often mismatched price expectations between buyers and sellers. In the case of the former, the business landscape across the region is characterised by the proliferation of family businesses, many of which are large conglomerates with operations spanning a range of diverse industries. Inevitably, a level of rivalry exists, with any one family business reluctant to enter into a transaction with another that may result in conferring a potential advantage.

The situation is about to change. In the United Arab Emirates (UAE) new financial regulations were announced at the end of 2014 that became effective at the end of January. The introduction of a risk-based capital model – not dissimilar to Europe's Solvency II – will require the implementation of a raft of new systems and processes in order to ensure compliance. These changes will come attached with a significant cost which many of the smaller players – whose profit margins are slim – will likely be unable to afford. The net result could be forced consolidation in the industry.

Indeed, Ibrahim Al Zaabi, Director-General of the UAE Insurance Authority, has said that the regulator is encouraging M&A in the country's insurance sector and expects to see a number of deals completed at the end of 2017. In an interview with the Khaleej Times he said that the recently introduced insurance rules "will eliminate insurers with small amounts of capital" adding, "The implementation of these rules is the most critical challenge to the insurance industry."

Volume of deals in MENAA: January 2009 – July 2015



Wider optimism

It is not just domestic insurers with growth ambitions that are benefitting from a sense of renewed optimism. There were two in-bound transactions in the last year, both involving Bermudan entities taking stake in UAE businesses: Ironshore in Visionary Underwriting and Arch Reinsurance in Gulf Reinsurance Ltd. More may be set to follow.

Up to now in the UAE there have been challenges for international participant, as the rules have capped their ownership of local insurers at 25%. However, the regulator has suggested that there is a strong possibility that this limit may be raised to 49% in the near future. Such a move would see much greater scope for international participation in the UAE than there's ever been before.

Elsewhere in the Gulf Cooperation Council (GCC) – the political and economic alliance of Saudi Arabia, Kuwait, the UAE, Qatar, Bahrain and Oman – similar legislative changes are in the pipeline. Qatar has recently released a draft insurance law, the regulator in Saudi Arabia is also reviewing its requirements and in mid-2015 draft regulation was published that will bring to fruition a new financial free zone in Abu Dhabi, which will provide an alternative route into the market.

Meanwhile, international players have been continuing to come into the Dubai International Financial Centre (DIFC) – the federal financial-free zone situated in the UAE – where 100% foreign ownership of reinsurance entities is permitted. In December 2014 Beazley opened an office in DIFC to serve as a staging post in the region from which it can explore other options for entering into fronting arrangements with the local market. In a statement, Adrian Lewers, Beazley's Global Head of Political Risks and Contingency, said: "The Middle East possesses tremendous potential. Not only is it a region of healthy economic growth but much of this growth tends to be re-invested domestically – which in turn is driving increasing demand for insurance in the region. Having a presence on the ground will allow us to target markets across both the Middle East and North Africa, and deliver locally the highly specialised underwriting for which we are known in London."

In January 2015, Markel was also granted regulatory approval by the Dubai Financial Services Authority to operate within the DIFC, and in March Lloyd's officially opened its new specialist underwriting platform in Dubai. There are now nine Lloyd's syndicates with operations in Dubai and more are set to follow. A number of reinsurance brokers are also trying to establish operations in the region, and with the regulator itself having set the ambitious target of doubling the number of the insurance entities by 2018, these are exciting times.

Takaful developments

The fact that two of the deals this year described above involved takaful players is evidence of an interesting emerging trend. Up to now the takaful market in the Middle East has yet to really take-off and has been characterised by a high proportion of smaller players who have yet to build sufficient scale to get themselves on the map. With profitability an on-going challenge, those companies that are struggling to compete are potential acquisition targets.

Takaful businesses also need to comply with the new regulations in the UAE and it may be this that pushes them to seriously consider consolidation. According to a report on Reuters in April, several more Islamic insurers are seeking guidance from the UAE Insurance Authority on the possibility of M&A deals in the sector.

