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Introduction

The stage is set for the continuation of an active insurance industry M&A environment in 2019. Sustained US economic growth, rising interest rates, and higher investment income are among the positive factors bolstering insurance companies’ results in 2018 and positioning them for enhanced top- and bottom-line growth in 2019.1 In addition, debt rates are relatively low, available capital remains abundant, and 2018 deal volume and value are supportive of sustained and/or increased deal-making. One factor likely to be a potential influencer—either positive or negative—is the whipsawing stock market. If falling prices and sell-offs extend far into 2019, they may spur companies with strong balance sheets to scoop up distressed assets or, conversely, ratchet up corporate uncertainty and reduce M&A activity. Of the two possibilities, we anticipate an uptick in M&A, given current industry dynamics.

This report looks back at 2018 and explores key trends and drivers for 2019 to help insurance executives plan their M&A strategy as they position their organizations for growth. And while we continue to focus primarily on conditions and activity in the United States and Bermuda, we are broadening our view to include an appendix with snapshots of insurance M&A in several other global markets.
2018 in review

At the beginning of 2018, we expected that insurance M&A aggregate deal volume and value would remain consistent with recent history. We also anticipated that the deal flow would comprise primarily transactions less than $2 billion, although we did expect to see a handful of transactions greater than $5 billion. The year’s deal-making activity supported our prognosis, with virtually all subsectors showing solid performance across deal volume, aggregate deal value, and average deal value (figure 1).

At the summary underwriter level, the 87 recorded transactions through December 31, 2018, represented a modest (4 percent) year-over-year (YOY) improvement on 2017’s 84 deals. However, underwriter aggregate deal value took a steep upward swing—it increased an impressive 189 percent YOY, from approximately $15 billion to approximately $43 billion, driven by two significant property and casualty (P&C) deals: AXA’s $15.3 billion acquisition of Bermuda-based XL Group, creating the largest global P&C commercial lines insurer based on gross written premiums; and American International Group’s (AIG) $5.5 billion acquisition of Bermuda reinsurer and specialist insurer Validus. 2018 brokerage deal volume continued to impress after a record-setting 2017, with 594 recorded transactions through November 16 (up 11 percent YOY) and a 50 percent increase in aggregate deal value.

Figure 1. Insurance sector M&A activity, 2017–2018 (US and Bermuda)

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<th>Number of deals</th>
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<tr>
<td>L&amp;H</td>
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<td>26</td>
</tr>
<tr>
<td>P&amp;C</td>
<td>53</td>
<td>61</td>
</tr>
<tr>
<td>Brokers</td>
<td>537¹</td>
<td>594²</td>
</tr>
<tr>
<td>Total</td>
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<td>681</td>
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</table>

Source: Deloitte analysis using SNL Financial M&A database
1. 2017 and 2018 represent full calendar year 2017 and 2018, respectively.
2. Includes Lincoln/Liberty Life Assurance ($3.3b); Resolution Life (Parent in UK)/AMP Limited Australia ($2.3b); Western & Southern/Gerber ($1.5b)
3. Includes transactions: AIG/Validus ($5.5b); AXA/XL ($15.4b); Apollo/Aspen ($2.6b); Bain/Esure ($1.2b) and Hartford/Navigators ($2.2b)
4. Includes Apollo/Aspen ($2.6b); Bain/Esure ($1.2b) and Hartford/Navigators ($2.2b)
5. Includes Marsh & McLennan/Jardine ($5.5b); Brown & Brown/Hays ($740m)

Notable 2018 P&C transactions included the previously mentioned AXA/XL Group and AIG/Validus deals, as well as Kemper Corporation’s acquisition of Infinity Property and Casualty Corp., a provider of auto insurance focused on serving the specialty, nonstandard segment, for $1.4 billion. In the life and health (L&H) subsector, Lincoln Financial Group’s $3.3 billion acquisition of Liberty Mutual’s group benefits business, making the combined company a group benefits market leader, is an example of sellers using M&A to clean up their balance sheets by exiting noncore business, and buyers expanding on their niche business.
In addition, the rising interest rate environment attracted private equity (PE) firms and other financial sponsors to L&H in 2018. Voya Financial’s closed block variable annuity (CBVA) and its entire individual fixed and fixed indexed annuity businesses.

PE firms are especially focused on the insurance sector, in part, because of US tax reform’s reduced corporate tax rate.

**Insurance underwriters**

As stated above, the number of underwriter deals through December 31, 2018, increased slightly—4 percent—from 2017. However, this represented the second-most active M&A market since 2013. In addition, as figure 2 illustrates, 2018 aggregate deal value was second behind 2015 over the period presented, with the average P/BV multiple showing only a slight decline from 2017. 2018 also saw a surge in large deals in the underwriting space: six transactions with value in excess of $2 billion were announced; there were none of this magnitude in 2017.

**Figure 2. M&A trends for insurance underwriters**

**Insurance underwriter transactions**

Price-to-book value multiples

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<tr>
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<td>5.99x</td>
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<td>2.53x</td>
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</tr>
</tbody>
</table>

Source: Deloitte analysis using SNL Financial M&A database

- Transactions grouped by the year they were announced.
- Deal multiples represent closed multiples, unless the transaction is still pending close.
- Outliers have been removed from the average deal multiples. Outliers include all deals with a P/BV multiple smaller than 0.5x or greater than 3.0x.
- Analysis as of 12/31/2018.
- SNL has noted that some numbers may not reconcile to prior years as there may be a lag between deal public announcement and disclosure.
Life and health

2018 L&H M&A deal volume fell by 16 percent compared to 2017; however, aggregate deal value continued an upward trend begun in 2016 (figure 3). 2017 saw several deals completed in L&H space in excess of $1 billion; however, there were no 2018 deals announced in excess of $2 billion. We observed that, whereas the total deals announced greater than $1 billion decreased from four to three, there were two transactions announced with deal values in excess of $2 billion.

