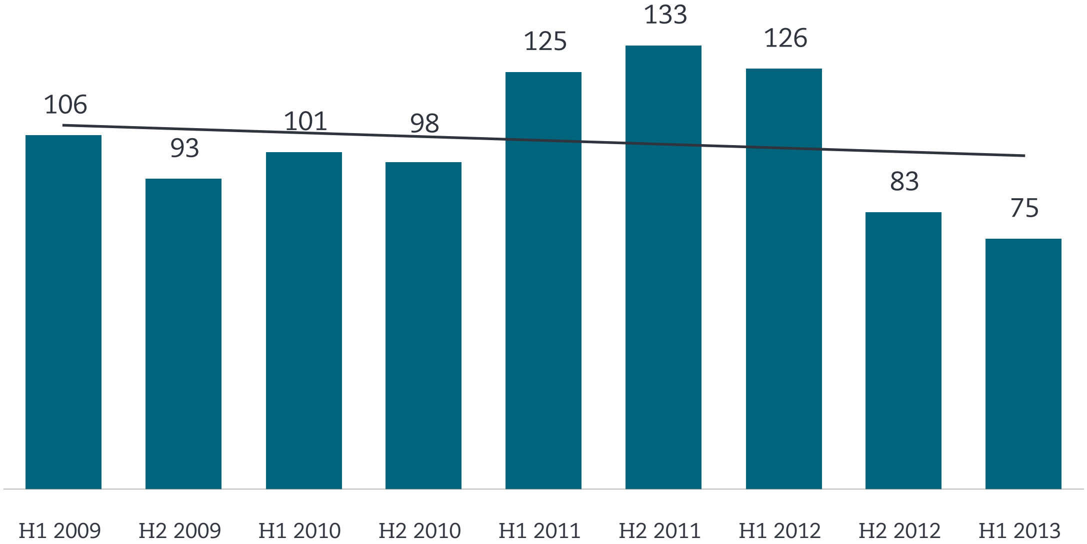
The Americas

The overall level of M&A deal activity in the Americas from 2009 to the end of June 2013 has been broadly flat. After peaking in the first half of 2011, the trend since then has been downwards. Within the Americas the US is the country with by far the most activity with 75% of all deals in the region.

Although this US-dominant trend continued into 2013, Canada, Brazil and Bermuda also saw significant activity – albeit at a lower level. There was also steady activity across other countries in Latin America, mainly in Argentina, Chile and Peru.

Volume of deals in the Americas



USA

While the US remains the most active country in terms of M&A activity overall – not surprisingly given its maturity and size – the overall trend has nevertheless been downward. The US accounts for around 32% of global M&A activity in the insurance sector over the last four years, but activity has fallen by around 40% in the last 12 months.

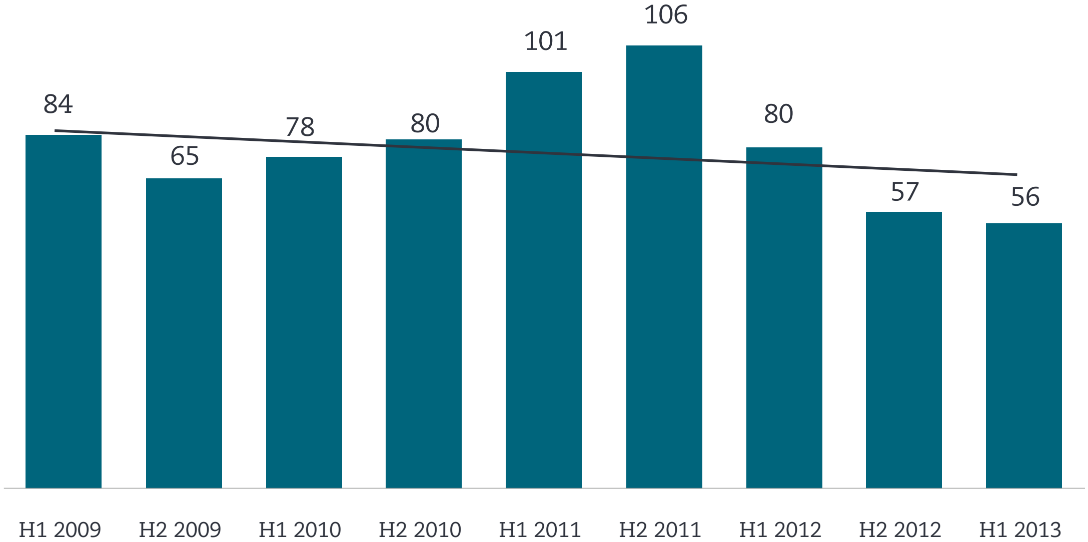
Undoubtedly, this drop in activity level has been driven by the lacklustre economic performance in the US, insurance pricing being at the bottom of the cycle and poor valuations. However, there may be some shifts in different sectors of the industry and alterations to trends that may affect the deal environment going forward.

