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Economic Confidence, Dry Powder To Prompt Insurance M&A

By **Chelsea Naso**

Law360, New York (April 10, 2014, 4:08 PM ET) -- Merger and acquisition activity in the insurance market will get a boost in the coming months as the improving economy and growing interest from private equity firms laden with unspent capital allow companies to finally ditch financial crisis woes and begin expanding services, experts say.

A recent survey of 75 insurers and reinsurers by Mayer Brown LLP in association with Mergermarket found that after several years of "tepid" transaction volume, 88 percent of respondents expect deal activity in the property and casualty sector to rise, while 87 percent anticipate the same for life insurance.

The main drivers of M&A activity in the global insurance market are the growing economy, limited ability for organic growth and the desire of private equity firms to plunk down dry powder, according to Mayer's Global Insurance M&A Outlook, which examined the factors that impact M&A appetite and activity in the property and casualty and insurance sub sectors.

"It's been a bit in the doldrums," said Eddie Best, a Mayer Brown partner who heads the firm's capital markets and financial institutions practice and helped develop the report. "A budding economy is going to make the industry better and make more people willing to take the risk of investing."

Stronger Economy Offers Assurances

The economy is showing signs of recovery, dishing out confidence to weary companies that made it out of the financial crisis alive. The report found that roughly 68 percent of those surveyed said the current upward direction of the economy is one of the main reasons insurance companies are once again considering more M&A.

With the worst perceived as being over, insurance companies, particularly in the property and casualty and life lines, are beginning to re-examine the potential benefits of a merger or acquisition, explained Todd Freed, a Skadden Arps Slate Meagher & Flom LLP partner who serves as co-head of the firm's financial institutions group.

"Now that the macroeconomic environment has stabilized and shows signs of real improvement in the U.S., insurance companies, particularly in the property and casualty and life insurance sectors, are accelerating their M&A activity," Freed said.

A growing economy can also stabilize an insurance company's balance sheets, making the possibility of a deal a more viable, and attractive, option, according to Debevoise & Plimpton LLP financial institutions partner Marilyn Lion.

"As the economy improves, insurance companies themselves find their financial position is improving, and they can deploy their capital in M&A," she said.

Organic Growth Unlikely

Even though the economy is on the mend, organic growth in the insurance market remains a challenge. This will drive more insurance companies toward small and mid-market transactions that add value by expanding geographic reach or service offerings to meet increasing demand from a growing middle class and an aging population, the report found. Of those surveyed, 47 percent said they anticipated inking deals that range between $100 million and $250 million, the report said.

Desire for geographic growth is expected to be particularly strong for property and casualty insurers looking to build revenue by broadening their potential customer base and selling more plans, with 29 percent of respondents indicating that geographic expansion will be a top driver of M&A over the next 12 months, the report found. Many companies are also mulling "bolt-on" acquisitions of particular product lines, the report said.

"Everybody is looking for growth. You either charge more for the same product or sell more product," said Best.

Bolt-on acquisitions offer an alternative to the costs associated with trying to snap up human capital or the transformations that can come with larger deals. These transactions offer an opportunity to supplement or expand services, like MetLife's expansion into emerging markets with its $2 billion acquisition of Banco Bilbao Vizcaya Argentaria SA's Chilean pension business.

"The pressure on insurance companies to expand either geographically or through a 'bolt-on' acquisition of particular lines of business highlights how competitive the insurance market is," Freed said. "While some companies may still be hesitant to engage in a 'bet the company' M&A deal, targeting particular lines of business or geographic areas is a relatively safe bet and is very appealing for companies looking to accelerate organic growth."

PE Firms Look to Invest Dry Powder

On the surface, several factors might deter a private equity firm or an alternative investment vehicle from investing in an insurance company. The insurance industry is heavily regulated throughout the world, and changes to capital requirements for insurers, like Europe's Solvency II, can add an extra hurdle to navigating a successful investment. It has also prompted some of the larger companies to divest.

"The concern about increased regulation about large systemically important financial institutions, which some consider insurance companies can be, can deter people from wanting to invest," said Larry Hamilton, a partner in Mayer Brown LLP's corporate and securities practice and insurance industry group who helped create the report.

However, private equity is expected to be a major stimulant for M&A activity in the insurance market, as firms have significant dry powder waiting to be invested and insurance investments can often offer more predictable returns. According to the report, about 88 percent of respondents anticipate private equity activity will increase in the life subsector, while an even larger 93 percent of respondents think it will increase in the property and casualty subsector.

The survey also noted that 68 percent anticipate private equity firms to be among the most active buyers in life insurance, and 71 percent believe they will be the most active in property and casualty. About 55 percent of respondents also expect private equity buyouts to be the most common deal type in life insurance, and 60 percent in property and casualty.

“We have seen a lot of private equity and alternative assets interested in getting into the space of insurance. We’ve seen very competitive auctions for some of these divestitures. Private equity buyers have the cash to invest in the industry,” said Lion. “There’s also a perception that a private equity firm would be able to correct some of the inefficiencies there due to the current interest rate environment.”

--Editing by Kat Laskowski and Philip Shea.
