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ASIAN INVESTORS: RISING FROM THE EAST

Asian insurers continue to look to Europe and North America for diversification and growth opportunities, but what impact will these investments and acquisitions have on the western insurance sector?

By Pádraig Floyd

It is said that to survive one must change. That is certainly true of the global insurance sector. But the pace of consolidation within the global insurance markets is transforming evolution in this sector into revolution, as companies eagerly seek investors willing to put their capital to work.

In the past, acquisitions in the European insurance market were conducted largely by European – and occasionally other western – insurers. There was little or no interest from Asian buyers in this market, but this has been changing rapidly.

"It began with Japanese insurers expanding into Asia and the US, and two or three years ago they started to look at the European market," says Jerome Nebout, principal at Milliman in Paris.

Some firms established a small team – usually in the UK and often with an asset management focus – to start analysing the different European markets, in order to understand the products and regulatory environment.

"Japanese insurers have been actively engaging in European expansion, but around a year ago they were joined by Chinese buyers who began to show interest in the European market," says Nebout.

The obvious target for potential buyers is a Lloyds name. London, and specifically Lloyds, is the centre of the insurance world and has a reputation for innovation.

Buying into such a market is not easy, as there are not so many targets and there is ample competition. At the start of 2015, XL (Dublin) bought Catlin for £2.8bn and Fairfax (Toronto) purchased Brit. However, Mitsui Sumitomo sealed a deal to buy Amlin in September 2015 for £3.5bn.

Though Chinese and Japanese investors are also looking at the Netherlands and France, the US market is equally attractive to Asian companies and there have been a number of medium-sized – yet significant – acquisitions being made (see box).

When it comes to a bidding war, Asian companies are well placed, as they have shown a willingness to pay a premium for the right company, and there are a number of well-funded Japanese companies ready to move on the market. Nippon Life, for example, is said to have a war chest of $12bn and is in the market for US acquisitions.

Demographic shift

There is more to this expansion into western markets than merely seeking profit. It is a complex equation bound up with how long its population is living. Japanese – in fact pan-Asian – demographics tell a worrying story as workforces shrink at a rapid pace.

"Though there's a very good market for certain healthcare products and within the retirement income space, overall the life insurance market has been shrinking for many years," says Stephen Conwill, CEO – Japan, based in Milliman's Tokyo office.

Japan has long experience of a deflationary economy. Returns are low and show little sign of improving any time soon, and Japanese organisations are now looking for something to do with their capital. Markets that offer higher returns are an attractive proposition, as is the diversification that comes from investing outside their domestic market.

Kelvin Lee, a partner in the Hong Kong office of legal firm Ince, is a specialist in insurance and reinsurance in China and has worked extensively with Japanese clients.

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> Jérôme Nebout, principal and consulting actuary, Milliman

Lee says while foreign expansion offers an opportunity to Japanese organisations, these firms are also pioneers. Once they move into new regions, they have a ready-made book as existing domestic clients follow them there, offering them a guaranteed business base and a book from startup.

The history of Chinese acquisition is much shorter and has been encouraged by the relaxation of the rules governing foreign investment.

"The outflow of Beijing dollars has only begun recently, with existing domestic Chinese insurers investing not just in overseas insurance, but also property – including Ping An buying the Lloyd's building in London – and collateralised instruments," says Lee.

Just as the Japanese have been experiencing for some time, Chinese organisations are finding returns on domestic investment less attractive than they were. So insurance operations in China are looking to buy foreign insurers, but they are not the only ones doing this.

Fosun International is a giant Shanghai-based conglomerate that is diversifying itself across leisure, healthcare and in particular insurance markets in both Asia and the western world.

In recent months Fosun has bought US insurer Meadowbrook and Phoenix Holdings in Israel, and in 2014 bought a majority stake in Bermuda-based Ironstone and Portugese insurer Caixa Seguros.

Market consolidation

The irony is, the fundamentals of the western insurance markets are not good, says Sarah Lewandowski, an insurance analyst at Espirito Santo Investment Bank.

So it may seem odd for new capital to pile in. However, it is the perfect environment for the consolidation we have been seeing in western insurance markets.

"Underwriting rates are falling due to excess capacity as there have been no major catastrophes for two or three years, so growth is not looking good," says Lewandowski.

When underwriting is not good, insurers can usually generate revenues from the investment side of their business, but the heavy allocations to bonds in a low interest rate environment – compounded by the effects of quantitative easing – have damaged the profitability of these companies. Both sides of the business are suffering, so why should they be so popular?

Despite the lack of growth, insurance companies generate a lot of cash through premiums and that is attractive, particularly to Japanese investors who are in the mood to buy.

