GIRO conference and exhibition 2011
Peter Allen

For sale - an update on merger and acquisition activity in the insurance sector

12 October 2011

Agenda

• trends in global M&A volume
• why deals are being done
• what are the acquisition targets
• why are deals not being done
• crystal ball
The bottom line is: activity never recovered and is now dropping sharply

Global volume of M&A deals Quarterly

New money coming into public markets has somewhat recovered but is volatile

Global IPO's
Private equity deal flow is even more volatile: the peak was higher due to cheap credit. It is also dropping sharply.

As banks struggle to recapitalise, the supply of finance reduced and then appeared to recover.
And just in case you thought this didn’t affect you

No. of Property Transactions in the UK

Source: ONS

Property and casualty insurers are bumping along the bottom of the underwriting cycle

PERCENT CHANGE FROM PRIOR YEAR, NET PREMIUMS WRITTEN, P/C INSURANCE, 1975-2010 (1)

(1) Excludes state funds.
Source: ISO.
Although insurance M&A has also dropped globally it has done so by less than the drop in the all-sector M&A.

Volume of Global Insurance deals completed: 2009-2011

Source: Clyde & Co

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….. almost certainly supported by the attraction of Asia Pacific markets to global insurers

**Asia Pacific % Share of World Market by Premium**

As Asia Pacific insurance markets converge on Europe in terms of scale

**Premium Volume**
P&C insurers' values drop as the cycle bites

Source: Morgan Stanley, Research factsheet
Just when you think they've got the hang of it….

As recently as 2001, insurers paid out nearly $1.16 for every $1 in earned premiums.

- Heavy use of reinsurance lowered net losses
- Best combined ratio since 1949 (87.6)
- Relatively low CAT losses, reserve releases
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- Cyclical deterioration
- Higher CAT losses, shrinking reserve releases, toll of soft market

Source: Aegis

Insurance broker public valuations are rising, probably on expectations of a hardening market.

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Source: Thomson
Reasons for deals - Top 50 global insurance deals

- post crunch
- geographic repositioning
- cyclical/consolidation
- bolt-on
- private equity
- run-off

Geographic repositioning and the forced sale of insurance assets are major drivers of deals

By number

By value

Source: Thomson
UK transactional activity is dominated by the purchase of intermediaries

Run-off is a measurable segment of the UK insurance market

Source: Thomson
Source: KPMG
Private equity is attracted by the deconsolidated nature of the insurance market

What specific factors have drawn you to the Financial Services sector?

- Large number of niche businesses: 62%
- Some areas of Financial Services industry are counter cyclical: 33%
- The Financial Services sector accounting for a substantial percentage of overall UK GDP: 31%
- Financial Services management can benefit from PE discipline: 29%
- Other: 8%

Source: Grant Thornton - Smart Money

Private equity is keen to transact, but as we have seen there are strong headwinds

Source: Grant Thornton - Smart Money
Investors agree that post crunch deal flow will remain significant

How important will the following factors be in driving private equity activity in the UK Financial Services sector?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Percentage of respondents</th>
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<tbody>
<tr>
<td>Financial crisis recovery</td>
<td>50%</td>
</tr>
<tr>
<td>Regulation developments</td>
<td>44%</td>
</tr>
<tr>
<td>Consolidations</td>
<td>37%</td>
</tr>
<tr>
<td>Asset sales/restructuring activity in the part of banks</td>
<td>37%</td>
</tr>
<tr>
<td>Development of private equity structures</td>
<td>13%</td>
</tr>
<tr>
<td>Valuation</td>
<td>12%</td>
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</tbody>
</table>

Source: Grant Thornton - Smart Money

Transaction risk - anatomy of an uncompleted deal

- Urgent requirement for financial due diligence completed in three weeks
- Valuation disagreements result in complex deferred consideration structure
- Deal is discretionary for both parties
- Due diligence uncovers PI risk and major client uncertainty
- Vendor not willing to pay for top up PI cover
- Deal remains uncompleted
And I have no explanation for this

Withdrawn deals as a percentage of total deals 2005-2011

Source: Thomson

Regulation may increase deal flow

- Solvency II
  - sale or merger of smaller entities
  - portfolio rebalancing: return of composite
  - internal restructuring
- post crunch
  - disposal of non-core assets
  - Vickers
- RDR
  - distribution merger
Summary

• global all-sector M&A is probably at a (recent) historic low
• but insurance deals have not declined so dramatically
• this is (probably) due to the P&C cycle, the disposal of non-core banking assets, and growth in Asia-Pacific markets
• UK insurance M&A is dominated by intermediary and service company deals
• transaction risk remains significant
• regulation may increasingly drive deal flow