The upward trend may continue. Life insurance and annuities companies may see more financial rather than strategic investors in 2019, as rising interest rates make them increasingly attractive assets.⁹

Figure 3. M&A trends for life and health

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Source: Deloitte analysis using SNL Financial M&A database
- Transactions represent US and Bermuda companies making acquisitions on a global basis and international buyers making acquisitions in US and Bermuda.
- Transactions grouped by the year they were announced.
- Deal multiples represent closed transactions, unless the transaction is still pending close.
- For years 2007, 2009, 2010, 2013, and 2014 there is only one deal with data, respectively.
- Outliers have been removed from the average deal multiples. Outliers include all deals with a P/BV multiple smaller than 0.5x or greater than 3.0x, except in 2016.
- Analysis as of 12/31/2018.
- SNL has noted that some numbers may not reconcile to prior years as there may be a lag between deal public announcement and disclosure.
Property and casualty

2018 P&C M&A deal volume increased considerably from 2017—up 15 percent. Aggregate deal value increased 316 percent, as the P&C sector garnered the year’s most insurance industry activity. This was driven by, among other factors, the need for P&C companies to increase growth in the low-to-no rate adjustment environment and the desire to diversify into niche markets. Figure 4 illustrates that this sector experienced aggregate deal values at levels only observed in one year (2015) over the time period analyzed. We also noted that there was a decrease in the deal multiple observed compared to 2017; buyers, while still willing to pay a premium to book, appeared to be cognizant of the ROI that would need to be presented to stakeholders in a challenging environment. Still, P&C sector activity was heavily influenced by transactions in excess of $1 billion, with eight deals of this size being announced in 2018, of which four were in excess of $2 billion—a significant change in deal composition compared to 2017, where we saw only two transactions announced with consideration in excess of $1 billion and no deals in excess of $2 billion. So, while investors might have been more aware of their ROI, some also chose to swing for the fences and execute on transformative deals.

Figure 4. M&A trends for property and casualty

Property and casualty transactions
Price-to-book value multiples

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<td>1.56x</td>
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<td>1.29x</td>
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<td>1.97x</td>
<td>1.53x</td>
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</tbody>
</table>

Source: Deloitte analysis using SNL Financial M&A database
- Transactions represent US and Bermuda companies making acquisitions on a global basis and international buyers making acquisitions in US and Bermuda.
- Property & Casualty include P&C, Multiline, Title, Mortgage Guaranty, and Finance Guaranty sectors covered by SNL Financial.
- Transactions grouped by the year they were announced.
- Deal multiples represent closed multiples, unless the transaction is still pending close.
- For 2004, there is only one deal with data.
- Outliers have been removed from the average deal multiples. Outliers include all deals with a P/BV multiple smaller than 0.5x or greater than 3.0x.
- Analysis as of 12/31/2018.
- SNL has noted that some numbers may not reconcile to prior years as there may be a lag between deal public announcement and disclosure.
Insurance brokers

2018 broker deal volume achieved another milestone: With 594 announced transactions it was the most active year on record. Aggregate 2018 deal value increased by 50 percent from the previous year (figure 5), driven by the Marsh & McLennan/Jardine transaction. This put the aggregate deal value at levels not observed over the period analyzed. In addition, average deal value also increased 26 percent from 2017 ($194 million to $245 million). Similar to prior years, we observed that there were several players in this space that are very acquisitive—five companies announced more than 20 acquisitions in 2018.

Figure 5. M&A trends for insurance brokers

Insurance broker transactions
Aggregate deal value

Source: Deloitte analysis using SNL Financial M&A database
• Transactions represent US and Bermuda companies making acquisitions on a global basis and international buyers making acquisitions in US and Bermuda.
• Transactions grouped by the year they were announced.
• Analysis as of 12/31/2018.
• SNL has noted that some numbers may not reconcile to prior years as there may be a lag between deal public announcement and disclosure.
2019 outlook

2019 insurance M&A aggregate deal volume and value should remain generally consistent with that of 2018 as companies continue to seek nonorganic growth—absent continuing stock market upheavals, a large catastrophic event for P&C, a decrease in interest rates for L&H, or the early onset of an economic downturn (see sidebar) that could dampen deal-making.

We anticipate that life insurance and annuities companies may see more financial rather than strategic investors in 2019, as rising interest rates make them increasingly attractive assets. PE groups appear to be particularly bullish on insurance entities with a sizable asset base, such as annuities providers. Meanwhile, continued soft rates could drive larger P&C acquisitions in 2019 to increase market share, diversification, and growth in niche areas.

Among potential acquisition targets are midsized reinsurance companies (a continuation of 2018 activity), smaller personal lines companies, and niche specialty companies and InsurTechs that offer bolt-on capabilities for larger insurance companies.

We see potential 2019 insurance transactions generally falling into five buckets:

• Cross-border deals. US-based insurers that have benefited from reduced corporate tax rates may use some of their gains to purchase Bermuda-based companies that are not faring well under the new US tax laws. Asia may also yield acquisition targets for US buyers and Canadian firms on the life side. Meanwhile, foreign interest in the US insurance market could ramp up inbound M&A. Following the AXA/XL deal, more European companies may look to grow their US presence to offset limited organic growth at home. However, relatively high market valuations may make it more likely that Japanese players seeking to expand beyond saturated local markets will dominate, as they historically tend to take a longer view in return models.

