Defying gravity

Insurance M&A on the rise

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MERGERMARKET

Willis Towers Watson

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Fergal O'Shea
Life M&A Leader, EMEA
fergal.o'shea@willistowerswatson.com
+353 1 614 6820

Jack Gibson
Managing Director, Global M&A, Americas
jack.gibson@willistowerswatson.com
+1 212 309 3922

Isabelle Kerneuzet
Life M&A leader, APAC
isabelle.kerneuzet@willistowerswatson.com
+852 2593 4528

Andy Staudt
P&C M&A Leader, EMEA
andy.staudt@willistowerswatson.com
+44 20 7170 3476

Alessandro Santoni
Director, P&C M&A, Americas
alessandro.santoni@willistowerswatson.com
+1 212 309 3533

Methodology

In the first half of 2015, Mergermarket surveyed 750 senior-level executives within the insurance industry. Half of those surveyed work predominantly in the life sector and half in the property and casualty (P&C) sector. The companies involved were split equally across the Americas, Asia and EMEA regions.

All of the firms surveyed had considered an acquisition over the last two years (with a particular target identified and the deal proceeding to at least the early stages of the bid process), with 86% having gone on to conduct at least one acquisition. As well as providing information about their overall strategy, respondents gave detailed insights into the most significant deal with which they had recently been involved.

The survey included a combination of qualitative and quantitative questions and all interviews were conducted over the telephone by appointment. Results were analysed and collated by Mergermarket and Willis Towers Watson and all responses are anonymised and presented in aggregate.

All quantitative deal data, such as M&A volumes and values, is from Mergermarket.

Foreword

We are delighted to introduce the latest edition of Willis Towers Watson's investigation of mergers and acquisition (M&A) trends in the insurance sector, carried out in conjunction with Mergermarket, the global proprietary M&A intelligence provider.

After two years of jointly publishing a report covering the Europe, Middle East and Africa (EMEA) region only, the scope of this year's survey has been extended to be global, reflecting the increasing internationalisation of the insurance market. Our timing couldn't have been better, coming in what was an extremely busy year for insurance M&A transactions. The market has certainly lived up to the title of the last edition of the report: 'Ready for take-off'.

Indeed, far from just taking off, the appetite for deals exceeded most people's top-end expectations – almost defying gravity in its voracity. Over the course of 2015 the value of deals done was more than triple that for 2014 and comfortably exceeded the previous annual high of the last decade (in 2010).

BIG DEALS ARE BACK

A major reason for this leap is that large and very large deals have been back in vogue – not only in the insurance sector it has to be said, but more widely across the global economy. How long this can continue in the insurance market may be as much determined by the number of big fish still available to be swallowed as by the degree to which companies are looking for such deals.

In any event, what does seem inevitable is that competition for attractive assets will increase, thanks to a considerable surfeit of companies that say they are planning to acquire in the next three years compared to those that expect to make divestments.

Value of deals aside, the survey has also detected some changes in the drivers of the transactions taking place. Most notably, top-line revenue growth and geographic consolidation, rather than geographic expansion (except for many Asian insurers), are among the leading factors pushing companies into the market. These trends are reflected in some of the preferred metrics used to evaluate deals, with less emphasis on return on capital in favour of sales volume and market penetration-type information.

Even though plenty of deals are getting done, the survey shows that around a quarter are still falling through. This is rather surprising, given that many respondents, perhaps with the exception of those in certain parts of the Eurozone, refer to the diminishing impact of economic volatility in their decision-making. If, as we expect, the competition for suitable targets continues to increase, companies will have to be wary about unnecessarily wasting time and money on abortive M&A activity. Furthermore, we continue to be surprised about firms' recognition of the post-deal challenges of integration and talent retention but limited use of related metrics to evaluate success in these areas.

DIZZYING HEIGHTS

These and many other points are considered in much more detail in the pages that follow. The insights provided in the report would not be possible, however, without the involvement of the many senior insurance industry M&A executives that agreed to speak with us. We are very grateful to them for giving up their time.

The insurance M&A market reached dizzying heights in 2015. There is very little in this report to suggest a significant change in the near term, but companies will have to hold their nerve to acquire the assets that fit their needs – at the right price – in the face of stiffening competition.

Executive summary

Global M&A activity in the insurance sector hit new highs in 2015, with €129.3bn ($143.5bn) worth of transactions announced during the year. This surge reflects a number of macro themes, including the continued availability both of cash on balance sheets and affordable capital in a post-financial crisis environment. Underlying these, there are some emerging themes that have been identified from our survey results:

The drive for top-line growth. Almost half of the insurers doing deals were seeking to enhance their market position and increase customer numbers – top-line growth has been the key driver of deals, as well as the most important metric in M&A pricing. It is also the prime challenge post-acquisition, with insurers focused on customer retention and satisfaction. While it may come as a surprise that insurers have been turning away from value and return metrics, there is no doubt that, for many firms, achieving organic growth has become increasingly difficult in crowded and competitive markets. M&A provides a new source of revenues.

Competition and consolidation dominate. A wave of consolidation, particularly in the US and speciality lines, has spurred a rise in the number of megadeals. Looking forward, four in five insurers expect to focus their M&A activity on core markets. However, competition for the best transactions is tough. Incumbent local insurers are fighting hard, international competitors are also trying to cherry-pick the best deals, and an increasing threat is posed by emerging players such as private equity and non-insurance investors from Asia.

Asia is rising. The Asian market is expected to be a centre of M&A activity over the next three years – more than half of the respondents to this survey see it as the marketplace where activity will rise most significantly. This reflects the fact that in 2015 the value of deals with an Asian target was four times as high as 2014, at €19.1bn ($21.2bn), while the value of deals with an Asian acquirer was nearly five times as high, at €43.3bn ($48.1bn). At a global level, Asian competitors and new non-insurance investors are key players in deals in the developed markets of Western Europe and North America.

Insurers seek modern distribution options and innovative technology. Distribution is a key driver of more than a third of M&A activity, as insurers seek new routes to market and begin to reinvent distribution models such as bancassurance. Digital platforms feature strongly on insurers' wish-lists and the desire to access and secure new technologies is a key element of many transactions.

There is much to learn from both M&A failures and successes. Deals that failed to complete amid challenges such as disagreement over price, competition, regulatory concern and economic volatility provide lessons for both regular and more occasional dealmakers. The evidence shows that even serial acquirers are not always sufficiently reflective about what deals actually deliver post-completion or how best to measure success.