For example, in the P&C sector, uncertainty as to the ultimate exposure to Superstorm Sandy will have undoubtedly put some business plans on hold while they work through the full claims picture. However, a desire to improve both performance and top line revenue will cause some either to look for domestic acquisitions or to expand their horizons into the faster growing markets outside the US.

The life and health sector has only seen lacklustre activity with most focus being on annuity business, which has been badly affected by the ongoing low interest rate environment. Some examples include blocks of business being sold to PE firms or European companies selling US assets as they review their balance sheets in preparation for Solvency II. It is likely that there will be a continuation of this trend as life insurers look to spin off non-core or underperforming assets.

In early 2013 for example, Hartford Financial Services Group sold its individual life insurance business to Prudential Financial for USD 615 million in cash. The deal allowed Hartford to increase shareholder value by concentrating on its property and casualty business, while Prudential gained scale and expanded distribution.

Volume of US deals by half year



2012 also saw the acquisition of SRLC America Holding Corp. from Swiss Re by Jackson National Life Insurance Company. According to a statement from the company, the acquisition will add about 100 million pounds of pre-tax profit to Jackson National Life in the first year of ownership. For Swiss Re, the transaction unlocks capital for use across the group and is expected to boost the reinsurer's return on equity, earnings per share and economic net worth growth targets.

The intermediary sector has also seen some activity as brokers continue to look for acquisitions that will provide new clients or additional revenue sources. This is also a sector that interests PE houses since the businesses are cash flow, not balance sheet, based. The former trend is illustrated by the acquisition of John T Fretz Insurance Agency by Univest Insurance. This was Univest's seventh acquisition since 1999 and was aimed at broadening the product base and increasing market share in their home market in Pennsylvania.

In December 2012, Canadian private equity firm Onex Corp completed its acquisition of USI Insurance Services for approximately USD 2.3 billion. USI is ranked in the 10-largest insurance brokerages in the United States and the 13th-largest brokerage in the world by revenue, according to insurance ratings agency A.M. Best Co.

Michael J. Sicard, USI Chairman, President and CEO, commented that the investment will allow them to continue with their growth strategy of actively acquiring smaller insurance agencies and brokers, most recently buying TD Bank's US insurance subsidiary.

Economic and regulatory uncertainty

The difficult economic conditions of 2012 have improved somewhat in 2013, which may encourage more consumers and businesses to buy more insurance to protect valuable assets. Equally, it may give more overall confidence to the M&A market. On the regulatory front, there is increased clarity around legislation and regulations of importance to the insurance industry that may help market confidence, even if they also increase compliance costs and oversight. For example, the implementation of the Dodd-Frank Act and the creation of the US Treasury's Federal Insurance Office, as well as the finalisation of the criteria for Systemically Important Financial Institutions (SIFI).

The uncertainty around these criteria has meant that some companies have been deterred from substantial acquisitions in case that would put them into the SIFI category. So, greater certainty may unblock that log jam as well as encouraging some to divert assets so they become smaller and less connected.

