

## Trends in insurance transactions part 1: private capital

Stephen Quinlivan

Hello and welcome to the A&L Goodbody insurance podcast. My name is Stephen Quinlivan and I'm a corporate partner here in A&L Goodbody. I'm joined today by my colleague, Laura Mulleady from our insurance and reinsurance group.

Laura Mulleady

Hello, everyone. Today, we're going to be discussing some recent trends in insurance transactions in Ireland and in the European market. And we're also going to talk about what the central bank looks at and for, when asked to approve a new prospective owner of an Irish insurer.

So, to get us going, Stephen, I know we're going to focus a bit today on one of the trends we're seeing being the continued interest of private capital in insurance businesses in Ireland and in Europe. And we've given this some close focus at a recent event we held with a number of our clients. But do you want to kick us off by starting with a word on some recent transactions we've been involved in as well as some general trends in insurance M&A?

Stephen Quinlivan

Yeah, sure. Thanks, Laura. I think, as you mentioned, the big trend has probably been the interest of private capital across the insurance sector in Ireland and across Europe over the last sort of 10, 20 years. Consolidation of distribution channels in Ireland and elsewhere in particular has been a really big trend. And this has touched on consolidation of both insurance distributors and also financial advisory type businesses.

Some of the platforms that have been acquiring these businesses have become very, very large. They have a really big scale. They're putting a lot much more pressure on insurers. Some of them are also entering into a type of exit phase at the moment as well, where they're looking at the sort of next steps in their development.

In some cases, it's difficult to know where some of these platforms will go, given how large they are. It may be that sort of IPOs are needed to facilitate exits in some cases. So that'll be an interesting area to watch. In the last 12 to 24 months, we're starting to see a little bit more strategically driven M&A across the sector as well, involving both life insurance and non-life insurance undertakings. To name even a few local examples we've been involved in recently, we've seen Zurich's agree to acquire the red-click insurance business from

Generali. We've seen IFG agree to buy the Irish headquartered Octium Life Group. We're also involved in Zurich's announced takeover of Beasley, which again has another non-life insurance undertaking in Ireland. A lot of these deals have just signed and we're going through various regulatory approvals at the moment, which are keeping the team quite busy here.

We are continuing to see many life insurers dispose of closed books of life insurance also. And consolidators such as Thora Monument Phoenix are very active in this space in acquiring these books. So, this is a useful external run-off solution for life insurers in Ireland, a lot of which are quite well established here. At a European level and in particular in Northern Europe, we're starting to see a renewed interest in bank insurance structures. Bank insurance has probably gone out of fashion in Northern Europe to a large extent due to misselling issues and restrictive capital rules around the extent to which banks can hold insurance subsidiaries against the regulatory capital. Those rules have been relaxed somewhat recently and that's sort of triggered a renewed interest in this space with a lot of banks looking to internalize insurance offerings. So that's given rise to lots of joint ventures and acquisitions in that area. So it's another one to watch again.

In terms of private capital interest in life insurance in particular, a big driver of these deals worldwide has been what people are calling the convergence of insurance and asset management.

And this is where private capital are looking not only to acquire life insurers to generate underwriting returns, but also to generate new asset management opportunities through more diversified investment of the insurers on capital and also through investment to policy holder funds and earning fees and commissions from those opportunities. So, we'll talk a bit more about that topic shortly, but given the trends we've just touched on, we thought it'd be useful to bring Laura back in to touch on some of the regulatory concerns that these acquisitions in particular by PE buyers can give rise to.

Laura Mulleady

Yeah so I suspect those listening in will be aware that across the EU and indeed in the UK as well financial services regulators really play a gatekeeper role when it comes to a life or a non-life insurer changing hands. And that same gatekeeper role applies where there are certain changes in percentage holdings of shares or control in an insurer. These triggers and indeed the approval or non-objection timelines are all set out in the Solvency 2 Directive and they probably merit a podcast all on their own. So, for now I'll assume that our listeners are generally familiar with them and if not do please come and talk to us. So rather than on the mechanics I'm going to say a few words on the lens the Central Bank puts on a prospective change in ownership.

The Central Bank's attitude has really evolved over the last decade with a greater awareness of the potential benefits of PE ownership including access to capital, diversified investment strategies and operational efficiencies. But equally I think it's fair to say that the

Central Bank and other EU regulators are now more aware of the potential risks in particular for more complex long-term life insurance business where exit scenario analysis is going to be particularly important. A lot of attention has been given recently to an AOPA consultation on a proposed supervisory statement on the authorization and ongoing supervision of insurers related to private equity and like us, I suspect some of our listeners may have read this and probably reflected that the Central Bank has certainly been scrutinizing acquisitions using the themes and features in that paper for quite some time and we certainly feel that if the supervisory statement takes that form, it should actually be quite helpful to a levelling of the playing field across Europe in this regard.

So I'll touch on the Central Bank's key focus areas many of which are as relevant to a change in ownership of a non-life insurer as to a life insurer. So firstly what will the impact on the business model be?