Section 1

Deal drivers

Building on the growth in dealmaking seen in 2014, deal value tripled in 2015. Megadeals, consolidation and the search for top-line growth are the big stories in the insurance sector. In addition, the hunt for innovative technology is also becoming a key driver for acquisitions.

M&A activity in the insurance sector surged during 2015 with €129.3bn ($143.5bn) worth of deals – three times the deal value recorded during 2014 (see figure 1). The deal values in the insurance sector achieved in 2015 are the largest on record, even surpassing the boom years prior to the financial crisis.

Although the deal count in 2015 did not quite reach levels seen in previous years, with 230 transactions compared to 235 in 2014, activity was buoyed by a notable increase in the number of large-value transactions – 2015 saw 33 deals worth more than €500m, compared to only 18 in the previous year (see figure 2).

These larger transactions include four ‘megadeals’, each worth more than €5bn (see figure 3), compared to just one in 2014, the €5.1bn ($5.7bn) purchase of US insurer Protective Life by Japan’s Dai-ichi Life Insurance Company. Megadeals in 2015 included US health insurance company Aetna’s €33bn ($37bn) takeover of rival Humana and Swiss giant Ace’s €25bn ($28bn) acquisition of New-York based P&C insurer Chubb.

“Sometimes megadeals can start a major trend,” says Jack Gibson, the Global M&A Leader for Willis Towers Watson. “The Dai-ichi/Protective megadeal in 2014 led to four other deals during 2015 where Chinese or Japanese insurers acquired US insurance businesses. I expect this trend to continue in the coming years.”

The return of the megadeal to the insurance sector partly reflects industry-specific factors such as the drive for scale and reach, but is also part of a broader trend across M&A as a whole. There were 117 megadeals across all industry sectors during 2015, the largest number on record, with low interest rates and loose monetary policy generally providing plentiful supplies of cheap finance.

UNITED FRONTS

In insurance, our research suggests the key drivers of M&A are a desire for consolidation and a drive for top-line growth. “There is certainly an expense story with many people talking about operational efficiencies when you cut together two very large organisations,” says Andy Staudt, EMEA P&C M&A Leader at Willis Towers Watson. “Another reason for these deals is size: given the type of competition we’re seeing for some of the business out there, there are a number of very large, mature reinsurance purchasers, for example, really looking to distil their panel of reinsurers down to mainly the top five or the top 10.”

Fig 1. Value and volume of global insurance M&A

Deal value (€bn)

Deal volume

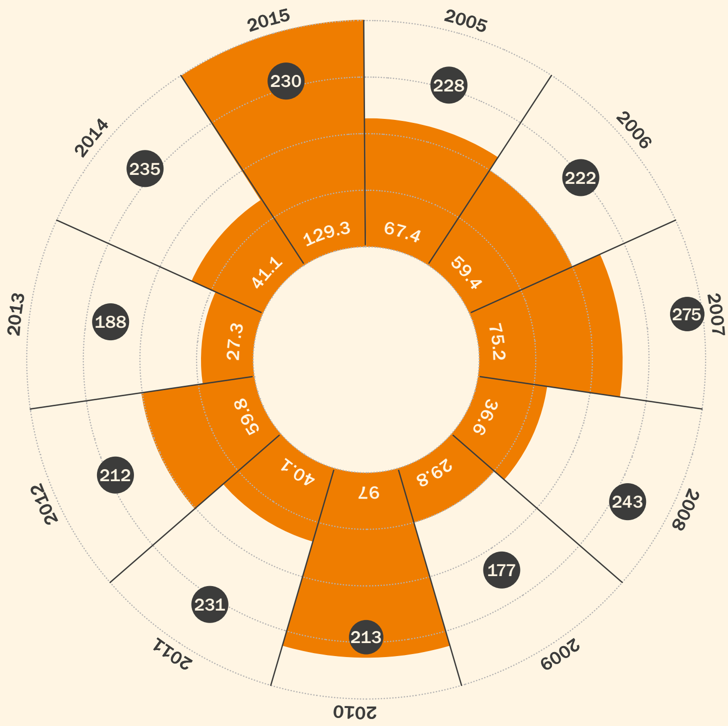


Fig 2. Global insurance M&A deal size split

>€500m
€251m-€500m
€101m-€250m
€15m-€100m
<€15m
Not disclosed

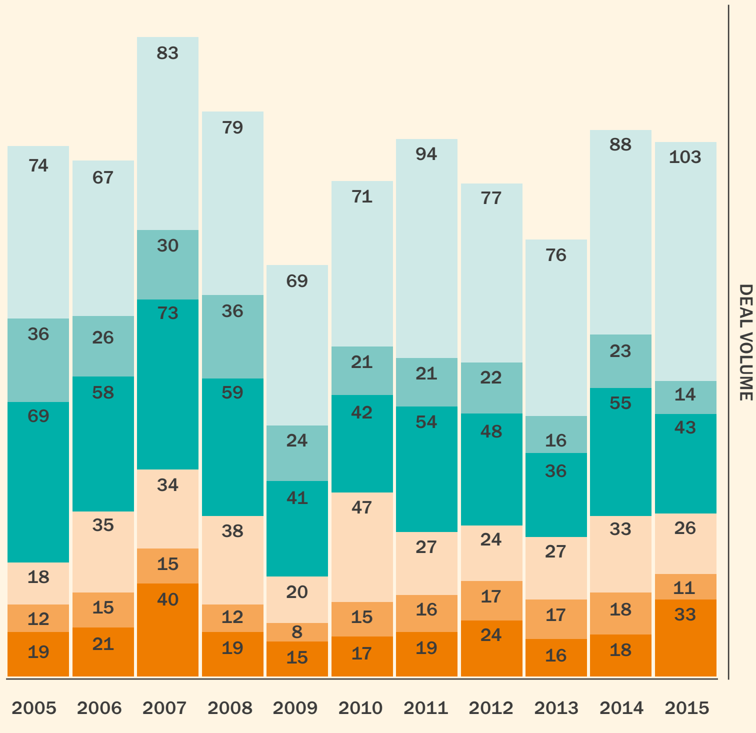
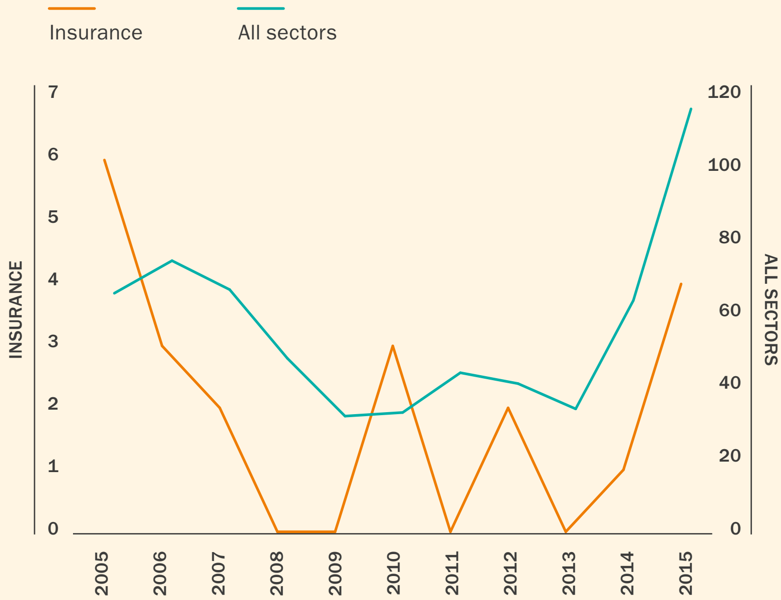