Are signs pointing to a slowdown or recession in 2020?

While 2018 and 2019 are shaping up to be banner years for insurers, some concerns are being raised about an economic slowdown, if not a full-fledged recession, as early as 2020. Some early 2019 economic indicators may be pointing in that direction: the World Bank cut its growth forecast; China is investing hundreds of billions of dollars in its slowing economy; Apple’s downgraded sales forecast, which led to a market sell-off, was one of several companies’ warnings of earnings issues.

According to Deloitte’s 2019 Insurance Industry Outlook, many are worried about the potential for ongoing disputes between the United States and China as well as other nations over tariffs and trade rules. Meanwhile, some expect the economic stimulus from federal tax cuts and additional government spending to peter out by 2020, while rising interest rates could perhaps discourage consumer borrowing, housing construction, and business expansion. Vanguard recently warned that the chances for a recession by late 2020 are between 30 and 40 percent. One warning sign cited by economists was a flattening yield curve between short- and long-term interest rates—a development that has historically indicated a recession ahead.
• **Middle-market match-ups.** For many years, middle-market personal lines and small commercial insurers (those between $500 million and $2 billion in size) were content with their role as community or niche players in the insurance value chain. However, with InsurTechs changing the customer relationship narrative, scale is going to matter much more than in the past. Since many of these middle-market insurers are mutuals—a construct that doesn’t easily lend itself to roll-ups—we expect to see companies that currently find themselves sitting in no-man’s land to consolidate or form alliances to expand their size, scale, and breadth of capabilities. Also, there is increasing evidence that small and midsized entities are creating upstream holding companies that would allow more flexibility in the way they use capital to buy other companies and invest in InsurTechs. American Family Insurance announced the creation of a mutual holding company structure.

• **Portfolio optimization:** Insurance companies are likely to be interested in acquiring businesses that diversify their product portfolio and customer base; smaller, high-performing specialty businesses that provide bolt-on opportunities are likely to sell at a premium:
  – The pursuit of new market revenue may drive more M&A activity in highly commoditized businesses. Small-to-medium companies operating in the fragmented personal lines insurance market may pursue acquisitions to diversify into the small commercial insurance space. Kemper’s purchase of Infinity is a 2018 example: Kemper companies offer insurance for home, auto, life, health, and valuables. Infinity sells auto insurance in the specialty, nonstandard automotive segment. The combined company will have a more diversified portfolio across auto, home, life, and health insurance.15 Similarly, Progressive Insurance has expanded its offerings to include small-business commercial truck and auto policies, and currently insures more than one million commercial vehicles.16
  – Some insurers may shrink before they grow. Liberty’s sale of its group benefits business to Lincoln, and Voya’s carve-out of its CBVA and individual fixed and fixed-indexed annuities allowed the companies to exit certain markets, clean up their balance sheets, and use deal proceeds to acquire assets that better support their future strategic direction. With companies looking closely at their books of business and rising interest rates making underperformers more attractive to potential buyers (especially on the L&H side), we expect shrink-to-grow M&A activity to continue.

• **InsurTech imperative:** Insurance companies’ appetite for InsurTech investments should remain strong in 2019, as many would prefer to buy rather than build industry-disrupting capabilities to drive market growth and improve long-term financial performance. Other indications of continuing InsurTech interest is the creation of new venture capital (VC) funds, some within insurance companies, that are making partial investments now with an eye toward full-on acquisitions of successful startups. Fortunately for prospective buyers, InsurTech targets should be more plentiful in 2019, as current PE and VC investors seek to liquidate their maturing holdings.17

• **Private equity participation:** PE firms such as Apollo Global, Carlyle Group, and Blackstone Group are among a slew of competitive buyers (e.g., sovereign wealth funds, pension funds, closed-block specialists, and special purchase acquisition companies) that have been expanding their insurance industry investments and acquisitions. In doing so they gain access to a stable business model, premium income, investable assets and capital, and a good source of short-term earnings, especially for asset-intensive lines like run-off insurance. We expect competitive buyers to continue their pursuit of insurance acquisitions in 2019—the reinsurance sector appears to be of particular interest for its mix of good yield, better interest rates, and relative safety.

Since many insurance companies may have difficulty increasing their capabilities, scale, and footprint organically, those positioning for growth in 2019 are likely to turn to inorganic engines including M&A. Whether selling, buying, or partnering, insurance executives should consider planning for and addressing the following trends that may either help or hinder their ability to use M&A to execute on their strategic growth plans:

• Tax reform results
• Regulatory breather
• “Frothy” valuations
• Changing face of InsurTech
2019 Insurance M&A drivers and trends

Tax reform results

The sweeping changes brought about by the US Tax Cuts and Jobs Act of 2017 (Tax Act) are expected to vary significantly across insurers depending on a company’s profile. In general, the domestic tax reform changes applicable to insurers were intended to broaden the base to offset the tax rate decrease. Whether the increased tax base fully negates any benefit from the tax rate decrease will depend on each company’s profile. The biggest tax reform implications specific to life insurance companies are changes to calculations for life insurance reserves; deferred policy acquisition costs (DAC); basis of computing reserves; and companies’ share of certain tax-favored investments. Life insurers will also be affected by changes to insurance product law, including new reporting obligations on reportable policy sales for both the purchaser of the policy and the issuing life insurance company. Significant changes to the taxation of P&C and health insurance companies affect loss reserve discounting and the proration of certain types of investment income. Loss reserve discounting is projected to raise $13.2 billion from 2018 through 2027. Proration rules for nonlife insurance companies are projected to raise $2.1 billion from 2018 through 2027. Net operating losses (NOLs) may experience increased complexity due to divergence of the law applicable to noninsurance companies, P&C insurers, and life insurers that file a consolidated tax return. Adding to companies’ challenge of adapting to the Tax Act’s changes, the Treasury Department and the IRS have not yet issued final guidance on certain important, newly enacted provisions.

