insurance insider

Monte Carlo Roundtable 2022

In association with

LLOYDS BANK

www.insuranceinsider.com

insurance insider

Monte Carlo
Insurance Insider M&A Roundtable 2022

Roundtable participants

Rachel Dalton
Lead Reporter
Insurance Insider

Tracey Anchundia
Head of Insurance
North America
Lloyds Bank
Corporate Markets

Jason Howard
President, Acrisure
International &
Chairman
Acrisure Re

Stephen Velotti
Chief Executive Officer
and Chief Information
Officer
Pillar Capital

Mark Craig
Chief Financial Officer
Howden

Richard Askey
Managing Director,
Head of Insurance
Lloyds Banking Group

David Govrin
Global Chief Underwriting
Officer & President
Americas Reinsurance
SiriusPoint

Leo Beckham
Partner
TigerRisk

Andy Beecroft
Managing Director, GC
Securities M&A Advisory
Guy Carpenter

Welcome Letter:
A uniquely complex and dynamic topic

The debate over where the best home is for a reinsurance business is an age-old one, and in an environment where investors are less than keen on reinsurance as an opportunity, it has become even more critical.

Some believe reinsurance businesses ought to stand alone, given that they are specialist and prone to volatility. Others believe a pairing of a reinsurance business with a primary business, or even within a consumer lines or composite financial services group is a better play, with the other elements of such an entity working to diversify away cat risk.

At our roundtable at the Monte Carlo Rendezvous, sponsored by Lloyd's Banking Group, we assembled a panel of experts from the reinsurance broking and underwriting arena to tackle the thorny questions around reinsurance M&A.

Our experts discussed the reasons why investors are presently less than enthusiastic about reinsurance, with a five-year run of outsized cat losses featuring principally among them.
We also looked at the recent spate of sales of reinsurance businesses (or attempts thereof) and whether or not there is the opportunity for a new investor to enter the scene, buy up unwanted reinsurance businesses and make a consolidation play.

In the broking world we looked at the unprecedented levels of consolidation, driven by private equity and institutional investor hunger for a cash-generative investment in a fragmented marketplace. We asked how much further the broker consolidation road has to run, and where the next hotspot might be for such an opportunity now that the UK and US markets are fairly mature in that respect.

Lastly, we looked at whether investors might turn to the legacy market as that too heats up – and whether or not this corner of the market could experience its own phase of consolidation.
We explore these themes and many more with our panel of experts over the next few pages. We hope this summary helps to further understanding of a uniquely complex and dynamic topic.

Rachel Dalton
Lead reporter, Insurance Insider

Rachel Dalton

To kick us off, can you give us an overview of what you see as the main forces at work in the sector.

Richard Askey

Volatility, whether that's macro-economic, insurance sector specific or equally in the bank space, feels like it's here to stay. From an insurance client perspective, the rate outlook in most classes of business is positive. The situation is probably ahead of expectations from when business plans were starting to be formulated in the summer. And clearly from the London market for example, the market looks in better shape than probably many participants have seen for quite a while now.

However, I think you've there are several headwinds still. You've certainly got the understanding of the mark-to-market situation on the underwriter's balance sheets. I don't think there's any question about the quality of the investments that businesses are holding so we see that as something that will unwind over time but produces "noise" in the financial statements.

I think you've possibly got some capacity constraints that we're hearing about as well. The availability of new capital appears to be more limited, trapped capital for ILS structures is prevalent thus capacity for reinsurance and retro feels to be tighter despite the hard market outlook.

Rising interest rates and (claims) inflation add to the complexity of navigating business planning assumptions.

Tracey Anchundia

I think I'll probably say that the financing question is probably a bit more sensitive in terms of what we're seeing in the US.

Rachel Dalton

In terms of reinsurance, what is the best type of ownership for a reinsurer: within a larger composite group that provides insurance and retail services or a standalone entity, bearing in mind we're in a world where volatility seems to be a norm and investors don't really like that? Would anyone like to kick off with that one?

David Govrin

I'm happy to start with that. In my opinion, it depends on the ownership structure. It's almost impossible to be a mono-line public reinsurance company and satisfy investor returns. So, if you want to be a reinsurance only company, I think, private structure is better.   I think reinsurance is optimal considered as a product line within a larger insurance group. So, a composite.

Andy Beecroft

I think there are several factors which means there are advantages for a reinsurer to be housed within a larger group. One of them is the diversification benefits, particularly on the cat exposure side where reinsurers have heavy cat loadings, on which the rating agencies are quite penal. Therefore diversifying that against the insurance portfolio means you get some capital benefits.