Driving deals

As we reported last year, insurance companies – across property & casualty, life & health and reinsurance – are still trading well below their historical book value. This creates a disconnect between the company's view of how much the business is worth, and Wall Street's view. Currently, the mis-match of pricing expectations is preventing many deals being consummated, however it could be that other pressures (possibly regulatory) will impact activity.

The first half of 2013 has seen some rate hardening across most lines and, as a result, revenue growth which – if sustained – could push analysts to increase valuations. However they are likely to stay below book value for some time.

Last year this meant that many insurance companies with excess capital were buying back stock rather than going for M&A. This however is unlikely to satisfy shareholders looking for growth in the longer term, so this year has seen more interest in plowing capital back into the business to drive organic growth through initiatives such as differentiating technology and improved customer experience. It may also lead to more niche acquisitions that can improve the bottom line.

While the bulk of M&A activity in the US is likely to be domestic, many are expected to invest in emerging markets where there is a prospect of higher growth and less competition. For example, Principal Financial Group Inc. agreed to buy Chile's AFP Cuprum SA in a USD 1.5 billion deal early in 2013. Principal's Chief Executive Officer Larry Zimpleman has been clear about his ambition to expand in Latin American nations including Chile, Brazil and Mexico to capitalise on the region's growing middle class and the increasing role of private companies managing retirement funds.

ACE Limited also completed its acquisition of Mexican personal lines insurer ABA Seguros from Ally Financial – aiming to take advantage of the growth opportunities in both Central and Latin America with a well established brand and wide network of agents. Examples such as these illustrate the tremendous potential of moving into new markets, but regulatory and compliance considerations as well as operational and investment issues should not be underestimated.

Pricing

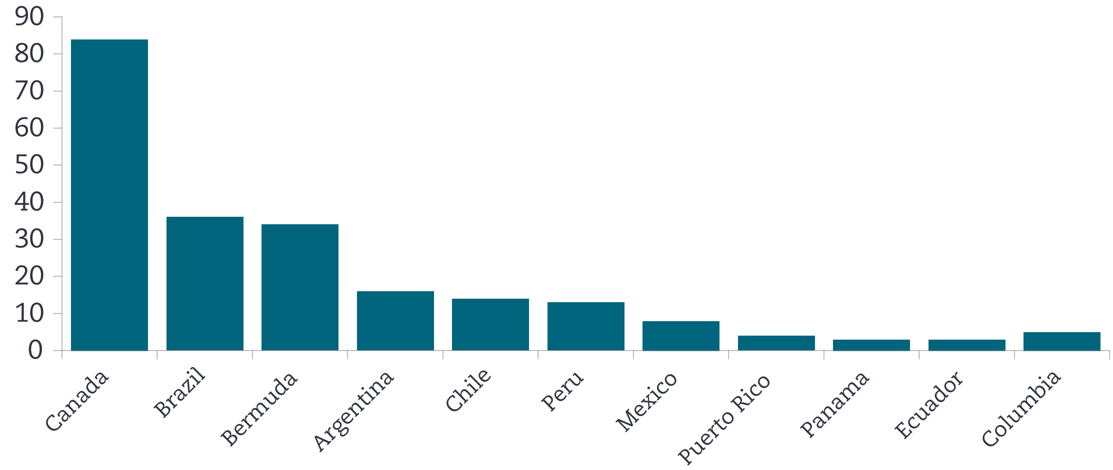
2012 had been a relatively quiet year for catastrophes until Superstorm Sandy struck the East Coast on October 29. Once this is combined with the Mid West drought and some tornado/severe weather damage, 2012 is likely to be the United States' second costliest year on record (after 2005) for weather and climate disasters. RMS estimated that insured losses from Sandy alone could top USD 50 billion.