In addition to reforms affecting the US operations of domestic insurance companies, the Tax Act includes a major overhaul of the international tax rules that impact the global operations of many multinational insurance companies and groups. Most significantly for US-parented groups, the Tax Act creates a new category of foreign income (Global Intangible Low Tax Income or GILTI) loosely derived from “intangibles” that generally cannot be deferred. It also creates a new “participation exemption” system for earnings derived by qualifying foreign subsidiaries. For foreign-parented groups, the Tax Act significantly curtails—through a new base erosion anti-abuse tax (BEAT)—the efficiency of certain business operating models having a material cross-border component (e.g., reinsurance from a US direct carrier to a foreign-related party reinsurer) that is deemed to erode the US tax base. Such operating models may require significant restructuring to retain tax efficiency. Further, a potentially unintended consequence could result in US reinsurers that assume foreign-related party business incurring BEAT due to claims payments from the US reinsurer to the foreign-related party.

Among the Tax Act provisions with strategic M&A implications:

- The reduction in the corporate tax rate from 35 to 21 percent should increase the profitability of insurance companies’ US operations (separate from the impact of the BEAT and GILTI) and free up capital for potential acquisitions, joint ventures, and investments.
- Changes to reserving methodologies may decrease the after-tax profitability of certain long-tail P&C lines and shorter-tail life policies with low cash surrender values, reducing these assets’ desirability as potential acquisition targets.
- An increase in M&A activity is expected as insurers analyze their projected returns under the BEAT; however, as BEAT may make it less efficient to do affiliated cross-border reinsurance transactions, we may see more multiparty transactions to limit participants’ liability.
- Some of the positive aspects of being a non-US-headquartered insurance or reinsurance company—in particular, of operating in a low-to-no-tax jurisdiction—have been reduced. As a result, certain insurers may restructure their operations or reinsurance agreements. Others may decide to consolidate, sell, re-domicile to the United States, or treat their non-US reinsurers as US companies for US tax purposes where US tax reform will not be a detriment.
- Understanding the Tax Act’s implication on deal structuring and planning for efficient tax structures and elections is crucial to enhancing value. To that end, tax due diligence becomes more important, given the wide spectrum of potential positions companies may have taken in implementing the Tax Act.

In general, the Tax Act’s changes to the US taxation of worldwide groups and cross-border transactions may alter the underlying economics of certain inbound transactions, and are generally expected to drive industrywide M&A and restructuring efforts to mitigate their impact. It is, therefore, important for insurers contemplating M&A to analyze their specific “before-and-after” tax profiles and thus position themselves to develop and implement plans to mitigate potential post-deal tax increases.
2019 Insurance M&A outlook | Positioning for growth

Regulatory breather

Regulatory barriers to M&A continue to fall, which is good news for well-capitalized insurance companies looking to investments or acquisitions as ways to boost inorganic growth. However, regulation should remain top-of-mind for 2019 as insurance regulators around the globe broaden their focus from solvency to include market conduct oversight as macroprudential regulation (aimed at reducing systemic risk) nears final adoption. In addition, we expect that regulators across sectors will likely remain highly vigilant to the risks of economic downturn and market shocks.

The current regulatory environment appears more settled compared to the recent past and, absent a significant unexpected event, we see little prospect of major new regulation in 2019, especially in relation to bank and insurance capital. Regulators’ key priorities are to consolidate and safeguard and—in some jurisdictions—refine the reforms of the past decade.

Outside the United States, the International Association of Insurance Supervisors’ (IAIS) Macroprudential Committee (MPC) continues its development of a holistic systemic risk framework that broadens the emphasis beyond an entities-based, capital-focused system to an activities-based system less focused on size and more on potentially risky market conduct wherever that might happen. The new framework, approved in November 2018, is designed to prevent systemic risk from materializing, identify the buildup of potential systemic risk, and mitigate risks should they materialize anyway. For 2019, the MPC will continue work on global monitoring, which will include annual data collection from individual insurers, data collection from supervisors on sector-wide trends, and data analysis by the IAIS to assess potential systemic risk.

In the United States, member regulators of the National Association of Insurance Commissioners (NAIC) have indicated an interest in market conduct, and state regulators are considering the use of consultants for market conduct examinations and quality. Perhaps the single biggest discussion item related to market conduct thus far has been the possible creation of new, higher sales standards for annuity and life insurance. Regulators have been moving toward consensus that a “best interest” standard might be appropriate for annuity sales, and the state of New York has already issued regulations instituting such a standard for both life insurance and annuity sales. These standards may increase regulatory scrutiny throughout the sales process for both insurers and producers.

Cybersecurity and data privacy concerns continue to drive regulatory actions, with several countries—Brazil, France, Singapore, United Kingdom, and Australia among them—either implementing or enhancing existing regulatory requirements. In the United States, most of this activity is occurring at the state level: the New York State Department of Financial Services (NYDFS) cybersecurity regulation (which took effect on March 1, 2017, with a phase-in period concluding on March 1, 2019) requires nearly 2,000 insurers registered with the state to establish and maintain a risk-based cybersecurity program and supporting capabilities. California enacted the California Consumer Privacy Act of 2018 (CCPA), which greatly expands data subject rights and introduces provisions for civil class action lawsuits based on statutory or actual damages. That law takes effect in July 2020. Smaller insurers in New York, California, and other states where cybersecurity and data privacy regulations are driving up the cost of doing business might explore consolidation to achieve the dual goals of compliance and cost mitigation.