So, I totally take your point there, standalone mono-line becomes really difficult because the diversification is not there, and if you write perhaps property, specialty and casualty, you get a bit more. That said, I do think there are some advantages of being a standalone reinsurer such as avoiding channel conflict. It's also probably easier to stay small and nimble in terms of headcount as a standalone insurer, and to be in a more beneficial tax jurisdiction.

Jason Howard

I think from an investor standpoint there is a cap on multiples which limits the valuation of reinsurance carriers. And that's why I think a number of heavily reinsurance-focused businesses have diversified into the insurance space because there's a bigger headroom on what you can achieve from a multiple standpoint. And I think that's probably a trend that's set to continue. Pure public market only reinsurance? Very limited investor appetite for that scenario. Even the big reinsurers are all diversified into insurance classes as well.

Leo Beckham

We are seeing a third way and emerging new paradigm of being a manager of reinsurance risk. RenRe, has demonstrated that you can have lots of different pools of capital, which also provides you with an income stream from managing third party capital. You can also see what Ariel Re is doing in terms of using third party capital alongside its own capital base from its shareholders.

And I think very interesting to see another (re) insurer, Fidelis, moving its balance sheet away from its distribution facing underwriting arm. So, maybe there are other ways of managing the balance sheet component of reinsurance [other than as part of a composite group or as a "pure play" reinsurer].

David Govrin

The drag on valuation isn't the issue, it's the returns on reinsurance underperforming insurance returns. If you ran only an insurance business, and the reinsurance business produced the best return, you would allocate more capital to it and investors would likely reward you for it, depending on their view of the sustainability and growth. So, it's a drag because of performance and franchise value.

Richard Askey

With challenging conditions in public debt capital markets, strong investment grade (diversified) counterparties, who are regular issuers are likely to currently be the only clients who find favor with investors.

Andy Beecroft

At the moment fundamentally there's not been enough average return, particularly over the last 5 years to compensate for the volatility. Arguably if the return was there to compensate for the volatility, then possibly the standalone reinsurer becomes more attractive. And that's because we've been living in a very low interest rate world for a long time and capital has been plentiful. Capital has become less abundant over the last 3 or 4 months and that trend will probably continue. So perhaps there might be a change in the dynamic.

Rachel Dalton

Given the way in which we've – this might be about to change as you pointed out Andy, but given the way that investors have been so down on reinsurance as a sector, the fact that there are a number of assets on the market, do we think that there is a sensible argument you could make for a consolidation play of those reinsurance vehicles that are available?

Andy Beecroft

I think you can make a strong argument for the investment case for going into reinsurance at the moment. Underwriting conditions are pretty good. After years of extremely low interest rates, significant investment returns can now be made. And if you want to go it alone, you can probably pick up assets at a reasonable price.

Arguably, insurance and reinsurance tend to go through almost an inverted cycle between the rating on underwriting environment and the M&A valuation environment in that when rates are at their peak, valuations and M&A interest are often at the floor. We saw this in the last cycle between 2010 and 2013 when rates were probably at their highest and actually, the M&A wave and the high valuations, particularly for Lloyd's anyway, came in 2014 to 2017.

Leo Beckham

The high value deals happened at that time because it had been a sustained period of soft market conditions, so there was a perceived benefit of scale and relevance, and as such high-quality assets were trading at high prices. So that's where we see that apparent "counter-cyclical" phenomenon.

At the same time, a bunch of average performing assets were also trading for lower valuations (i.e., around book value), driven by basically not having a right to exist independently anymore and not being able to generate sufficient returns. So, a sustained soft market does drive heightened M&A activity, of which some is at counter-cyclical high valuations for the highest quality assets.

I think in terms of whether there is an opportunity for a new investor to come in [and acquire and consolidate reinsurance businesses with depressed valuations], yes, but you have to ask what are you actually buying, for a start? This (in particular proper cat) is a (largely) commoditised market so why buy something that exists versus starting up on your own? So, you're not going to pay a big multiple for it, probably book value (or a small premium) at most.

Leo Beckham

And the second thing is who is going to run it? Most of the available and qualified talent did their deals in 2020 so it's not like there's a long list of people who are capable of doing this, and it's not an easy task to do, to combine and run four or five businesses that aren't performing where they currently are. Yes, we would like to see it happen and it would potentially be positive for the market, but it doesn't mean it's going to be easy.

Rachel Dalton

Obviously there have been a multitude of broking M&A deals, particularly in the reinsurance space, of certain sizes. There was one very big one that didn't happen. How much scope do we think is left in the market for broking M&A specifically?