While this undoubtedly helped to drive rates higher at the beginning of 2013, it appears that the momentum was hard to sustain for even six months and by July 2013 a more pessimistic tone was prevalent in the stock market. The recent upturn in US primary insurance prices appears to be running out of steam, with prices in the key US property market coming under pressure because of stiff competition from new entrants, including the recently launched Berkshire Hathaway Specialty Insurance and Chinese heavyweights such as People's Insurance Company of China, according to brokers. Analysts estimated that reinsurance and specialty rates fell by about 5% between April and June. At the 1 July renewals, catastrophe insurance prices were falling as a result of the growing availability of cheap reinsurance cover in the insurance-linked securities (ILS) market, driven by burgeoning demand for ILS investments from pension funds.

Taxation

Tax reform typically creates M&A uncertainty as taxes can have a significant impact on deal values. The insurance industry has enjoyed a long history of favourable tax legislation. However, as Congress searches for increased revenue, it may feel that it is time to alter models or increase rates. While there is not yet clarity about what form this might take, the industry is considering reform elements that could include capital gains and dividend rate increases, changes in US taxation of foreign entities, limitations on the tax-free benefits of life policies and the tax-free increase in value of whole life policies.

Deals in Americas by country: 2009 – June 2013



Canada

The structure of the Canadian insurance market has changed considerably in the last few decades as the market has become more domestically-owned, with the market share of Canadian-owned insurance companies increasing significantly, while the Canadian operations of European and American insurers' have decreased. There are a number of reasons why this might have come about but there are two structural issues: the relatively onerous Canadian regulatory environment which may have made it less attractive for foreign companies to invest in Canada and a very robust independent broker channel that domestic insurers have been able to leverage very successfully.

2013 saw rising activity in the regulatory arena as authorities followed the global trend and focused on strengthening insurance solvency and corporate governance. In January 2013, the Office of the Superintendent of Financial Institutions (OSFI) finalised the Corporate Governance guidelines which applies to all federally-regulated financial institutions. While large insurers are more likely to have the resources and capabilities to meet these increased requirements, mid-sized and smaller underwriting businesses may have more difficulty.

These increased compliance costs combined with weak investment returns and a very competitive market may drive increased consolidation in the P&C sector which is still very fragmented and has several hundred carriers competing for business. Consolidation has also been a trend in the brokerage sector as intermediaries look to expand their regional footprint. Western Financial Group has remained acquisitive with several deals expanding their operations into more specialised niche services – such as their purchase of BC Yacht Insurance Brokers – and People Corporation acquired three agencies in the last 12 months.

The federal government has not – at the time this report went to press – published its regulations for the demutualisation of property and casualty insurers, proposals which have been in the works for almost two years. This issue is of interest to brokers because Canadian-owned insurance companies represent nearly half of the Canadian insurance market, and there are 106 mutual insurers operating in Canada – about a third of the market by number. Demutualisation could potentially open up the ownership of mutual insurance companies, making them the targets of mergers or acquisitions.

Bermuda

While there have been some mergers and acquisitions in the last 12 months, including the acquisition of the Bermuda-based Alterra Capital Holdings Ltd by Markel Corp, the levels of activity have not picked up noticeably from previous years. Nevertheless, the fact that opportunities for organic growth remain limited and the underwriting market highly competitive might increase the momentum for future deal activity.

Although there has been some expectation of consolidation amongst the island's re/insurance community, the deal activity this last year has been more focussed on the acquisition of small to mid-tier businesses to bolt-on specialist activity. For example Partner Re made a substantial investment in Entitle Direct Group – a direct-to-consumer title insurance company as well as acquiring specialty accident and health reinsurer Presidio. Both of these were part of Partner Re's long standing strategy of diversification into areas that have limited correlation with their existing books of business. Endurance Speciality Holdings acquired the assets of Galileo Weather Risk Management to form a new unit offering a suite of customised products to help manage the risk of weather variability. This will complement Endurance's current property catastrophe and agriculture products. The other key Bermudan deal was the purchase by Validus of Flagstone Reinsurance. This illustrates the trend for mid-sized reinsurers to merge in order to both diversify their business mix and increase their balance sheet in order to take on larger risks from primary insurers.