Fig 3. Volume of megadeals (€5bn+)



The statistics show that the majority of deals (92%) were taking place in regions where insurers already had existing operations. Common motivations included the need to access a larger customer base and a requirement for enhanced distribution access. “We see that particularly in Asia, where there is a great deal of interest in banking and life distribution,” says Isabelle Kerneuzet, Life M&A leader, APAC at Willis Towers Watson.

SEEKING TOP-LINE GROWTH

Almost 50% of respondents say they made their last major acquisition because they were attracted to the target’s existing market position and customer base (see figure 6). This was the most significant motivation for companies doing deals by some margin, but the next most important deal driver, the attractiveness of the target’s distribution, could also be considered as reflecting a desire to boost top-line growth.

In a sector where margins are under pressure, particularly in the many markets where competition is tough, revenue growth achieved through greater scale may represent the best chance of outperformance for many insurers.

As one CFO of a European life insurer said of his company’s deal in 2015: “The growth rate of the target was good considering the current market situation, but what we really wanted was access to its unique customer base and its product set, so that we could offer an expanded product range to a broader group of customers.”

Similarly, the Director of Underwriting at another larger European insurer said: “The distribution capabilities of the target firm gave our board the impetus to go ahead with the deal – we could see the commercial synergies were going to be high.”

In most cases, our respondents gave different drivers similar levels of significance whether they came from the life sector or from P&C. However, more than a third of P&C firms said they had been looking for deals that would diversify their product lines, twice the number of life insurers motivated by this driver (although this is not surprising).

“Recent deals have capital efficiencies and diversification as a common denominator,” says Alessandro Santoni, Americas P&C M&A Leader at Willis Towers Watson. “Given the continuing soft status of the underwriting cycle, companies in Bermuda and the US have been focused on achieving cost synergies, product diversification, and geographic expansion. This is to be contrasted with Asian investors who are looking primarily for geographical diversification and diversification across asset classes.”

The focus on top-line growth is somewhat surprising as it harks back to an older investment thesis, to the detriment of other more value and return-focused metrics where the focus is on bottom line growth. This brings its own challenges and it is a point we return to later.

EXPANSION THROUGH CONSOLIDATION

While insurers are keen to expand their geographical footprint, as new opportunities emerge in international markets, it is relatively rare for firms to use M&A to move into a particular territory for the first time. Just 8% of respondents had no operations in deal target markets; by contrast in almost two-thirds of cases (61%), insurers already considered themselves to be top-ten players or even market leaders in the market where their transaction took place (see figure 5).

This consolidation theme is likely to continue as insurers survey an increasingly competitive trading environment. “We looked for deals among the top five companies in our marketplace because we wanted to take out the competition in an overcrowded marketplace,” said the Head of Investment at one Asian life insurer. “Going forward, we see scope for more M&A activity as the route to the top for our firm.”

An exception to this rule is that insurers are looking to move into new developing markets, amid explosive population growth and the burgeoning numbers of middle-class customers with the disposable income to buy a broad range of general and life insurance services. International insurers still have a limited presence in a number of newly developing markets. One Director of Strategy at a North American life insurer that acquired a business in Asia reflected this opinion: “We now have a strategy to capitalise on high-growth opportunities in emerging markets and we look for targets that will give us a platform with distribution and customer numbers already in place.” In many emerging markets new licences are not available so the only entry route is via acquisition.

IN SEARCH OF MODERN DISTRIBUTION

For insurers competing on a global scale, the different ways in which distribution models continue to evolve in different markets represents a significant influence on M&A activity, as firms seek to identify the most effective routes to their customer base.

For example, in deals in the APAC region and also in the Americas, insurers for whom distribution was an important driver are more likely to rate direct sales channels as important. The Portfolio Director of a Japanese life insurer buying in North America said: “Customer preferences continue to change and we will be able to serve more segments with the direct channels that this deal has brought us.”

In Western Europe and the Middle East, digital distribution was more likely to be a driver of deals – 45% and 56% respectively (see figure 4). The Chief Strategy Officer of an American P&C firm buying in Europe, said: “We saw the company’s digital channels, which were among the most prominent in the region, as offering huge potential.”

Other distribution channels generally play a less important role in driving deals – however, there are some definite regional differences. For example, independent or tied agencies were important in 23% of developed Asia and Latin America deals. Meanwhile bancassurance was key in a number of deals involving firms in Central & Eastern Europe (24%), developed Asia (14%) and the Middle East (11%). It is also important to note that there have been a number of bancassurance distribution agreement transactions in Asia that do not involve an equity transaction of an insurer. In other respects, these have all the hallmarks of M&A, including some sizeable payments involved for distribution, essentially providing a sharing of insurance manufacturing margin with the distributor.

It is particularly interesting that digital distribution plays a significant role in emerging markets, such as Africa, as well as more developed regions. Access to mobile technology can enable rapid development of insurance market coverage, leapfrogging more traditional distribution platforms.

Fig 4. Which aspect of the distribution was most important?