Mark Craig

There are about 20 private equity backed brokers in Europe alone and probably 30 or 40 in the US, all of whom are acquiring businesses. There's equity and debt available especially for smaller M&A. Large deals are currently difficult because underwritten leveraged loan market is gummed up with stuck syndications in the US. But for anything under £1 billion, you can still raise money. So, I think there's a long way to go.

Jason Howard

Yes, I'd agree with that. I think if you just look at the deals that have been done in 2022, they have involved small to medium-sized brokers being acquired. Acrisure has done in excess of 100 transactions so far this year, there are plenty of excellent business looking for new partners. Do I see something of the size of an Aon Willis? I can't imagine anything like that is going to happen. I do not believe that any of the large brokers out there are not for sale at the moment. However, never say never, some of them may be looking for new homes down the line.

The market comprises the large quoted brokers, the large private companies such as Acrisure, the Private Equity-backed consolidators and then the independent brokers. There's still a wall of PE money out there to be invested, but with interestsrates rising on an almost daily basis, the cost of capital is going to get a lot more expensive.
yet have that.

"A sustained soft market does drive heightened M&A activity, of which some is at counter-cyclical high valuations for the highest quality assets."

Leo Beckham

Richard Askey

In lieu of public debt market issuance, we are seeing requests for bridging finance to support certain strategic / M&A activities. Thus, clients can find a financing solution for the right transaction until an improvement is seen in the public markets to refinance.

Mark Craig

And even without the leveraged loan market we have raised $1.4 billion this year from debt funds. So, it's still possible.

Rachel Dalton

Talking about the availability of financing, we have a question here about the impact of rising interest rates on the availability there. Is that something that concerns everybody or are there ways round it? mindset of hoovering vendor data but not sharing their own data (to their own benefit) will not help the industry advance; thus, more innovative approaches are necessary to break this impasse.

in insurance insider

Mark Craig

From a borrower perspective we, like many others, have fixed the rates of our existing loans. So historic loans will have good visibility on rates. For new borrowing rates will be much higher. However, these businesses are very cash generative, they can afford to pay higher interest rates. So, the increasing interest rates tends not to slow down M&A in the short term.

Rachel Dalton

But what about on the balance sheet business side, rather than broking?

Andy Beecroft

Moving on from data. Adrian, could you give us examples of where there's been product innovation or risk innovation around a smart application or partnering with a tech company or insurtech?

Adrian Jones

On the balance sheet side, I think it makes things more interesting. As interest rates go up, capital is going to become harder to attract. Balance sheets have been undervalued for quite a while and the change in the interest rate environment makes capital scarcer, insurers will finally make some money on their float, which they haven't done for a long time, and that might actually come at a time of a slightly harder market conditions, so you end up with gains on both assets and underwriting for balance sheets.

So, I think the value of balance sheet insurers should rise over the next few years. That will eventually lead to M&A but I'm not sure about the exact time scale.

David Govrin

I completely agree with you on that. Looking at asset leverage versus premium leverage, most balance sheets have significantly more asset. With increased yields, run rate investment income is going to be materially higher at the same time as the premium is getting more profitable. So, the returns on balance sheets will be going up and should be recognised in valuations.

Andy Beecroft

And this is what happened in the past particularly for longer-tail lines. The people had priced in insurance rates and then when insurance rates fell, it took a while for the prices to adjust. The question is whether that happens in reverse. We're still not sure

"There are several factors which means there are advantages for a reinsurer to be housed within a larger group."

Andy Beecroft

where interest rates are going so, I think at the moment, particularly in the current market, people are going to be reluctant to be pricing for investment gain.

Stephen Velotti

Certainly, on the property side where results have been below average. We talk about the hard market. Whatever you thought risk was 10 years ago, it's more today. But certainly, if you look at the rate increases, any of the pricing indices from the brokers, those are revenue indices. It has nothing to do with risk. So, if 2021 is 10% price increase, even though the company grew by 10% and inflation was 10%. So, it actually went down, it's actually a reduction in profitability.

So, they don't risk adjust that anymore and if you look at those pricing indices, it looks like it went back to where we were in 2007. It's nowhere near that. It's maybe pricing in 2013 or 2014. Risk is materially higher today regardless of how we want to try and calculate that. So, the rate increases are being reduced by expected loss and inflation.

We were down in the 5% expected return after fees and expenses and now we're getting closer to 10 expected returns. That's after 4 or 5 years of rate increases. So, it's far from plunder and pillage. So, I'd say the market is certainly healthy but it's far from just write anything and you're going to make some money. It's still pretty tenuous.

