At the beginning of 2020, we published our 2020 insurance M&A outlook: Pursuing growth amid uncertainty. In terms of uncertainty, no one could have imagined the degree of uncertainty and volatility we are experiencing in the economy more broadly. As one would expect, this has had a negative impact on new mergers and acquisitions (M&A) activity in the insurance sector. In our article, we discussed several factors that could affect insurance M&A in 2020; however, these factors have been overshadowed by the far-reaching influence of COVID-19. This impact has caused M&A headwinds in the form of the economy, interest rates, and financial market uncertainty. The post-COVID-19 world may unleash structural and systemic changes across multiple industries, and it is widely expected that recovery will be highly asymmetric across regions and sectors. Most industries, including insurance, will need to reinvent themselves in order to thrive and M&A activities are expected to have a strong influence in shaping the “next normal” environment.

In this update, we revisit some of the key factors we identified in our 2020 insurance M&A outlook and their potential to affect insurance M&A in the second half of 2020 through 2021. We also consider additional factors that have risen over the past six months and provide a historical perspective. Based on our perspective, most significant transactions that were in flight prior to the partial closing of the economy continued to close.

Portfolio optimization: COVID-19 has forced many insurance carriers to hit pause on new M&A activities and focus on preserving capital. In this regard, the recent property and casualty (P&C) price hardening in the US commercial insurance sector should aid in this effort (for example, for Q1 2020, the aggregate price change reported by US commercial insurers exceeded 6%, compared with Q1 2019).1 As such, this may be an optimal time for carriers to reevaluate their product and service portfolio and plot the path of greatest organic growth. However, in considering the history of a hard market, this may exist over a limited time period, so carriers should continue to strategize how to achieve profitable growth on the downside of the pricing cycle.

In addition, the economic shift experienced over the past six months may have a long-lasting effect on the P&C sector, whether it is through government-backed pandemic insurance, rebates, disruptions to exposure and cost trends, or new interpretations of coverage language. As insurance carriers assess how to manage coverage exclusions related to viruses like COVID-19, the pandemic will likely disrupt investments, finance and capital, underwriting, claims, and actuarial functions due to catalytic events ranging from the closure of nonessential businesses to changes in state and federal regulations.

Further, COVID-19 is causing life and health (L&H) and life and annuities (L&A) insurers to refresh macroeconomic scenarios and assumptions for current market conditions, as well as a potential prolonged economic downturn.
recession and low-interest-rate-spread environment. Companies are further considering whether the use of extreme economic scenarios would yield reasonable results and how to position their products while considering interest rate sensitivity and outlook for capital position.

The aforementioned factors may force insurance carriers to make strategic choices in terms of evaluating their core offerings and disposing of noncore operations. Disruption tends to create M&A opportunities, and we expect that to be the case in the second half of 2020 and in 2021. A Deloitte survey of insurance industry executives (which was conducted prior to the pandemic) found that more than half expect to complete an M&A transaction in the next two years. Some companies may need to consider radical actions, including distressed asset sales, to salvage value from loss-making divisions and preserve the viable core business. Companies that have a strong balance sheet but expect a significant degree of structural disruption could use M&A to safeguard their customer base and accelerate long-term transformation of their business model.

The insurance brokerage industry continues to remain relatively active in M&A, even during this time of uncertainty, although the pace of consolidation has decreased compared with the same period in the prior year. From March 31, 2020, to June 30, 2020, there were 94 deals completed, compared with 142 deals over the same period in 2019. As this sector is capital-light, the impact of the previously mentioned factors are less severe than that experienced by underwriters.

**Customer experience:** Due to the economic slowdown, customers may be more likely to reduce or cancel coverage. As a result, a carrier’s ability to retain existing customers will be an increasingly important driver of financial results. Some carriers will have more opportunities to leave customers with positive experiences, as there is expected to be an increase in request volumes (especially in areas such as billing and policy changes) as customers look for additional flexibility to support their response to the slowing economy. Being able to respond to customers quickly through digital capabilities can help carriers make these “moments that matter” and encourage customer loyalty. For example, COVID-19 has increased the benefit of contactless technologies, with leading P&C insurers advancing remote claims capabilities, including accelerating toward using remote adjusting and drones. This inward focus may cause some insurers to hit pause on their M&A activity until a greater degree of economic uncertainty is perceived.

**InsurTech market:** 2019 presented a high-water market for InsurTech investment over the past decade ($5+ billion). After a slow start in Q1 2020, investment ramped up due to larger deals for later-stage companies, such as the IPO of Lemonade Inc.

As insurers move toward late 2020 and into 2021, we believe there may be an increase in insurance carriers acquiring and partnering with InsurTechs. This is because InsurTechs may have a greater willingness to partner or be acquired due to the uncertain economic outlook, and carriers seeking to quickly respond to a rapidly changing world (such as an increased need for virtual or touchless claims) may find InsurTech investment a more appealing allocation of capital than investing in the current low-interest-rate environment.

InsurTechs can also be involved at the other end of the M&A spectrum, where they become acquirors of small carriers. For example, Hippo Analytics Inc., a P&C-focused personal lines broker, announced on June 3, 2020, its acquisition of the carrier Spinnaker for an undisclosed sum. Another example is the workers’ compensation InsurTech Pie Insurance, which raised $127 million in May 2020, in a new round; of this, $100 million was earmarked to purchase a licensed insurance company or start a new one. While these InsurTechs may decide to vertically integrate, it remains to be seen if this type of M&A will gain momentum in 2020 and 2021.