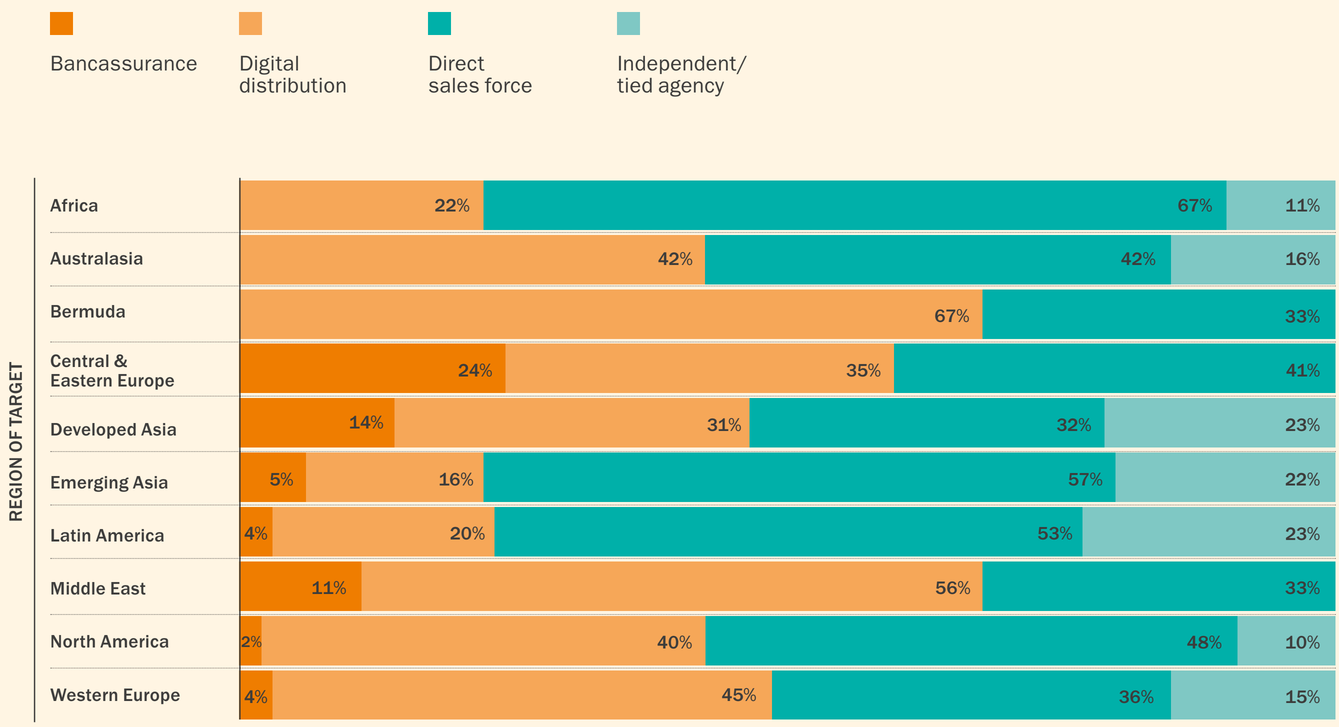
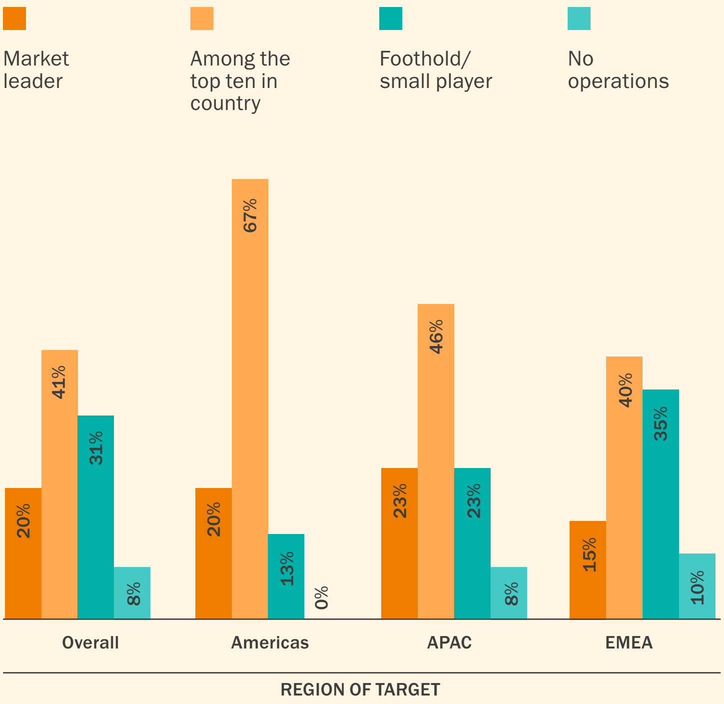


Fig 5. What existing operations did you have in this market?