Rachel Dalton

One of the things that I wanted to ask about was the legacy space particularly in terms of M&A, given that there's a lot of private equity interest still and that's an area of the sector that hasn't seen that many deals. What do we think? Is it ripe for consolidation?

Leo Beckham

I suppose the first thing I'd say is that more, higher quality capital coming into the legacy sector is only a good thing for the market overall. The legacy sector has come on leaps and bounds from where it was 20 years ago when typically, it was a market of last resort if you had a problem portfolio that no one else would touch. Now it's a respected tool for capital management for CEOs and CFOs of insurance companies and reinsurance companies.

Clearly, [new capital is] going to demand returns but much of that is coming out of longer term "Strategic/Tactical" type funds. And therefore, they're not constrained by for a typical PE type cycle or traditional PE type returns (e.g., 20%+) either it's more measured than that with target hold periods more like 7+ and target returns in the high teens. And therefore, I think it's there for the longer term, which is again, good for the sector.

Andy Beecroft

Yes, I agree. Traditional consolidation which is what you first asked about is very difficult in this sector because the deal dynamics just don't work in the same way as particularly brokers and the same for insurers. You don't get the same economies of scale. If you've got somebody who is in the US who wants a Lloyd's/European platform, then there are some synergies there. But if you've already got that, as most of the players have now, then one company buying another is not going to value that franchise and the synergies are not there. So, they're not going to pay much goodwill and unless you're in a fire sale situation, the rest of the companies aren't going to sell at minimal goodwill.

However, consolidation in the form of all-share mergers if the shareholders can all get on board could be a possibility.

Leo Beckham

There are at least a small handful of CEOs in the sector as well as shareholders who are open to it. But no one is quite ready to shoot first at this point in time is our sense.

Jason Howard

And we are certainly seeing a lot of demand for the legacy product. As capital becomes more expensive, and balance sheets are affected by carriers having to mark-to-market their bond portfolios, many are looking to release capital through a legacy transaction. So, I think the appetite for the product is there and will be for the foreseeable future. I believe it is quite possible that there is consolidation amongst legacy carriers as you suggest, it feels it's about time.

Leo Beckham

The general consensus is why would they want to distract themselves by doing a messy merger with someone else where they can just go and do more deals at the front end? I think if that pipeline dries up (and there's no sign of that happening any time soon) then that changes the dynamics a bit.

Rachel Dalton

I just want to bring Tracey and Richard in here to check if there are any points that you want to bring up before we finish today that we haven't had a chance to get to yet.

Tracey Anchundia

On the M&A side of things I think one especially for the Bermudians is the impact of the US public [DCM] markets not being in great shape, especially the broking space of the leveraged loan. Really the only market that has stayed stable is the banking market. But you have the bridging facilities that Richard mentioned, and in addition to that you have the changes on the [S&P] side which is going to impact what the Bermudians do from a [senior note] perspective. So, you don't know exactly how they're going to take out the bridging loans, you don't know how the banking facilities are going to finance these transactions. So, I think you have a bunch of people who are waiting on the side-lines and seeing what's going to happen across all markets and saying let's see how the next 6 to 12 months shapes up. And

"It's almost impossible to be a mono-line public reinsurance company and satisfy investor returns."

David Govrin

then deciding on M&A or just their own capital financing.

Mark Craig

From a risk perspective bridging loans aren't attractive. I've witnessed situations where it's been difficult to replace them.

Rachel Dalton

Any final comments that anybody wants to throw into the mix?

Stephen Velotti

Investors want a fee-generating group. And then all you have to do is control your expenses. You've got to pay the right price, but a big balance sheet is something that is not appealing right now.

"In lieu of public debt market issuance, we are seeing requests for bridging finance to support certain strategic / M+A activities ."

Richard Askey

Andy Beecroft

It's going to have a discounted valuation but arguably it's got more longevity for the business model. If you have fixed commission and you're not delivering to the balance sheets, then you're going to lose that capacity. So, MGAs need to create a balance. Obviously, they want fee income to get a valuation, but I think they need PCs for alignment with insurers and make sure the model stacks up.

Rachel Dalton

Thank you very much.


COMMERCIAL BANKING
By the side of the insurance sector
As the insurance sector addresses increasingly complex regulatory, economic and financial changes, it helps to have a bank that's close to the issues you face.
Lloyds Bank is a long-standing supporter of the UK insurance industry. We are also a leading player in the Lloyd's of London insurance market and have strong relationships with firms in global markets including Europe, Bermuda, North America and Asia.
With a long track record of working with clients in the life, non-life and broker markets, our dedicated, experienced team is positioned to support clients through the accelerating pace of change in these markets.
lloydsbank.com/financial-services
By the side of business
LLOYDS BANK