The Central Bank is going to want to know if there will be changes to the business plan that are driven by value extraction by the private equity firm. Things like extensive outsourcing to lower cost centres, changes in investment strategy which Stephen, I know you're going to speak to shortly and changes to investment in long-term operational capabilities such as IT will be a focus. The Central Bank will also look to whether the investment horizon of the private equity firm could impact negatively on the insurer's long-term commitment to policy holders. Now this is really important - the Central Bank is going to want to stress test whether there's an inherent conflict between the long-term investment and commitment that life insurance needs and the classic PE model of buying an asset and then selling it again within, say, three to seven years.

Part of the Central Bank's stress testing will be to require a whole range of exit scenario analyses. In looking at this, the Central Bank really wants to see that the acquirer gets the nature of the business and that long-term policy holder certainty and security is paramount and that understanding is probably taken as a given under financial institution ownership, but it does really need to be probed in a private equity context. Then transparency of ownership is a focus.

Private equity firms can have very complex ownership structures which often separate capital or economic rights from voting rights. Some structures will also include investors with particular sensitivities such as sovereign wealth funds that do not want their investment to become widely known. But I think it's fair to say the Central Bank is by now familiar with all of these dynamics and they are generally fermentable when there's early and open engagement with the Central Bank.

The last one I'm going to mention is the impact on insurer governance and conflicts of interest. I think, suffice to say, that the board of the insurer must have sufficient control to ensure that it is sufficiently independent from the PE firm and my personal experience is that this can be one that needs to work both on paper so in how it's put to the central bank as part of the acquiring transaction process but also in the sense that the central bank gets when it engages with the private equity firm management pre-acquisition.

So having talked a little about how the central bank may stress test the acquirers suitability and intentions, perhaps Stephen, we should now think about what the impact on the insurer itself might be. Though, would we expect to see a change in strategy and on the insurer's business plan?

Stephen Quinlivan

Thanks Laura, that's an interesting question. And look, as we mentioned at the outset, a lot of private capital's interest in life insurance in particular extends beyond the ability of the target company to generate underwriting returns. More and more in recent times, private capital's interest in this sector is driven by the opportunity to generate increased returns from asset management opportunities, in particular with respect to life insurance companies with long-term capital-intensive businesses like whole of life annuities.

For private capital, these types of insurance vehicles offer access to well capitalized balance sheets and consistently high levels of long-term assets under management. The increased return on investment for buyers on the asset management side can be generated both for more sophisticated and diversified investment of the insurer's own capital into alternative assets such as private credit, real estate and infrastructure, as well as from commissions and fees which can be earned from the investment management of policyholder funds.

In the latter case, those returns are often made through affiliated asset management companies and managed funds. The consultancy for McKinsey has labelled this playbook used by private capital managers, investing in life insurance as a virtuous flywheel that has three main elements. Issuing or acquiring policies to scale, which is in essence, generating or acquiring insurance liabilities in order to fund assets and capital requirements.

The second element is managing capital in a more dynamic manner, including taking in additional third-party capital where required and using reinsurance structures to free up capital internally. The third element then is the differentiated investment of the insurer's capital and also policyholder funds were required to earn commissions and fees. So, these three elements are seen to be self-reinforcing, they'll continually generate more capital and the ability to issue more policies and then greater returns for the private capital investor. So, there's an element as to what could actually go wrong with this structure and I know, Laura, you've been thinking about some of the more practical elements and regulatory risks for policyholders and things insurers need to think about when implementing these changes.

Laura Mulleady

Yes, so for those within the insurer, including on its board, as they work through the acquisition process, they need to ensure continued alignment between and good communication with all of the different functions and committees within the within the business. And the types of things that will need focus by the board will include things like arrangements with other, be that internal or external asset managers, that may need to be

terminated or revised, and the acquirer may want to discuss that with the insurer's head of investments.

The board, and this is important, the board is going to want to know that the customer perspective has been considered very carefully. And then at the very least, on the surface, it can be that policyholders may be in a better position. They'll have better returns on investments, they'll have a wider choice of investment fund options, and they'll probably have lower annual management charges as well.

In the short term, the insurer's solvency position may improve due to capital optimisation strategies. And these are all good things, but I suppose the question for the board and of course for the regulator as part of its assessment will be, is there anything else going on below the surface or what else needs to be scrutinised?

And in looking at that, both the board and of course the Central Bank will be thinking of the potential for conflicts of interest. One side of the private equity house may originate alternative assets. The insurer then invests premiums in those assets or offers them as investment choices to unit length policyholders. These will then be extracted by the private equity firm at various stages of origination, sale and management. And we may see the introduction of or increase in alternative assets by private equity owners to back liabilities, particularly if originated by another entity in the group.

So the board will be thinking, could the investments be more illiquid? Could they be more complex, harder to value? The chief risk officer and the head of actuarial function are going to want to look at asset quality in stress scenarios. So, I think what I'm saying is there's an awful lot for the acquirer to consider, and then there's an awful lot for the board to focus on going forward. And of course, those areas of focus for the board will be common to areas of focus for the Central Bank.

Stephen Quinlivan

We hope you find this podcast helpful. Stay tuned for part two and our colleagues, Stephen D'Ardis and David Main, will focus on pension risk transfer deals. If you have any questions on what you've heard today, I can be reached at [squinlivan@algoodbody.com](mailto:squinlivan@algoodbody.com).

Laura Mulleady

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