Takaful insurance is one of the eight pillars of the UAE's push to become the centre of the Islamic finance world. Later this year the regulator will establish a committee to oversee takaful insurance and help standardise the sector and monitor the products on offer. As these changes take hold we expect to see further M&A.

African interest

In our 2014 report we described an increase in deal activity in Africa and suggested that the international insurance community was finally waking up to the continent's huge potential. Twelve months on, this certainly appears to be the case; the total number of transactions involving African entities – either as targets or acquirers – has increased to 30 from 26 a year ago.

There are a range of drivers behind these deals. Regulatory developments such as the upgrade of solvency regimes in South Africa and Kenya are driving domestic consolidation as smaller insurers struggle to comply. Meanwhile, in Nigeria, new rules requiring banks to divest insurance subsidiaries or clearly separate them in a holding company structure has boosted M&A activity. Further afield, private equity firms raised an estimated USD 4 billion for investments in Africa in 2014, which could act as a further spur for deal-making in the insurance sector, according to Swiss Re.

International insurers are increasing their interest across the region; Nigeria and Kenya are particularly attractive because of their size and rapid economic growth. In the last 12 months Swiss Re bought a minority stake in Kenyan insurance group Apollo Investments Limited for an undisclosed fee, while in the same country the UK's Prudential bought out life insurer Shield Assurance Co Ltd. Meanwhile France's Axa paid almost USD 250 million to acquire Nigeria's Assur Africa Holding Ltd. AXA's presence in Africa now consists of operations in Cameroon, Gabon, Ivory Coast, Morocco, Senegal and Algeria.

Others have opted for a different route. According to a senior official of the Kenyan regulatory agency in comments to Commercial Risk Africa, Allianz is in the advanced stages of being granted a licence to start-up operations in the country, hot on the heels of Barclays Life which was granted one in April. Shortly afterwards, in June, Barclays announced that it had struck a deal to acquire a 63% stake in First Assurance – the tenth largest general insurer in Kenya – for around USD 35 million. Lanz Zulu, a Managing Executive at Barclays Africa, described the rationale behind the move:

"The planned acquisition of First Assurance provides us with a strong platform to expand our bancassurance offering in East Africa and complements our target of increasing revenues in Africa outside of South Africa to between 20 and 25%."

> "New regulations in a number of Middle East markets are set to drive consolidation in the industry.
>
> **Peter Hodgins, Partner, Dubai**

A range of markets

It is not just Kenya and Nigeria that are seeing deals; M&A in North Africa also continues. Morocco has seen a combination of domestic consolidation and outbound transactions – mainly into Nigeria – in the last 12 months. At the same time while activity in Turkey has temporarily cooled – there was just one domestic deal in the period – this lull is likely to be only temporary. The insurance market in Turkey grew by 22% per annum between 2001 and 2012 and the OECD estimates that Turkey will be the third highest growing economy after China and India by 2017. International investors are watching the country with interest.

Meanwhile, after a spate of outbound deals last year involving South African acquirers, the pace has slowed with just one deal of this type in the last 12 months, Discovery Ltd's deal to take control of Prudential Health Holdings Ltd for around USD 246 million. The acquisition was described in a statement as part of Discovery's strategy to have the UK as its second home market. The Chief Executive Officer, Adrian Gore, emphasised the company's ambition: "Increased investment in the UK has always been part of our longer-term strategy. It will afford us the opportunity to realise our vision to further entrench our insurance model and to be recognised as the best protection provider in the UK." This trend for developing economy insurers looking to move into mature markets is only likely to accelerate as markets across Africa continue to develop.

Case study:

Prudential strengthens Africa platform

Following its move into Ghana, London-listed Prudential underlined its ambitions in the African market with the acquisition of Kenyan life insurer Shield Assurance. Prudential intends to make Nairobi the headquarters of a strategic new East African division and plans to invest up to USD 15 million in the company over the next 12 months and create around 4,000 jobs by 2020.