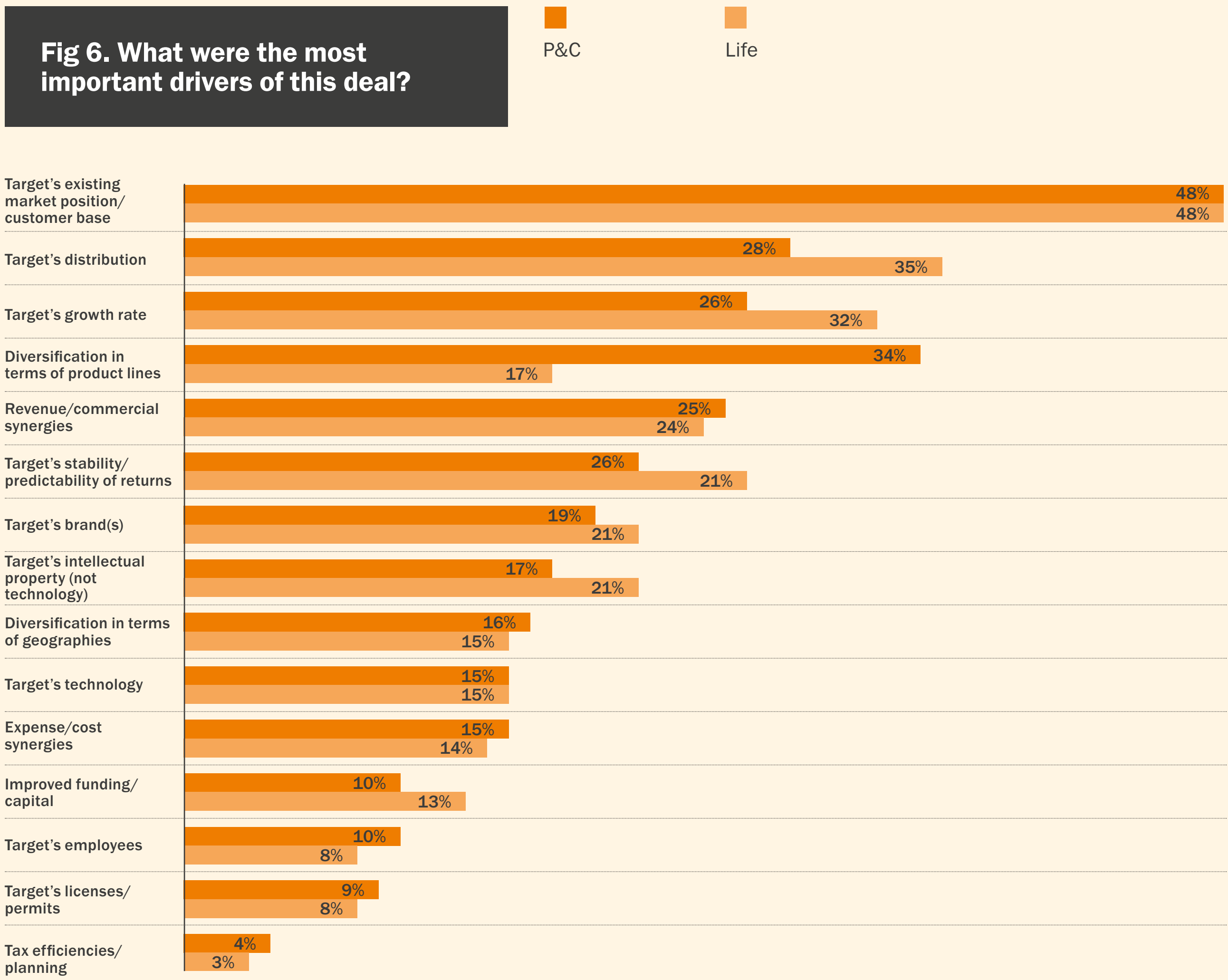


TWIN-TRACK TECHNOLOGIES

While many insurers cite their interest in acquiring new technologies and tools as a potential driver of deals, different firms have different objectives in mind. Broadly speaking, their goals fall into two categories: to secure technologies that will improve back office efficiency and to obtain more customer-facing technologies in order to access new parts of the market or to meet evolving client needs.

Overall, technology was a key driver in 15% of transactions (see figure 6). With digital tools and platforms increasingly to the fore, this relatively low figure is something of a surprise and likely reflects the fact that companies are investing heavily to develop solutions internally before considering acquisitions. In addition, these types of deals may be smaller and, as respondents were asked to talk specifically about their more significant recent deal, are being somewhat dwarfed by the larger deals focused on top-line growth. For those deals that were focused on this area, Asia Pacific insurers saw web technologies as especially crucial, while mobile and web were also important in EMEA. Big data and analytics tools are becoming increasingly important, particularly

Fig 6. What were the most important drivers of this deal?



for P&C insurers – and especially in the Americas. Cybersecurity was a consistent if lesser concern across all markets.

The regional variations partly reflect the nature of the market. Web and mobile platforms, for instance, may represent an attractive way for businesses to add scale quickly and affordably in new markets – particularly in developing economies – where they would otherwise have to build direct sales forces or bancassurance networks.

"Asian companies are looking to buy in Europe because of the technology comparative advantage."

Andy Staudt, Willis Towers Watson

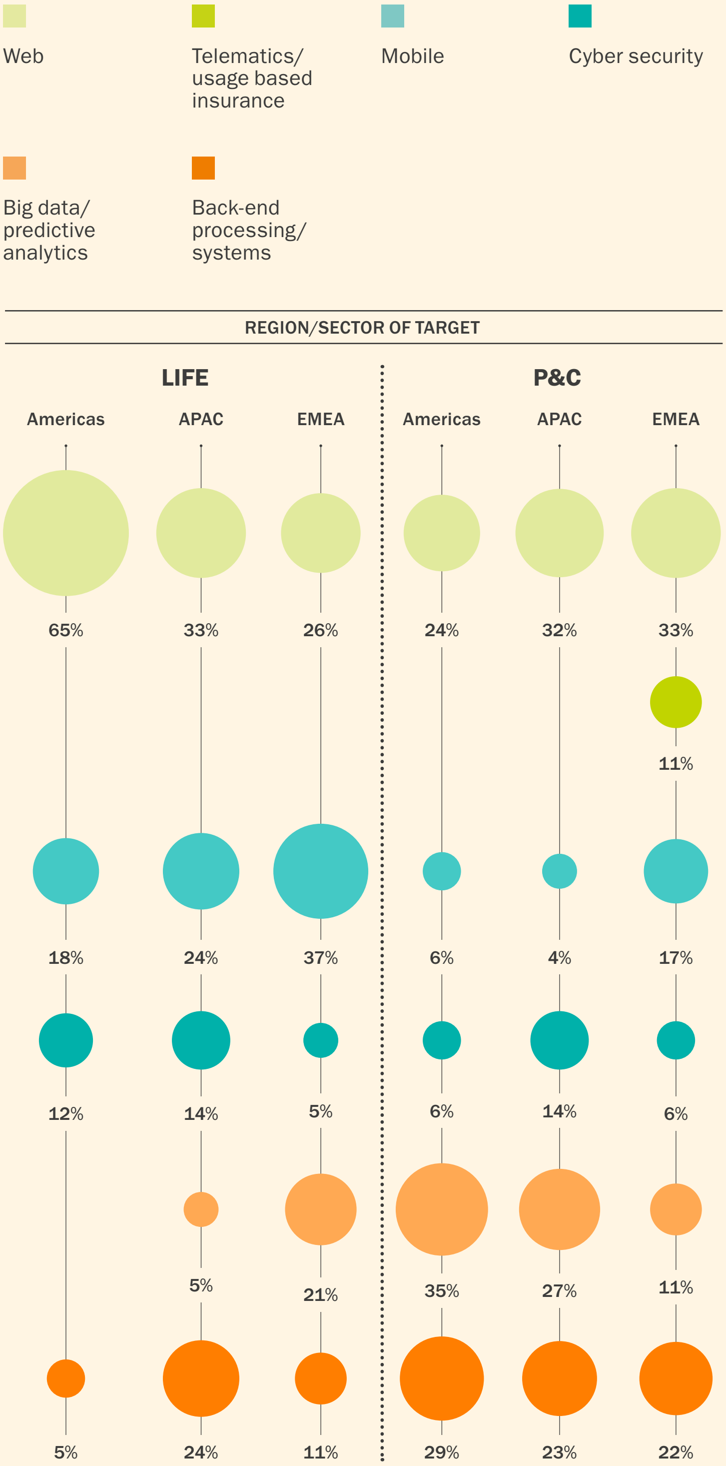
However, there is also diversity in what insurers are looking for, says Willis Towers Watson's Andy Staudt. "Asian companies are looking to buy in Europe not because it's a high-growth market but because of the technology comparative advantage," he says. "There are definitely systems in place, IT structures, pricing algorithms, distribution tools and so on – all of these skills that European insurers can bring to the table are very attractive to certain foreign entities that can take these skills back home."