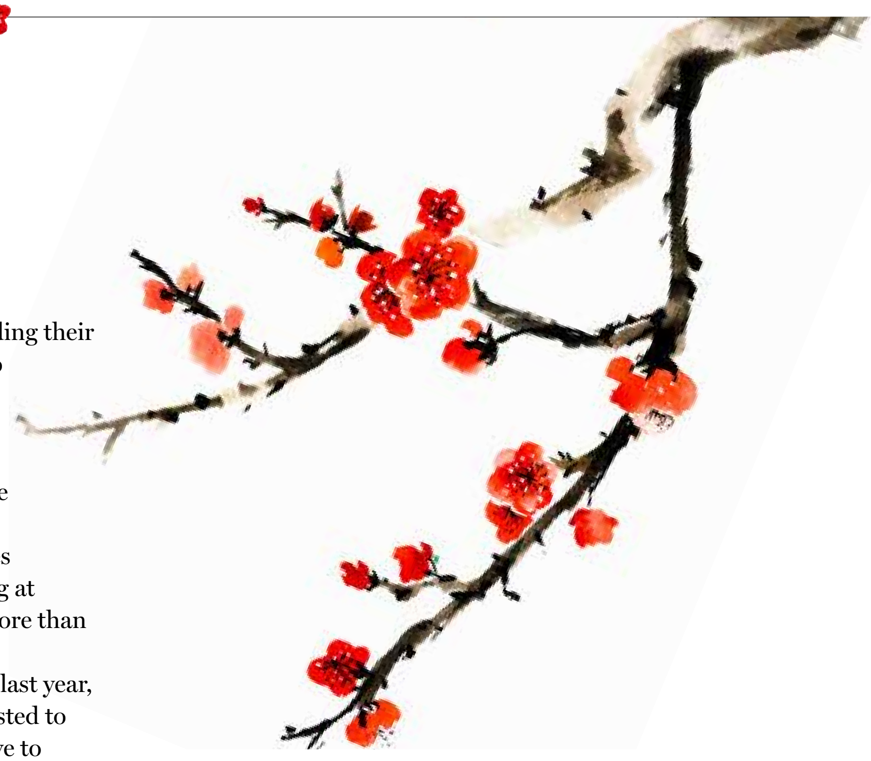
"Take M&A out of the equation and insurance doesn't look too good, but I upgraded the whole sector to a buy as there are Asian investors who are prepared to spend money," adds Lewandowski.

Diversification of product range is an important factor in these acquisitions, too, says Anthony Da Costa, equity analyst at Peel Hunt.

"The key is specialty insurance, which offers better rating and pricing than the rest of the market," says Da Costa, as catastrophe and property rates have fallen in recent years, while specialty rates have been going up, particularly in the US.

A major component of specialty lines is the growth of cyber insurance – a huge market with equally huge pricing increases – and as it evolves, the firms offering it may become targets.

"There is a lot of competition, so companies are looking for ways to be competitive in the market," adds Da Costa. "Many believe bigger is better, though there are those against such a position."



Sustainable funding source

Asian investors are certainly not afraid of spending their money on the right company. Mitsui Sumitomo paid 2.4 times net tangible assets to get control of Amlin, while Meiji Yasuda's $5bn offer for Stancorp Financial in July 2015 represented a 50% premium over the market cap at the time of the transaction.

Fosun's chief executive, Liang Xinjun, believes western insurance companies are cheap, trading at around one times book value compared with more than two for Chinese counterparts.

In an interview with *The Wall Street Journal* last year, Liang said insurers' pools of capital can be invested to seek high returns and this makes them attractive to Fosun as well as other investors.

"Insurance is the most important business segment for us – the build-out of insurance gives us a cheap and sustainable source of funding," said Liang. "The persistent low interest rate environment in the US and Europe has made the acquisition targets there look more attractive."

It can be dangerous to view insurance companies as cash cows, as some have learnt to their cost. But, with investment portfolios – particularly among the life insurance sector – heavily invested in bonds, many western insurers have struggled with profitability, leaving little to be invested in future growth.

Asian investors have the capital these companies need and are willing to invest in their future and to deliver better returns than they might expect from domestic markets – a truly symbiotic relationship.

Whether this is new capital or funds released from economies achieved through consolidation is something of a moot point, and may depend which side of the transaction you are sitting.