Despite the losses from Superstorm Sandy in the last quarter of 2012, capacity in the market remains high with re/insurers still sitting on considerable capital. This has been exacerbated by the emergence of the new hedge-fund-backed reinsurance providers and additional reinsurance capacity in the form of sidecars, catastrophe bonds and Industry Loss Warranties (ILWs). All of this has increased the levels of competition as well as further reducing the demand for more traditional forms of reinsurance and retrocessional capacity. This may in turn increase pressure for consolidation among existing reinsurers.

It is also possible that the coming year will see more activity amongst those companies that are owned by private equity firms as they seek an exit strategy. Most of these businesses date from before 2009 – in fact some go as far back as 2007 – which means the PE houses have been invested from five to seven years, a time period after which they will want to realise some value.

Outside the US, the dynamic Latin American markets continued to be of interest to investors, with Brazil and Argentina leading the way in terms of transaction activity. The last months have also seen considerable interest in other emerging markets in the region; in fact, two of the year's biggest deals worldwide involved US insurers making acquisitions in Chile and Mexico.

Brazil

Brazil's insurance sector is one of the world's most dynamic. It has seen a decade of significant growth, fuelled by strong economic development, expanding broker channels and the rise of lines including motor and property. The Brazilian market is predicted to grow in the region of 7-10% a year for the next few years, with continued real GDP growth supporting the demand for insurance products. The growing middle class will increasingly buy insurance to cover their newly-acquired assets, while people on lower incomes are driving demand for micro-insurance products. In addition, the insurance market will benefit from significant near-term infrastructure development, driven in part by preparations for the country to host the 2014 FIFA World Cup and the 2016 Olympics.

With more than 100 insurance companies the market is ripe for consolidation and, during the period from July 2012 to June 2013, Brazil saw a spate of deals in the insurance sector. The majority of these transactions were domestic, with activity being driven by the desire from regulators to have fewer, stronger insurers serving the market. In the largest domestic deal, Yasuda Seguros SA (a subsidiary of Sompo Japan Insurance Inc) acquired a 37 per cent stake in Maritima Seguros SA for USD 98 million.

Bancassurance is dominant in Brazil, with the three giant bank-related insurance groups, Itau, Bradesco and Banco do Brasil controlling around 65 per cent of the insurance market in terms of assets, either directly or through strategic alliances or exclusivity agreements. Their position is only likely to strengthen as they continue to develop their brands, invest in systems, improve underwriting and profitability, and introduce new products. This will put further pressure on smaller players in the market and will likely serve as a driver of further transactions.

Unsurprisingly, the country is also very much on the radar of large international insurers looking for acquisition targets to offset stagnant growth in more developed markets and in 2012 US company International Finance Corp bought a 7.9 per cent stake in SulAmerica SA for USD 197 million. In addition, US-based The Travelers Companies, Inc increased its ownership stake in J. Malucelli Participações em Seguros e Resseguros SA to 49.5 per cent. On the completion of the deal, Alan Schnitzer, Vice Chairman and Head of Travelers' Financial, Professional & International Insurance business segment, said: "We are very pleased with the performance of our joint venture in Brazil. It continues to be the market leader in the surety insurance business, with a market share of approximately 30 per cent. In addition, we are making good progress on our early efforts to expand beyond the surety business into the growing property and casualty market."

It is perhaps surprising that Brazil did not see more cross–border transactions in the period 2012-2013. This may be a case of the majority of larger players already having a presence in the market, or potential entrants may have been put off by a combination of factors. The country's growth rate has slowed – the question is how much further it will do so. The riots that took place in early 2013 may have raised a note of caution among those considering a transaction, but they are more likely to be concerned by some evidence of protectionism after the authorities began to restrict the outward flow of premiums, recently stipulating that 40% of reinsurance should be placed with local carriers and limiting intra-company cessions to 20%.