Other themes are only just beginning to emerge. Telematics technologies, for example, are beginning to penetrate European marketplaces and were a deal driver in more than one in 10 (11%) of deals in the P&C sector (see figure 7). One such deal was Japan-based Aioi Nissay Dowa Insurance's acquisition of Gibraltar-based telematics provider Box Innovation Group for €134m – a move which it attributed to the growing demand for connected car solutions.

Overall, distribution technologies have become incredibly important in the P&C space, according to Andy Staudt. "We've seen the motor insurance industry transformed by aggregators," he says.

Ultimately, insurers must balance their need for technologies that drive efficiency and lower cost against those that may deliver more dynamic customer benefits. "The business we bought had made considerable investments in technology and process that we knew would create shareholder value and keep investors happy," said the Director of Finance at one Middle Eastern life insurer.

Fig 7. Which aspect of the technology was most important?



Section 2

Lessons learned

From valuation gaps via competition through to post-merger integration, the various stages of a deal are fraught with challenges. Throughout the transaction process and beyond, executives need to reflect and learn to gain a competitive advantage in future deals.

The first challenge for an insurer targeting an M&A transaction is to get the deal to completion. Some of the most common reasons for deals breaking down are difficult to foresee, but others less so.

Economic volatility, for example – cited as a reason for a deal failing to complete by 42% of insurers – is tough to anticipate and mitigate (see figure 8). But other common sticking points in deals, including the price expectations of the seller (blamed by 49% of insurers for a deal failure), high competition from other bidders (40%) and difficulties with regulatory approval (35%), are more predictable challenges that can be addressed with careful planning and execution.

To some extent, insurers' priorities will depend on where they are transacting. Our research throws up considerable regional variations in the most common reasons for a deal failing to complete.

Ultimately, there will always be potential deals that do not make it to completion – by definition, where there is more than one bidder for an asset – but in order to avoid wasting time and resources, executives would benefit from heading off difficulties before they arise. Otherwise, they risk missing out to the competition.

MANAGING COMMON DEAL-BREAKERS: PRICE

In a competitive M&A marketplace, there will inevitably be debate about how much to pay for any individual deal. But for an insurer keen to secure a deal, flexibility on price is likely to be an important factor in clinching the transaction.

Equally, however, insurers are naturally keen to avoid overpaying for assets. The Chief Executive Officer of an Asian life insurer that saw its proposed deal fall through remarked: "If we had met the demands of the seller for the acquisition, it would have doubled the price we had to pay, given the cost of leverage and integration."

There is a window of opportunity says Willis Towers Watson's Fergal O'Shea. "Most analysts seem to sense the insurance sector is still oversold," he says. "Valuations are still attractive, though prices are hardening as capital comes in and sentiment improves towards insurance stocks."

In this context, insurers need to think carefully about the metrics they apply in order to determine the price they are prepared to pay for a deal. Respondents to our survey, across all markets, were most likely to rank the revenue growth an acquisition might deliver for the business as their most important price-determining metric (34%), followed by enterprise value (27%) and return on capital (22%) – reflecting their current drive for top-line growth (see figure 9). This suggests a reduced emphasis on metrics designed to measure value or capital efficiency, despite the increasingly high profile in recent years of shareholders that focus on such measures.

That said, the survey does highlight some notable regional differences. In particular, insurers were more likely to focus on revenue growth when thinking about the price of acquisitions in emerging markets – cited by 58% of respondents involved in deals in Latin America, for example. Enterprise value, on the other hand, is a more significant factor in deals in developed markets – cited by 26% of respondents doing deals in Western Europe, for instance.

"The level of returns that buyers are seeking have varied widely," says Willis Towers Watson's Jack Gibson, "with private equity buyers often seeking returns that are significantly higher than the return targets for insurers who are buying into developed markets."

It's also noticeable that market leaders and other dominant players in a particular market were likely to cite revenue growth as a key price determinant when doing a deal in that market (41% of market leaders and 37% of top ten companies). For businesses looking to expand their presence in a market from a low base, by contrast, return on capital was more likely to be the key price metric (27%).

"Valuations are attractive, though prices are hardening as capital comes in and sentiment improves towards insurance stocks."

Fergal O'Shea, Willis Towers Watson

These findings reflect the current dominant drivers for insurers engaged in M&A – particularly around top-line growth in key markets – but they also underline the wide range of metrics considered by insurers as they determine price.

Moreover, if it's important for insurers to remain flexible and open to negotiations on price, albeit within an acceptable range, there will also be potential for opportunistic transactions – in which case, an ability to move quickly is crucial. The Chief Financial Officer of a Middle Eastern life insurer said of its deal: "The price was lower than the business's actual value because the seller was

Fig 8. What factors caused this deal to fail to complete?