RECENT GLOBAL INSURANCE DEALS

Date announced	Investor	Acquisition	Deal
June 2014	Daichi Life (Japan)	Protective Life Corp (US)	$5.7bn
December 2014	Fosun International (China)	Meadowbrook Insurance (US)	$433m
January 2015	XL (Ireland)	Catlin (Lloyds, UK)	$4.0bn
February 2015	Fairfax (Canada)	Brit (Lloyds, UK)	$1.7bn
June 2015	Fosun International (China)	Phoenix Holdings (Israel)	$489m
June 2015	Tokio Marine (Japan)	HCC Insurance Holding (US)	$7.5bn
July 2015	Ace (Switzerland/Lloyds, UK)	Chubb (US)	$8.0bn
July 2015	Meiji Yasuda (Japan)	Stancorp Financial (US)	$5.0bn
August 2015	Sumitomo Life (Japan)	Symetra (US)	$3.8bn
September 2015	Mitsui Sumitomo (Japan)	Amlin (UK)	$5.0bn

Cultural synergy

Those with little or no dealings with Asian corporations may fear a culture gap could impede the smooth process of an acquisition – or even have implications for their careers.

Though Japanese firms in the past would often try to turn a foreign acquisition Japanese and parachute people in to run it in a Japanese style, that doesn't happen anymore.

"That is very old school," says Ince's Lee. "In the last six or seven years, Japanese organisations have given as much autonomy to acquisition targets as they would their own operations."

It's not as if they all lack experience, either. Mitsui Sumimoto and Tokio Marine have a long history of investing into western insurance and this growth is not confined to the US and Europe.

A good example is the Hong Kong office of the Mitsui Sumimoto Insurance Group, says Lee. It was previously an Aviva operation, and walking around the offices, you can hardly tell it is a Japanese company.

"They look at the figures very hard, in particular the major claims, but don't manage the day-to-day operation," adds Lee. "This is because they are interested in the business fitting within the local system, rather than looking Japanese."

Regulatory environment

Fitting in with the local culture is important, especially the business culture, says Richard Britain, a partner at DWF.

Britain says Asian investors are more likely to favour markets where there is a relationship between the industry and the regulators that it has in its domestic market.

"Singapore has a much more similar way of dealing with entities such as the Financial Conduct Authority (FCA) in the UK than perhaps in the North American market," says Britain.

"North America is a more box-checking regime and more litigious, where entities might sue the regulator if they do not like the direction of regulation."

Of course, business plans don't always run smoothly, even in a regulatory environment that Asian investors feel more comfortable within.

Mitsui Sumimoto was fined £3.3m in 2012 by the UK regulator for management failings in expanding into Europe.

"Japanese executives would come into the UK business for a tour of duty, but did not offer enough challenge to the boards and were considered too placid," says Jeremy Irvine, a partner in regulatory and insurance at DWF.

"Japanese – and Asian owners in general – are pretty hands off, but in that instance they were considered too hands off, which led to the problems."

Despite the occasional hiccough, as Asian investors derive a degree of confidence from regulatory infrastructure, they trust businesses in those regions more than they might otherwise. And Japanese businesses are not only good at process management, says Stephen Conwill at Milliman.

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Despite limited international expertise, they are in fact excellent employers.

"They're very good at managing employees. If you look at US or Japanese firms in the industrial sector, such as auto factories, the employees have been very happy long-term to be part of a Japanese group," he says.

This, combined with autonomy for the local management – at least for as long as the business is profitable – makes simple business sense. Continuity is the watchword if you are to keep your key staff and for Lee, these deals are often less of a takeover and more of a merger and as such, should be welcomed.

"There is additional capital and they allow insurers to do more business in their own way," he says. "If they introduce Japanese subsidiaries, they are generally set up as a different division inside the company, providing clear demarcation between the two that helps to build a book for both of them."

While executives are retained, some may find progress more difficult as they find themselves part of a larger Asian organisation. That may be attributed to cultural difference, but it is as likely to be due to individuals finding themselves a smaller fish in a larger pond, and with considerable competition.

Continuing trend

The trend for Asian investors to seek to expand into western markets hasn't finished, yet. A lack of experience in western regulatory regimes means they require skilful consultants with the local knowledge to help them build their overseas operations.

This lack of experience shouldn't be confused with naivety, though, and while Asian investors are buying into markets like London, it isn't simply to reproduce it back home.

These insurers are experts in their own right. For instance, the Japanese life insurance market is as large as Europe combined, second only to the US and followed by the UK.

"Though dominated by traditional products, there is a need for new products and this has resulted in joint ventures and initiatives with providers of credit insurance," says Lee.

Consolidation continues apace. Though the recent attempt by Ace/Chubb to buy RSA in the UK was aborted, these types of deals will continue to be made.

With no major losses reported from the 2015 hurricane season, there is increasing likelihood of merger and acquisition being used as the way to deliver growth.

Asian investors have the cash to help some capital-starved western insurers generate growth in a difficult climate. Perhaps we are about to witness the start of a new chapter for the global insurance industry.

However it plays out, working in partnership with these investors will prove to be a challenging and rewarding enterprise, as they learn to operate in different regulatory, business and social cultures.

Find out more

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