The general pull-back in US regulatory oversight and an anticipated global “breather” in major new legislation should help ease the path forward for insurance companies looking to engage in M&A in 2019.
“Frothy” valuations

The confluence of persistent market pressure to achieve sustainable growth, an abundance of capital and capacity, and rising interest rates may indicate that the insurance industry should prepare for a potential uptick in M&A—if “frothy” (overly high) valuations don’t get in the way.

Much like the performance of the overall stock market, 2018 was a volatile year for insurance company stock prices, as seen in figure 6. Over the period observed, the annual return for each segment was negative, with L&H taking the largest hit given its sensitivity to interest rates, which also experienced wide swings during this period. We would expect that the return on the insurance industry should continue to track that of the overall market absent a large industry-specific event.

Figure 6. SNL US insurance and S&P 500 index YTD total return (%)

Source: Deloitte analysis using SNL Financial M&A database

- SNL US Insurance Underwriter: Includes all Insurance Underwriters in SNL’s coverage universe whose primary shares trade on a US exchange.
Some of today’s higher insurance company valuations are a result of US tax reform: a lower corporate tax rate provides higher after-tax earnings and, therefore, higher valuations. A scarcity of good acquisition targets may drive up valuations, as may rising interest rates that improve asset yields. However, interest rate normalization could be a double-edged sword, because it may also make debt more expensive, lead to declines in some asset values, generate more credit defaults, and reveal structural weaknesses in both the global economy and individual firms.36

Are insurance valuations so high that they might impede 2019 M&A? In our view, relatively rich valuations generally feed deals. For example, a P&C company’s board can justify selling at 140 percent of book but not 85 percent. The buyer, meanwhile, can afford to pay a premium for a desirable asset because tax reform money boosted its own after-tax earnings and valuation. 2018’s two largest negotiated P&C deals—AXA/XL Group and AIG/Validus—went off at a healthy 1.5x/1.6x book. On the L&H side, some companies were willing to pay a premium for specific books of business that filled in holes from a market or capability perspective that they couldn’t develop internally.

Changing face of InsurTech

If it appears as though virtually everyone wanted a piece of InsurTech in 2018, that’s likely an accurate assessment. Insurance companies looking for cost-effective ways to meet customer demands for a digital experience akin to other industries continued their investments in and acquisitions of specific InsurTech capabilities to improve key friction points including product development, sales and distribution, policyholder services, underwriting, and claims management.

These “incremental innovation” deals are likely to predominate in the near term; however, we are noticing a subtle shift in some insurance executives’ thinking about InsurTech that may influence their 2019 M&A strategy. There’s a growing understanding that the industry is ripe for disruption and, to survive and thrive, insurers should leverage InsurTechs’ entrepreneurial thought processes, nimbleness, and flexibility to improve their existing operations. But how? It can be difficult and costly for large companies to germinate, cultivate, and incorporate truly disruptive ideas from within. One faster, less expensive option is to acquire that knowledge by engaging directly with an InsurTech—and there are multiple paths to do that: by establishing incubators/accelerators/innovation labs; making venture investments; forming partnerships; or buying assets or entire startups.

Are insurance valuations so high that they might impede 2019 M&A? In our view, relatively rich valuations generally feed deals.
PE and VC firms also remain InsurTech fans. Investment money continues to pour in, with first-half 2018 InsurTech investments of $869 million seemingly on track to at least equal the $1.83 billion in funds raised in 2017, which was the industry’s second-highest level of financing (figure 7).37 VC funds remain by far the largest source of InsurTech financing, accounting for 91 percent of investments in 2018’s first half, up from 74 percent in 2017.38

Figure 7. InsurTech investments on track to at least match 2017

InsurTech funding by category in $M

Source: Venture Scanner data, Deloitte Center for Financial Services analysis
Similar to insurance companies, we are seeing a shift in many PE and VC firms’ strategy for InsurTech investments: Rather than spread their money across a large number of new InsurTechs just getting off the ground, many investors in this second wave have started channeling more capital into proven entities, often in late-stage and follow-up funding rounds. Late-stage InsurTech investment in 2018’s first half—defined as Series D and above—was 64 percent higher than for all of 2017. This could suggest that VC and PE firms are seeking InsurTech investments that are better able to demonstrate results that justify additional financing and/or they are after not only financial returns but true learnings from the marketplace.

An important consideration is the possible impact of the shift in InsurTech investment strategy on 2019 M&A activity. Up until now, M&A has played a relatively minor role in InsurTech development, with only about one in 10 startups eventually acquired by others over the past decade. We think that could be ripe for change, with the pace likely to accelerate over the next couple of years for at least four reasons:

- Investors are more likely to consider acquiring a preferred InsurTech target before a competitor beats them to the punch and takes them out of play.
- More InsurTechs are likely to consolidate, whether to reduce competition, combine forces to bolster their market leverage, and/or expand capabilities to create platforms rather than point solutions, which are finding limited value because they address one problem without regard to related issues.
- As stated earlier, many insurance companies are considering acquisitions to bolster internal capabilities where they find that buying InsurTechs offering what they need to likely be far easier than building such applications themselves.
- Early PE and VC investors may be poised to liquidate their maturing InsurTech investments, putting more entities in play.