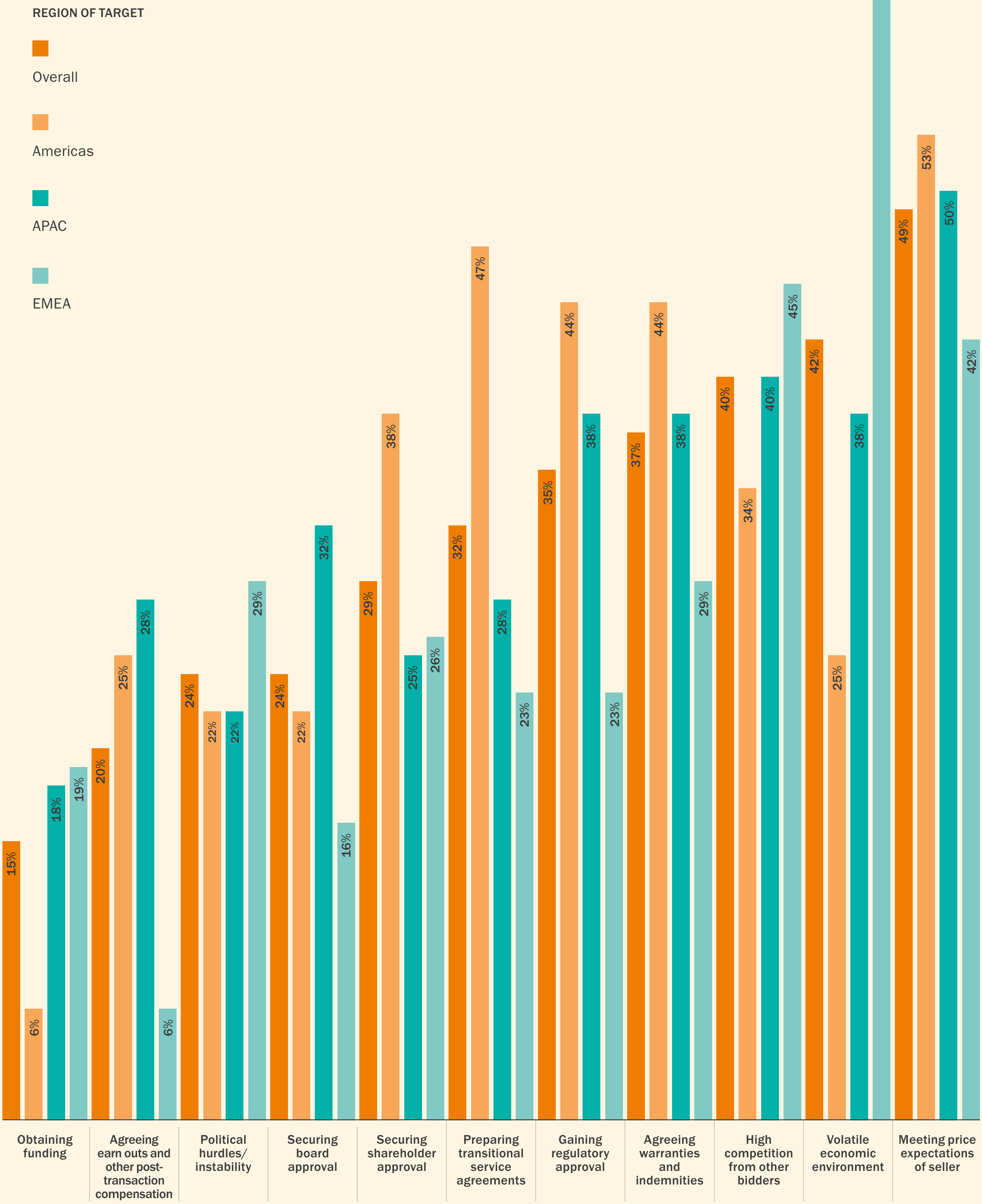
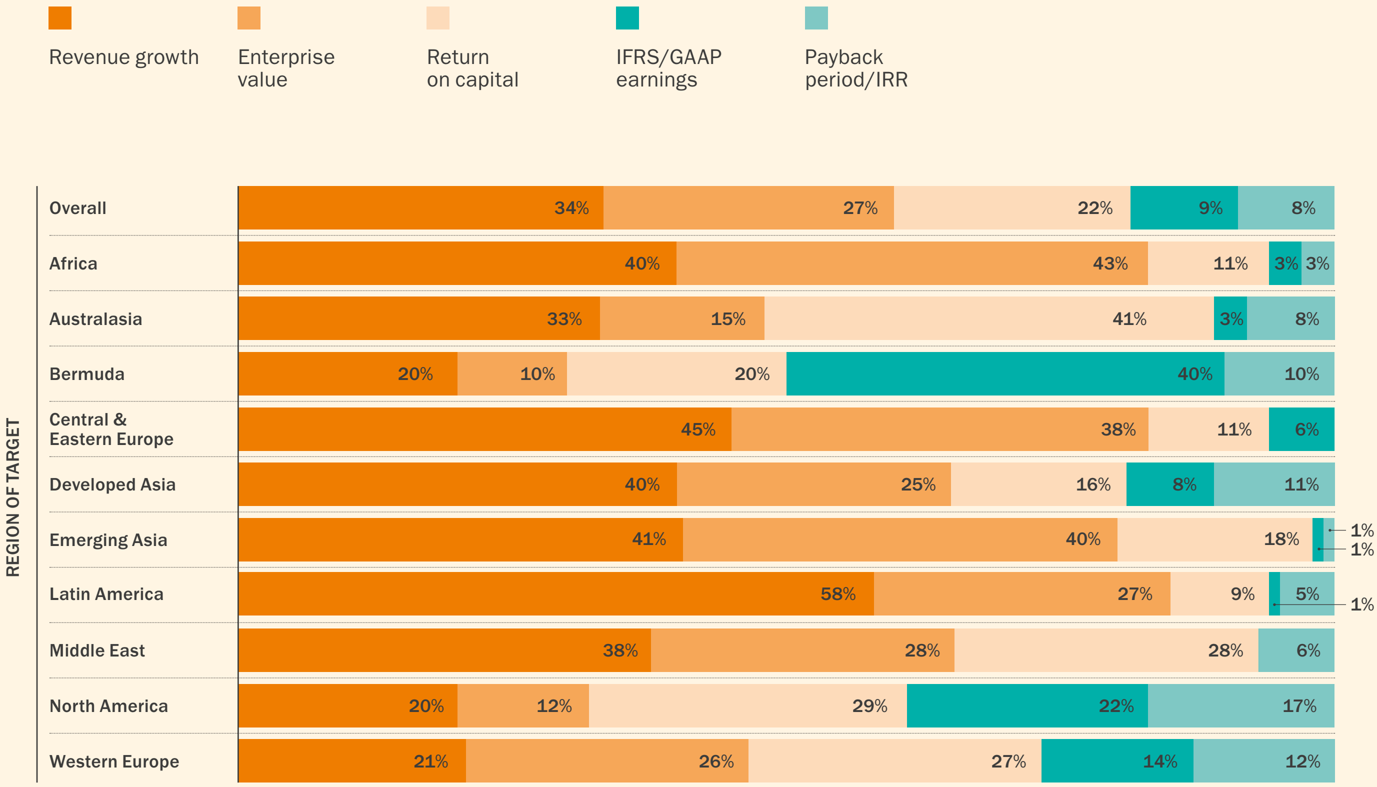


Fig 9. What was the most important metric used to determine a price for the business?



focused on its strategic plans after the sale – it wanted to be paid in cash, which we agreed to as we did not want to miss out on this offer."