However, it is likely that these factors will cause a slight slowdown in transactions at worst. The underlying fundamentals of the market point to continued M&A activity. This would be bolstered if plans that are afoot to create a national insurance centre in Rio de Janeiro to concentrate insurance and reinsurance expertise in one hub, based on the London model, come to fruition. Both domestic and international insurers are eyeing this potential development with interest.

Argentina

The insurance industry in Argentina is the third largest in Latin America and has sustained significant growth in recent years, with levels of premium reaching USD 12.8 billion in 2011. This has long attracted overseas insurers, leading to a significant level of transaction activity in the period 2009 to 2012, including notable deals such as Australia's QBE acquiring HSBC's Argentina Holdings SA and the UK's RSA Insurance Group acquiring Aseguradora de Creditos and El Comercio Compania de Seguros.

In a reversal of this trend, Argentina's insurance sector saw very limited deal activity between July 2012 and June 2013. The competitive landscape in the Argentinian insurance market remains relatively fragmented, suggesting that consolidation should be welcome and on-going, and those transactions that did take place were domestic. The 12-month period saw Galeno Argentina SA buy Mapfre Salud's workers' compensation and health business for an undisclosed sum in October 2012. Antonio Huertas, Chairman of Mapfre, said the deal would expand his company's distribution network of insurance products in Argentina. In another domestic deal, Grupo Supervielle SA and Sofital SA bought Aseguradora de Creditos in June 2013.

However, there were no transactions involving foreign insurers during the period. They will likely have been discouraged by the country's relative political and economic instability, and by reforms introduced in 2011 that limited the amount of risk companies could cede to international reinsurers.

This sentiment will have been reinforced by the announcement in December 2012 by rating agency Fitch that it was placing all its rated insurers in Argentina on negative outlook, warning that "the strong premium growth and profitability ratios of Argentine insurers may be hindered by a scenario of possible sustained lower economic growth, rising inflation and macroeconomic volatility". The agency also indicated that the array of controls and new regulations introduced by the government – including the recent imposition of a compulsory investment rule for all insurers – "limits the ability of insurance companies to deal with changes in the operating environment".

In another sign that deal-making activity in Argentina is likely to remain subdued, in July 2013 Moody's followed suit, changing its outlook for Argentine insurers from 'stable' to 'negative' for life and P&C sectors, citing high inflation and political uncertainty as continuing to have a detrimental impact on insurers' credit profiles.

Chile

Chile is the most developed market in the region. Its USD 9.67 billion in GWP means the country has the highest insurance penetration in Latin America, at 4.1%. This maturity, coupled with a small population, means there's less potential to grow in the long term. But in the near term, fuelled by a strong economy, business is thriving. In addition, despite facing significant catastrophe exposures, under-insurance remains an issue in the country. For example, the 2010 earthquake caused nearly USD 30 billion of damage, of which just US 8.2 billion was insured. However, since then, premiums have risen substantially, with demand for more sophisticated risks.

The Chilean insurance market remains relatively open to foreign companies, with potential entrants aided by a lack of regulatory barriers. In the tenth largest M&A transaction worldwide of the 12-month period, US Principal Financial Group Inc bought AFP Cuprum SA for USD 1.25 billion. Commenting on the transaction, Principal Chief Executive Officer Larry Zimpleman said: "This acquisition continues our effort to find targeted, strategic targets that strengthen our competitive position in the most attractive emerging retirement and long-term savings markets. Cuprum represents our sixth such transaction in the past two years and adds meaningfully to our fee-based earnings."

The period also saw a number of domestic transactions, the largest being the acquisition of Cia de Seguros de Vida Cruz Del Sur by Grupo Security SA for USD 300 million. These deals are likely to have been driven by pending regulation, with Chile moving toward stricter risk-based capital measurements. The Chilean insurance regulatory agency, Superintendencia Valores y Seguros, has issued its first risk-based capital (RBC) model as part of a bill that establishes a risk-based supervisory system for the insurance industry.