This is Prudential's second shot at the Kenyan market. It had operated an insurance firm in East Africa since 1930, but was forced to leave the Kenyan market in 1990 due to what it called a "harsh operating environment; a weak regulatory regime and restrictions on capital account transactions."

Times have changed. "We are delighted that more recently successive regimes and regulators in Kenya have adopted an open, pro-enterprise, pro-growth approach," said Charles Mangee, Chief Executive of Prudential Kenya. "Kenya has a youthful, increasingly affluent population, a highly trained workforce and robust, positive economic growth."

Insurance penetration is still very low, around one to two per cent of GDP compared to some countries in Europe at six to eight per cent. With 20% growth per annum, in 2013 Kenya was the fastest growing insurance market in Africa and the second fastest in the world, behind Jordan. Other international insurers are likely to move into Kenya. Meanwhile, Prudential is already moving on to the next stage of its African journey, with plans to launch operations in Uganda.

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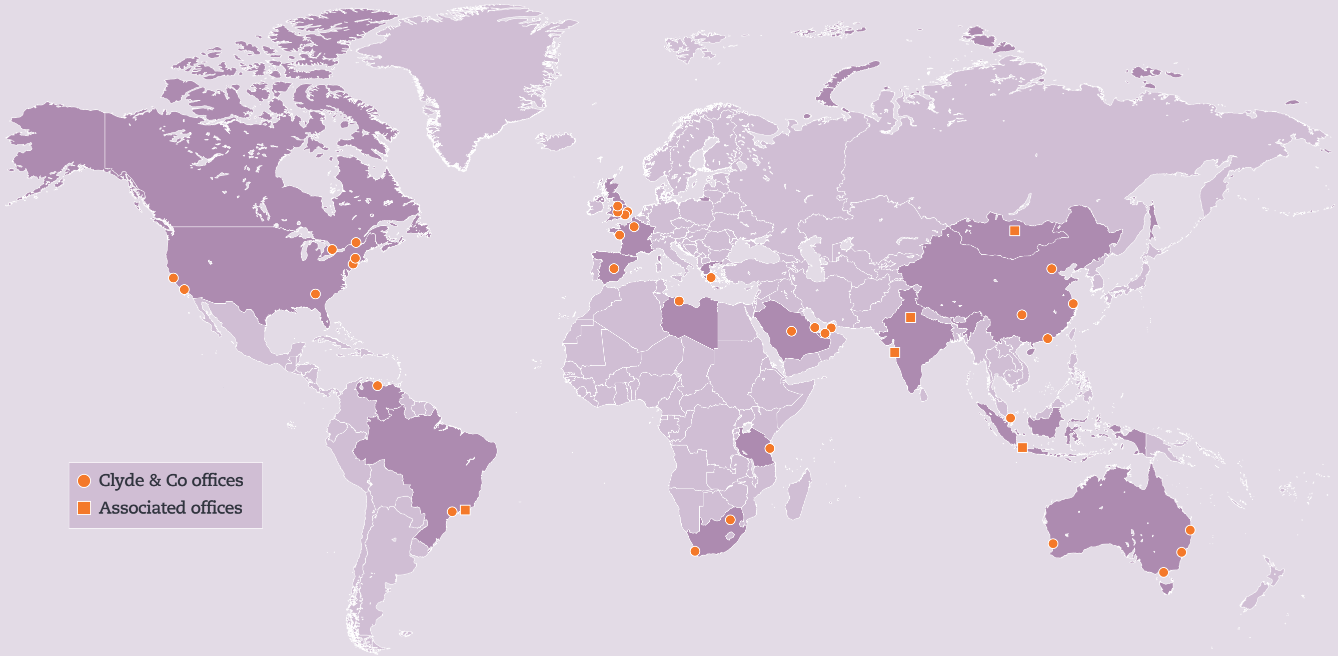

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