A.M. Best issues life/annuity M&A trend report

By Editor Test *Thu, Jun 27, 2013*

A June 19 report from A.M. Best offers a summary of recent merger history in the life/annuity industry along with an analysis of trends driving the industry.

From a new A.M. Best report on M&A in the life/annuity industry:

For many companies considering M&A, product mix has shifted to those that are less capital intensive as well as product designs with less generous benefits. Lines of business such as traditional fixed annuities, long-term care, banking, group medical and Medicare supplement have been de-emphasized by some industry players in favor of international expansion (largely through acquisition), fixed indexed annuities, indexed life, employer stop-loss and voluntary benefits sold through the worksite.

A.M. Best continues to see industry managers focused on core product lines, leading to decisions to exit product lines, which may lead to legal entity dispositions or reinsurance of certain business segments. For those transactions that include products such as level premium term insurance or universal life with secondary guarantees, disentangling from the often complex reserve financing that is in place presents unique challenges and require new solutions to be in place for successful execution. Systems integrations also represent a challenge.

Uncertainty in regulation continues to be a key challenge for the industry. Many of the regulatory issues that were on the horizon entering 2012 continue to be unresolved or yet to be implemented. This includes IFRS accounting, principles-based reserving, the NAIC Own Risk and Solvency Assessment (ORSA), Solvency II and the potential effects of the non-bank SIFI designation. Consequently, A.M. Best believes that life/ annuity companies will face significant costs of compliance, accounting volatility and likely greater capital requirements in the near to medium term.

Specifically, regulatory challenges, perceived or actual, are clearly driving dispositions of assets by international players and presenting opportunities for acquirers that were not previously present. This concern was certainly a driving factor for insurers looking to shed their banking assets. Some European-based organizations are feeling pressure to divest operations, largely driven by the impending capital requirements of Solvency II. Similarly, Canadian companies have also exited U.S. operations/business lines, largely driven by stringent domestic capital requirements.

The economy is also a factor driving recent activity. The prolonged low interest rate environment makes market/interest sensitive lines unattractive as margins are squeezed and capital costs rise. Into this arena have entered private equity asset management specialists who believe margins can be improved through perceived superior income generation and credit analysis skills.

These asset aggregators have grown rapidly and have caused some critics to question the long term value proposition and commitment offered to consumers and to the industry. Historically, plans included an exit strategy of five to seven years, either through an IPO, sale or run-off.

A strategy focused on investment acumen and to some extent, exploiting market inefficiencies, will need to be time tested to prove its effectiveness as an appropriate long-term strategy for the life insurance and annuity sector. A.M. Best remains cautious about the ability to fully integrate and extract long-term value from these blocks of business given the size and complexity of some of these recent transactions. A.M. Best will also evaluate the ability of private equity asset managers to effectively integrate management teams.

Potential for higher earnings and revenue growth is leading some domestic carriers to expand internationally through acquisition. Targets have included asset managers, distributors as well as insurance companies. However, foreign regulation may limit full ownership/control and necessitate accepting a minority ownership position instead. Not having full control of a foreign operation can present operational and managerial challenges. On the other hand, some U.S. carriers have abandoned certain international markets in favor of domestic opportunities focused more on mortality and morbidity risks, which generally exclude embedded guarantees.

Traditional factors also continue to drive M&A activity. In some of the cases cited above, geographic expansion was the main driver of an acquisition. In this case, a simple shell purchase can suffice if a company already has a built in distribution network in place or is looking to open up into a new market and only needs state licenses to broaden its strategy. In other cases, adding scale to an existing product platform or the opportunity to gain greater product diversification offer a compelling reason for a transaction. Finally, for smaller companies, divestitures were used to facilitate succession planning, unlock shareholder value, or as part of overall tax strategies, especially in 2012.