Any one or a combination of these catalysts should heat up M&A activity, perhaps substantially.
Moving forward on 2019 insurance M&A opportunities

Improving economic conditions, increasing interest rates, plenty of available capital, tax reform and a pro-business regulatory environment, and the quest for InsurTech capabilities provided a solid platform for 2018 insurance industry M&A. Many of these positives remain in place for 2019; still, current market conditions are volatile and there are likely to be plenty of challenges to overcome in the year ahead. Insurance companies contemplating M&A to boost their bottom line, broaden their product portfolio or geographic reach, and strengthen future competitiveness should:

- Evaluate where the industry is going, where your business is going (and the capabilities needed to get there), and where the two align.
- Conduct upside/downside scenario planning that accounts for, among other things, a potential economic correction in the next 18–24 months.
- Be clear on what you are solving for in evaluating organic/inorganic options (e.g., scale, geographic expansion, channel reach and diversification, customer experience capabilities).
- Develop an M&A strategy that supports what you are solving for and frames your appetite in approaching market opportunities.
- Select investment/alliance/acquisition targets that are consistent with the overall strategy, accretive, and synergistic. Avoid chasing a shiny object that may not support long-term goals.
- Give far greater consideration to the downstream integration implications in evaluating targets and their accretive potential, especially in acquisitions focused on upgrading your capabilities.
- Home in on high-quality properties, conduct thorough diligence to identify what they do/have of value and what could be carved out. Consider proactively reaching out to potential candidates to let them know about interest before others seize the moment and the acquisition becomes an auction situation.
- Be mindful of the changing tax and regulatory landscape in both domestic and cross-border deals.
- Review and potentially enhance in-house corporate development and overall integration capabilities to facilitate efficient and successful transactions before you embark on deals.

In today’s dynamic insurance M&A environment, where deal sizes and values may range from modest to transformative, both experienced and first-time buyers/sellers that adhere to a well-thought-out strategy should be well positioned to move forward with confidence and stay true to their goals.
Appendix

Spotlight: Insurance industry M&A in major global markets

United Kingdom

2018 review

Three multi-billion-dollar transactions in 2018 propelled UK insurance M&A to large increases in aggregate and average deal value compared with 2017.

Reinsurance markets remained fiercely competitive, with a high supply of capital driving down rates for many classes of business. As a result, returns from conventional reinsurance are under pressure. This is encouraging many reinsurers and other alternative capital to move further down the value chain, either by participating in primary insurance, securing solus capacity for Managing General Agents (MGAs), and often taking equity stakes in intermediaries to secure distribution. A key restraint on this for reinsurers has always been a risk of competing directly with their clients; however, we expect to see confidence growing to structure arrangements that move them down the value chain toward the policyholder.

2018 saw insurers intensify efforts to invest in new technologies and business models. This activity may indicate that their perception of InsurTech is transitioning from threat to opportunity. To date, direct investments have tended to focus on efficiency and automation of key tasks, particularly around the claims process, where tangible benefits can be analyzed and ROI monitored. Investment into and adoption of new technologies represent a key plank of Bain's strategy behind its £1.2 billion acquisition of a UK personal lines insurer.

UK life insurers' journey to wealth management continued in 2018, with companies focused on moving from insurance with high capital, high costs, and low multiples to a world with lower capital and higher multiples. Recent examples include Prudential's ongoing merger of its fund management business M&G, with its UK and European life insurance arm, a precursor to its proposed demerger of Prudential's UK operations.94 Life companies have moved from balance sheet optimization to portfolio optimization, shedding companies that are no longer core or are suboptimal performers; one example is Dutch financial group Achmea's sale of its Irish life assurance, pensions, and investment firm, Friends First.95 We expect that this is a trend that will continue.

2019 outlook

One of the trends we are likely to see extend into 2019 is the return of significant levels of PE interest. Valuation multiples have fallen and this has enabled PE bidders to start to see the potential for acceptable returns at these transaction multiples.

Inorganic growth continues to be a key area of focus for broking intermediaries on both sides of the Atlantic. Shareholder returns from M&A are being supported by a large volume of targets, opportunity for income, cost synergies, and favorable debt market conditions. In addition, PE appetite to invest in platform assets to support a consolidation play has increased. The large listed players also are continuing to seek acquisitions, supported by strong valuations and a desire to generate growth in mature markets. As a result, competition for assets has increased and valuations for smaller intermediaries have risen. Absent other factors (e.g., debt market cooling), we expect 2019 to see pricing rise for all intermediaries in the United Kingdom and Europe as competition intensifies and mid-market consolidators drive toward their own liquidity events.

2019 should be another busy year for life companies moving to wealth platforms as the default model for accumulation. We also expect insurance companies of all types to invest and partner with more InsurTech players across the value chain (from customer acquisition to claims remediation) and look at certain high-performing intermediaries (MGAs or brokers) as opportunities to secure profitable, agile, and growing routes to market that may even replace certain incumbent teams and processes.
China/Hong Kong

2018 review

Insurance-related M&A in China was fairly active in 2018, with nine announced transactions—more than double 2017’s total of four. Each of the P&C, L&H, and brokerage subsectors posted three deals, although P&C dominated in deal value. Hong Kong insurance M&A did not fare as well; 2018 saw only one announced deal, a significant drop from seven announced life insurance transactions in 2017.45

2019 outlook

We expect that 2019 insurance M&A volume in China will approximate that of 2018. For transactions involving foreign insurers, deal size may easily be north of $1 billion; domestic deal size may range from $50 million to $500 million, depending on available stake size. On the other hand, smaller foreign insurance players may decide to exit China due to increasing competition and limited availability of strong Chinese partners. Furthermore, domestic market consolidation in both P&C and L&H subsectors likely will continue.