Although the initiative is currently under discussion and is yet to be approved by The Chilean Congress, this is surely a question of when rather than if, as the oversight authority moves to step up protection for insureds and the State, and looks to minimize the risk of insolvency in the insurance industry. However, implementing the complex requirements will present significant challenges that will see many insurers struggling to comply, leading to a rise in potential targets for acquisition.

Peru

Peru's insurance sector has enjoyed strong, steady growth in recent years. The market has grown more than 13% a year over the past decade, and between 2011 and 2012 the country's total insurance premium increased 9.6% to USD 3.1 billion. With penetration among the lowest in the region at 1.3%, combined with a positive macroeconomic outlook, rising consumer interest in buying insurance and the increasing sophistication of insurance industry players, the insurance market in Peru has significant growth potential.

These factors led to several M&A deals between July 2012 and June 2013. The most significant was Colombia's SURA Asset Management acquiring 70 per cent of Peru's Invita Seguros de Vida y Pensiones in November for USD 96 million. In another cross-border transaction, Spain's Sura Asset Management acquired Seguros SURA for an undisclosed fee.

In contrast to a buoyant level of M&A activity in recent years in terms of domestic deals, there was just one in the period, the acquisition of Protecta SA Cia de Seguros by Grupo ACP Corp SAA in May 2013. Unlike some other countries in the region, Peru has relatively few players in the industry with 28 insurers and reinsurers registered at the beginning of 2013. This, combined with the fact that the market is dominated by four large entities – Peru's Rímac Internacional, Pacífico Vida and La Positiva, and Spain's Mapfre – suggests that targets for future M&A activity may be limited.

However, Peruvian entities are starting to look elsewhere in the region for opportunities. In September 2012, El Pacifico Peruano Suiza Cia acquired a controlling 51 per cent stake in Bolivia's Crediseguro SA, a possible early indicator of an emerging trend.

Mexico

Mexico is currently worth more than USD 20 billion in premium, second only in Latin America to Brazil. However, this represents just under 2% of GDP, as the country remains an underpenetrated insurance market. This potential is underpinned by a strong economic outlook, a relatively youthful population, and a rapidly growing middle class, which now comprises 50 per cent of Mexico's population, compared with 80 per cent living in poverty in 1960.

A government drive to invest in infrastructure will create further opportunities for insurers. Under the National Infrastructure Plan for 2013-2018, the Mexican Government will spend USD 400 billion on projects in sectors including energy, tourism, transport, water and urban development. This will bring opportunities for foreign insurance and reinsurance as there is not currently sufficient capacity in the domestic market to carry the large risks that these projects will entail.

Unsurprisingly, Mexico is increasingly getting on the radar of international insurers looking to expand into emerging markets to achieve growth. Indeed, in May 2013, Mexico saw one of the largest transactions worldwide this year, when US insurer ACE bought ABA Seguros SA de CV for USD 865 million in May 2013 – the latest in a spate of Latin American acquisitions by the insurer. In April 2013, ACE also bought Mexico's Fianzas Monterrey for USD 295 million.

Describing the rationale for these deals, Evan Greenberg, Chairman and Chief Executive Officer of ACE Limited, said: "ABA Seguros is a well-established, well-recognized, agency-based insurer with a solid service reputation and impressive creativity that can be leveraged across Mexico and the Latin American region. With ABA, combined with our existing ACE Seguros businesses and our new ACE Fianzas Monterrey business, we are extremely well positioned to take advantage of the many growth opportunities we believe will occur in this important country over the next decade and beyond."

In terms of domestic transactions, there were only two in the period July 2012 to June 2013, both of which were restructurings, by Reaseguradora Patria SAB and General de Seguros SAB. These will have been driven in part by the announcement of a new legal and regulatory framework for insurers, created along similar lines to Solvency II in Europe. This development will likely spur further consolidation and there should be no shortage of targets. Mexico has around 100 insurers in the market and the sector is highly competitive. Although this has historically restricted growth, many insurers have improved profitability in recent years as a result of tighter control of costs and higher prices.