**Insurance innovation:** The ability for most cross-sector insurance carriers to smoothly respond to COVID-19 by shifting to a work-from-home environment served as a positive referendum on recent digital and communications investments. For an industry that can sometimes be slow to embrace change, the quick action has been noticeable.
Looking ahead, the imperative for insurers to innovate has accelerated from a need to prepare for tomorrow to a need to compete today. Insurers across sectors are seeking to answer fundamental questions that structurally change how business is being completed, including selling and servicing customers without the benefit of person-to-person contact. The ability to perform tasks such as remote physical screenings and virtual claims will likely no longer be seen as a differentiator, but a required capability for operating in the market. In light of these changes, insurers need defined approaches for analyzing buy versus rent or build decisions, as partnering or acquiring with other companies may be more efficient and less risky than building capabilities internally.

**Role of private equity:** Private equity investors (PEIs) are playing increasingly important roles as managers of insurance company assets, which has implications for both the insurance M&A market and the private equity fund investment space. For L&A insurers especially, the average time period between the receipt of premiums and the payouts of claims can be many years, meaning that an insurer’s profitability will be driven in large measure by its success in investing the premiums it collects. PEIs may utilize their investment expertise to mitigate the effect of low interest rates and improve net spreads. With the relatively recent success of this asset management play, whereby the PEI assumes the role of asset manager for the insurance company, it is expected that there may be an uptick in this type of relationship.

Further, given the rate hardening in the commercial P&C sector, PEIs may be interested in looking at select opportunities in that sector. Based on our observations, these targets will likely be in the specialty segment of the commercial P&C market, as this is the sector that is expected to experience the biggest uptick in pricing. As stated above, the insurance broker market, while experiencing a slowdown during COVID-19, did remain active, and almost 50% of the deal volume in the first six months of 2020 was driven by PEIs and PEI-backed established aggregator platforms.

By some estimates, the private equity sector has approximately $2.5 trillion worth of dry powder ready to be deployed on opportunities. Also, downward economic cycles present unique opportunities for M&A (the private equity funds of 2008 and 2009 vintage were the best-performing funds in 20 years, since they invested during the depth of crisis). However, not all of the dry powder may be used for M&A activities. As the turmoil in the marketplace continues, many private equity clients are evaluating private investments into public equity (PIPEs) as a way to deploy capital, given the depressed valuations of and limited credit options available for public companies. These transactions usually do not provide the ability to control, but may provide ability for PEIs to influence.

**Past as guide:** In considering the potential severity and the longevity of the current economic environment, we reflected on the last period of significant economic distress and the subsequent recovery period. While we consider the 2009 crisis a guide, given differences in the current efforts to support the broad economy (significant stages of federal stimulus have been legislated) and recent strong economic performance, we may be poised for a quicker recovery, which is evident in some industry metrics.
recovery was observed. For insurance brokers, the SNL US insurance brokers index regained most of the losses for 2020, ending at 2,150 on June 30, 2020, compared with an index value of 2,204 at the beginning of 2020. As of June 30, 2009, the index was 473, versus 581 a year prior, approximately 20% lower.

While we are currently observing a more rapid recovery in terms of market multiples compared with what was experienced during the 2009 crisis, the significant level of uncertainty in the current market has caused M&A activity to decelerate. In 2009, there was an observable decrease in the number of insurance underwriter M&A transactions of 12%, but the deal market reverted to normal activity in 2010. While the insurance broker market has remained active during the first six months of 2020, it did experience a decrease compared with the same period in 2019, 249 transactions versus 324 (a decrease of more than 20%). Comparing this to the 2009 crisis, there was also a revision to the norm in 2010, with 100 broker deals completed in the first half of 2010 versus 92 deals in the same time period of 2009.8

Offensive and defensive moves:
Although economic uncertainty remains, the rapid recovery of the insurance sector may point to a return to the M&A activity experienced in 2019 in 2021. This presents insurance companies and brokers with an opportunity to expand their growth matrix via both inorganic and organic activities while maintaining the goals of portfolio optimization, customer connectivity, and innovation referenced above.

Unprecedented times create opportunities—which may explain why M&A could play a critical role in postpandemic business strategy. Some companies may be more eager and better equipped than others to eye M&A. Insurance plays a unique role in protecting the downside risk of its customers across all markets and sectors, and carriers may need to evolve their products, services, and capabilities to support significant systemic change across its customer base. Most sectors will need to reinvent themselves to thrive, which will likely have an impact on how insurance carriers respond. To do so, companies will likely need to explore a range of inorganic growth strategies, de-risking their approach to M&A by broadening their activities to include partnerships with their peers, coinvestments, and cross-sector alliances based on fit.

Yet, even as their company’s business model may be changing, insurance leaders need to evaluate prospective deals based on their strategic fit, as opposed to bargain pricing. That fit has to consider the changes occurring within and across industries that have reframed strategic considerations in insurance companies’ abilities to pursue M&A, whether doing so defensively or offensively. Companies can deploy a revised set of strategic choice options and scenario-planning tools to help identify the new capabilities they require and prioritize the markets where they need to operate in order to safeguard their future and drive growth.
Endnotes


4. Deloitte Center for Financial Services analysis using data from Venture Scanner.


8. Ibid.

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