In Hong Kong, insurance M&A activity may pick up a little in 2019 as some foreign insurers follow the recent example of Mass Mutual, and divest assets to shrink their geographic footprint; however, deal numbers likely will be in the low single digits. In terms of deal size, P&C transactions likely will be small (less than $50 million) while L&H deals could be as high as $1–2 billion.

Several factors may influence 2019 insurance-related M&A in China and Hong Kong:

• **Regulations.** In November 2017, the Chinese government promised that it would increase the foreign ownership cap on insurers from 50 percent to 51 percent, allowing majority control for foreign entities. It also promised to entirely lift the limits within three years. In March 2018, China’s insurance regulator announced new rules (effective April) that govern shareholding in domestic insurance companies in a bid to make ownership structures more transparent. The rules also state that a single shareholder cannot control more than one-third of an insurance firm’s registered capital, while investors cannot entrust others to hold shareholding in an insurer. This is one of the reasons we foresee domestic market consolidations, as we expect existing shareholders that hold more than one-third shareholding of a domestic insurance company will likely have to sell-down some of their stakes.

• **Valuations.** Given that many of the historical deals in China and Hong Kong saw buyers paying a premium to acquire insurance licenses, there has always been pressure for acquirers to justify the high valuation and to achieve full value realization post-deal. In Hong Kong, the largest insurance deals over the past five years all involved buyers from Mainland China, and the highest valuation was around 10x price-to-book. However, we believe that valuation of Hong Kong insurance transactions should normalize going forward and support more M&A in 2019. For China, given the size and growth story of its insurance market, valuation looks to be sustainable at a relatively high level for the foreseeable future.

• **Cross-border M&A.** Chinese authorities have tightened control of capital outflows over the past year, and there is an unofficial understanding that the government prefers players in the same industry to acquire overseas assets. Thus there are only a limited number of Chinese (re)insurance players able to make overseas acquisitions. Moreover, the ongoing US-China trade war is expected to affect economic development in the mainland and Hong Kong and may lead Chinese companies to rethink their overseas expansion plans.

• **InsurTech.** We continue to see China’s insurance companies invest in new InsurTech or digital upgrades, but do not anticipate large-scale InsurTech M&A in the near-term. Most traditional insurers remain cautious and are likely to take ample time to consider InsurTech opportunities. Legacy issues also pose challenges to decision making. We do, however, expect new, disruptive InsurTech startups to enter the market and exert pressure on traditional insurers to ramp up their technology investments in the coming years.
France

2018 review

The French insurance sector has been in a dynamic upward trajectory, with M&A deal volume increasing over the last three years. Twenty-nine deals were announced as of September 2018, compared with 28 and 17 transactions in 2017 and 2016, respectively.47

The insurance brokerage sector has been the primary driver of M&A activity. The French brokerage market remains fragmented, although smaller players are consolidating in an effort to scale operations to comply with increasing regulations and strengthen their bargaining power with insurance partners. PE firms, which are particularly active in this sector, are also fueling broker acquisitions and consolidations.48 CIPRÉS Assurances acquired Axelliance in June 2018, to develop its offering in P&C insurance brokerage.49

The French mutual insurance market is also fragmented, and smaller competitors, especially those with health and protection (H&P) business lines, have been consolidating to offset insufficient capital or erosion of their client portfolios. A FY2016 French regulation that generalized health insurance coverage to all private sector employees (creating a low-margin environment) incentivized mutual insurers to scale up in order to invest in digitalization, spread compliance costs, and build their client portfolios.

Among insurers, M&A deals have been mainly driven by a saturated P&C market, leading to acquisitions of insurance portfolios in a bid to gain market share and of insurance intermediaries to increase market access. AXA SA carried out the most significant transaction for a French corporation in 2018 by acquiring XL Group in March for €12.4 billion. In the process, it shifted its core business from predominantly L&H to corporate P&C insurance, enabling the XL Group to become the #1 global P&C commercial lines insurer based on gross written premiums.50

2019 outlook

French insurance M&A volume is expected to remain solid in 2019. We anticipate that smaller brokers will continue to consolidate, and PE firms will expand their acquisitions in the subsector. Merger volume among mutual insurance groups is likely to remain stable to support digitalization efforts and to disperse compliance costs. We also anticipate more acquisitions of P&C portfolios and insurers, as well as potential disposals of L&H closed books.

On the regulatory front, a key factor that may influence M&A activity in 2019 is Loi PACTE—for Plan d’Action pour la Croissance et la Transformation des Entreprises (action plan for business growth and transformation), which is expected to boost retirement savings for insurers and asset manager. On the other hand, IFRS 17 implementation could represent a significant cost for insurers, resulting in further consolidation for smaller players.

Brexit is likely to influence insurance cross-border M&A in 2019, with UK companies leveraging M&A as a means of securing an operational presence in France or other EU countries to preserve access to the European markets. Similarly, companies in the EU will likely consider acquisitions to secure an active presence in the UK market. The UK equities downward trend could lead to opportunistic transactions by French firms in the United Kingdom. We also see Brexit as a potential driver for internal restructuring operations within cross-border groups.51
Germany

2018 review

M&A deal volume in the German insurance sector picked up from approximately 20 deals in 2017 to more than 25 deals in 2018. The largest number of deals were in the insurance broker segment, where transactions mainly consisted of domestic small and midcap targets. We have seen a continuing trend of cross-border transactions, where German insurers dispose of small, noncore portfolios and acquire foreign targets in line with their international growth strategy. The life run-off sector had three announced deals following low-level activities in previous years; transactions reflect companies’ continuing replacement of traditional annuities with guaranteed minimum returns over the whole product life via other forms of life protection without such guarantees. Companies handled the run-off of these traditional books in a variety of ways including, in some cases, selling them to consolidated run-off platforms.

