Advisory Alert: M&A in the insurance sector on the rise

The insurance and reinsurance industry is making a contribution to M&A and consolidation in its own right. Hardly a day goes by that the insurance press doesn't mention M&A — whether it is reporting on specific transactions or interviewing CEOs, COOs and CFOs about their positions on the subject. The consensus is clear: Insurance sector M&A are being driven by a variety of forces, including several new sources of capital, such as pension funds, investment banks, hedge funds and private equity. Reinsurance companies are sustaining persistent pricing pressure, and middle-tier insurance and reinsurance companies are facing regulatory capital constraints, making them attractive consolidation targets.

Objectives and drivers

The primary motivations cited for insurance acquisitions include excess capital, price competition hindering year-over-year growth, access to new distribution channels, geographic and line of business (LOB) expansion, and synergy. Regulatory capital, tax efficiency and investment strategies also merit consideration. Transactions will take the shape of "bolt-on" and/or transformational acquisitions, and are singular in form or a hybrid of one or more of the following drivers:

- **Diversification —** Broadens the acquirer's offerings, lowers capital requirements, or provides a business profile expansion where a reinsurer buys an insurer with the intent of improving returns by lessening reliance on product commoditization.
- **Distribution model —** Acquirer gains a demographic or niche advantage, which may be driven by innovation, including evolving technologies and digital transformation.
- **Scale —** Acquirer achieves growth with varying degrees of focus on LOBs, geography or distribution, or as a defensive strategy (acquire a competitor before someone else does).
- **Synergy —** Typically, fairly matched companies in terms of LOBs and geography merge to reduce expense redundancy and improve earnings.

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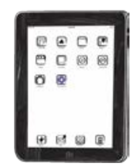

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In addressing excess capital, there is an added dimension regarding portfolio diversification, a fresh look at deploying capacity (e.g., risk-specific — a book or class of business), and the strengthening of balance sheets. For companies with sound capital positions, getting "bigger" is perceived as one way to manage the threat of third-party capital where, for example, private equity and hedge funds have demonstrated an appetite for investing in products, specialty carriers and specialty insurance-related businesses.

Although the industry has been profitable in recent years, pursuit of robust returns, achieving profitable premium growth, and the reality of rising expenses for technology and talent have driven the desire to acquire in deference to an organic build-out. Traditional and alternative sources of capital are shifting the shape of the industry for the rest of the decade.

Other observations

Beyond the primary drivers of M&A, several other factors play a part:

- large enterprises focusing on core businesses are likely to shed noncore businesses, providing opportunities for small- and middle-market companies to enhance scale, enter complementary lines, diversify product offerings and broaden distribution channels.
- strategic acquirers will pursue high-quality targets.
- opportunistic acquirers will behave more speculatively to avoid being squeezed out of the action or risk falling behind from being idle.
- some large, well-funded firms are content to sit on the side-lines, optimizing their current platform, while watching industry developments carefully.
- stakeholders' expectations for returns remain high.
- there is no perfect deal — alternative and hybrid structures will continue to emerge.

How we help: Strategy, due diligence, integration and transformation

Many clients and prospects may be among the industry leaders in strategic thinking, but are encumbered by limited resources and require third-party know-how for acquisition plan formulation, opportunity (target) assessment and execution. We provide insight and experience on the following strategies through the initial stages of the acquisition process:

- regulatory strategy
- tax strategy
- transaction strategy
- potential target identification

Further, in targeted acquisitions, the depth and breadth of potential latent liabilities in active, run-off and shell companies requires expert due diligence from many disciplines. The objective at this stage of the acquisition is reducing the risk of the investment decision-making process by providing data validation, comprehensive assessments of strengths (and, more importantly, gaps) and discovering facts to support the investment thesis. Exposures that potentially undermine strategic objectives must also be dealt with. We explore all facets of the acquisition target in these critical areas:

- financial
- regulatory
- tax
- technology
- operations
- human resources
- corporate culture

Acquiring companies must place significant emphasis on the success of the integration. In planning and executing around post-acquisition activities, the direction is set to pursue realization of the acquisition strategy. While many acquiring organizations are acutely aware of important decisions involving business retention, technology platform selection, cultural indoctrination, the broad array of issues and decisions around human capital, and other matters of financial consequence, working with Grant Thornton's Advisory Services can help you optimize realization.

Transformation for realization, the final important stage of acquisition and integration activity, is not always well-executed by acquirers. At this point in the acquisition process, managing to achieve the transaction's value is as critical as implementation around planned actions that improve performance of the combined organization.

Bibliography

Adapted from: Swanic, J., Tierney, M, Cox, R. (2015). M&A in the insurance sector. Retrieved March 14, 2016, from: http://www.grantthornton.com/~/media/content-page-files/financial-services/pdfs/2015/INS/150619-FIS-MA-Insurance-article-150629-FIN.ashx

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact one of our experienced advisors. We will be glad to assist you.