Meanwhile, domestic nonlife M&A in 2018 was subdued. The large multinational insurers headquartered in Germany sought to expand their nondomestic market positions by making targeted nonlife acquisitions and withdrawing from subscale, nondomestic activities.

2019 outlook

We expect 2019 insurance industry deal volume and value to be comparable to 2018—driven, in large part, by multinational insurers headquartered in Germany that are optimizing their nondomestic portfolio. We also continue to see foreign insurers interested in entering or expanding in German nonlife insurance; however, their efforts may be stymied by a scarcity of suitable targets and willing sellers.

Germany’s InsurTech arena should remain active in 2019, with traditional insurers participating in early funding rounds to access digital expertise and new technologies. In addition, we see traditional insurers entering into cooperation and supplier agreements with InsurTechs but not much full-scale M&A.

Finally, a couple of market factors may impact 2019 M&A activity. Solvency II and the gradual phase-out of 15-year transitional relief in the valuation of insurance reserves under IFRS, which has been granted to numerous German life insurers, is expected to increase pressure on solvency margins and capital positions. In addition, a continued low interest rate environment makes valuation of traditional guaranteed life books at or above book value challenging.
Japan

2018 review

Japan’s insurance industry saw limited M&A in 2018. Deal volume remained stable compared with 2017 but deal value decreased; not unexpected following the 2017 MS&AD Insurance Group Holdings’ $1.6 billion acquisition of Singaporean nonlife insurer First Capital Insurance. One deal to note: MassMutual International’s sale of 85.1 percent of MassMutual Japan to Nippon Life for about $955 million. This deal was something new for Japanese insurance companies, which have acquired US and global insurance assets over the past decade. It may indicate that Japanese insurance companies (or large corporations) are starting to think that an acquisition is not the only option when considering M&A.

2019 outlook

2019 insurance deal volume and value in Japan look to be flat, although there may be one or two billion-dollar deals, depending on the situation. We do expect that some domestic insurance companies, both L&H and P&C, will likely be looking for foreign acquisitions to diversify their product portfolio, expand their geographic footprint, and boost top-line revenue. In addition, P&C companies are likely to continue investing in InsurTechs.

Spain

2018 review

Spain’s insurance industry saw higher deal volume and value in 2018 than in the recent past, primarily due to the reorganization of incompatible bancassurance partnerships arising from banking industry consolidation. In addition, the few banks without bancassurance partnerships decided to look for a P&C insurance partner. There was traditional industry M&A in 2018, as well. In November, Telefónica reached an agreement with Grupo Catalana Occidente to sell 100 percent of its insurance subsidiary, Antares.

2019 outlook

Spain (and Portugal, as well) should see solid M&A activity in 2019, as some deals that launched in 2018 are still ongoing and other opportunities are emerging. In addition, certain insurers are looking to optimize capital consumption by disposing of large, low-value savings portfolios. Solvency II is expected to boost market consolidation, as there are many small and medium-size companies lacking critical mass to support the management capabilities required and expenses related to the new regulation.

We expect the majority of 2019 insurance-related M&A in Spain to take place among established players, although some foreign firms have expressed interest in entering the market. And because there is a strong appetite for inorganic growth and limited available targets, higher valuations should not inhibit deal-making.
Endnotes


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37. Sam Friedman, Malika Gandhi, Mark Purowitz, InsurTech entering its second wave: Investment focus shifting from new startups to more established innovators, Deloitte Center for Financial Services, 2018.
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Contacts

Insurance M&A leadership team

Mark Purowitz  
US Insurance M&A Leader  
Principal  
Deloitte Consulting LLP  
Deloitte United States  
+1 215 606 1983  
mpurowitz@deloitte.com

Ian Sparshott  
Global Financial Advisory Insurance Sector Leader  
UK Transaction Services Partner  
Deloitte United Kingdom  
+44 (0)20 7007 8680  
isparshott@deloitte.co.uk

Douglas Sweeney  
Managing Director  
Deloitte Transactions and Business Analytics LLP  
Deloitte United States  
+1 617 585 4848  
dosweeney@deloitte.com

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Prashanth Ajjampur, Principal, Deloitte Consulting LLP  
Dave Altschuler, Senior Manager, Deloitte Tax LLP  
Richard Baddon, Partner, Deloitte United Kingdom  
Catherine Code, Partner, Deloitte Canada  
Bruce Fell, Principal, Deloitte Consulting LLP  
Andrew Gould, Partner, Deloitte United Kingdom  
Will Geer, Partner, Deloitte United Kingdom  
Matt Hutton, Partner, Deloitte & Touche LLP  
John Johnston, Partner, CEO Bermuda and Caribbean, Deloitte Limited  
Jason Kaplan, Principal, Deloitte Tax LLP  
Kyle Karrenbauer, Senior Manager, Deloitte Tax LLP  
Eli Katz, Managing Director, Deloitte Tax LLP  
Taro Kuryuzawa, Director, Deloitte Japan  
Jose Manuel Lasa, Partner, Deloitte Spain  
Norbert Lauterbach, Director, Deloitte Germany  
Andrew Mais, Senior Manager, Deloitte Center for Financial Services, Deloitte Services LP  
Andy Masters, Partner, Deloitte United Kingdom  
Howard Mills, Managing Director, Global Insurance Regulatory Leader, Deloitte Services LP, United States  
Evgeni Pavlov, Manager, Deloitte & Touche LLP  
Todd Wood, Partner, Deloitte Tax LLP  
Vincent Rapiau, Partner, Deloitte France  
Kenneth Yue, Director, Deloitte China