Above all, however, insurers faced with difficult discussions over price must have sufficient information and analysis to make their case to sellers. As the Director of Strategy at one North American P&C insurer recalled: "Our deal valuations were derived following a rigorous analysis process carried out with the help of our professional financial advisers."

M&A practitioners and their advisors should challenge themselves at the start of a process to ensure that such analysis is completed and reasonable expectations – on both buy- and sell-side – are set. There has been a change in the way advisers are being used in Asia, says Karsten Wantia, Willis Towers Watson, P&C Practice Lead for Asia Pacific: "We are seeing the buyers paying much more attention to using advisers to support them in assessing and gaining confidence in the future sales projections and product mix to assess value and price. How much of the structural value to share with a seller or distribution partner and how to manage risk around the manner and timing of paying for this is a key question insurers are dealing with."

MANAGING COMMON DEAL-BREAKERS: COMPETITION

Competition is a huge challenge to insurers as they chase transactions.

"Where we are in the global economy, with interest rates so low, means people have a lot of excess capital and everyone is chasing a return," says Willis Towers Watson's Fergal O'Shea. "Investors, including PE and non-traditional investors, are looking for somewhere to employ their capital, so any deal run on a formal basis tends to get a lot of interest."

The nature of the competition has tended to vary somewhat according to where deals have taken place. In particular, PE players were most likely to pose a threat in more developed markets but less often in the Middle East, Latin America and Central and Eastern Europe (see figure 11).

In emerging Asia, the buyer typically needs to bring skills, experience and capability to ensure that the target achieves the ambitions embedded in the price paid. For broad-based insurer targets often the buyer is therefore a more successful domestic company or a multinational. Some specialist segment PE players are typically involved in a larger number of smaller transactions. An example is PE focused on microinsurance.

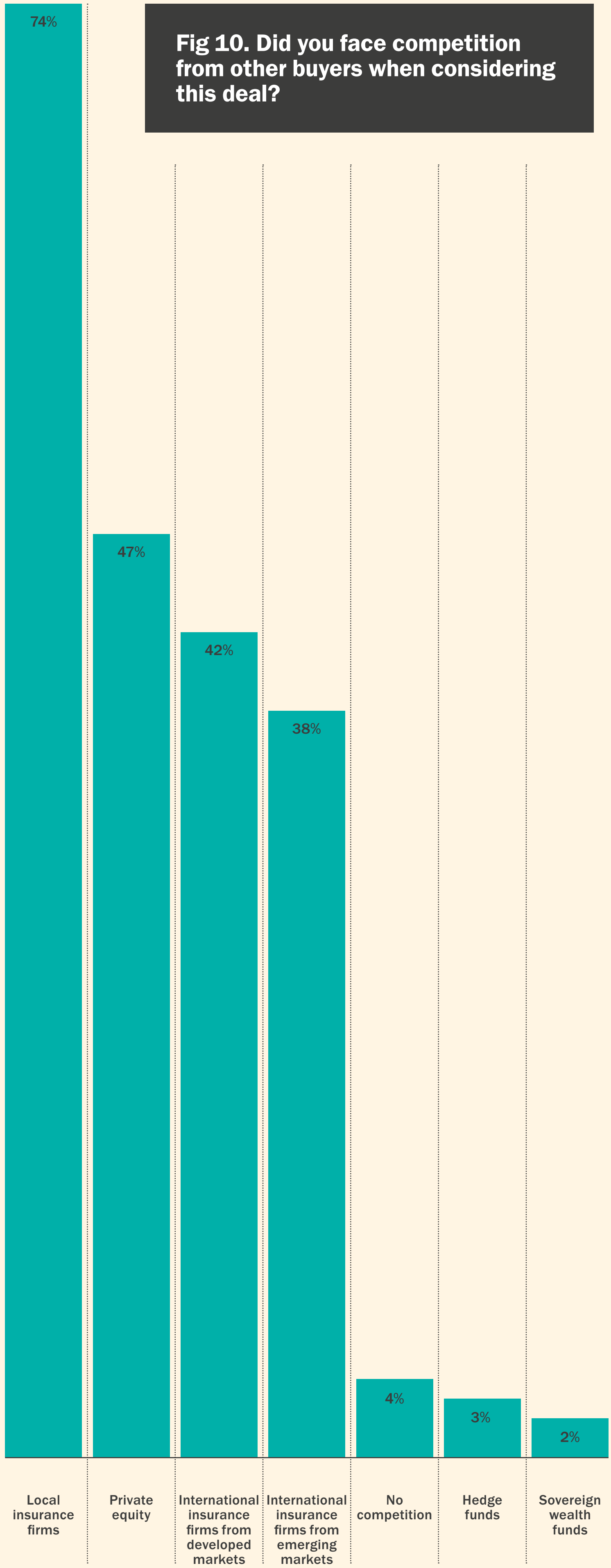
Given the scale of the competitive threat and its diversity, insurers engaging in M&A transactions need clear strategies for dealing with potential rivals.

There are a number of possibilities, but many insurers stress the importance of competing on the basis of strategic rationale rather than price alone. For example, the Director of Underwriting at one Asian life insurer said: “We were able to prove to the target that we were an ideal business to take ownership – we shared our diversification strategy which included a value road map that offered them an assurance on our forward-looking approach; it was that which encouraged them to choose us over other bidders.”

Another important tactic is to build relationships well before a deal takes place, by targeting markets carefully and vetting potential deals well ahead of time. “We faced competition from PE and other potential buyers, so we had to be more open to the expectations of the seller, but we were able to manage these as we had relationships with the target we had built up over time,” recalled the Chief Underwriting Officer of a North American P&C insurer.

Above all, argued the Director of Strategy at a European life insurer, the key to fending off the competition is honest and transparent negotiations. “We offered substantial information about how we thought we could both grow as a force capable of taking on much larger insurance competitors,” the executive explained.

Fig 10. Did you face competition from other buyers when considering this deal?



MANAGING COMMON DEAL-BREAKERS: REGULATORY APPROVAL

In a highly regulated industry, insurers will inevitably have to confront issues around regulatory approval as they work to execute proposed deals. More than half the respondents to our survey (56%) said they had found this challenging in their most recent acquisition – the most significant pre-closing issue faced by insurers (see figure 12).

Regulatory approval appears to be particularly difficult for deals in developing markets – it was a very significant challenge in Africa (affecting 72% of deals), the Middle East (72%) and emerging Asia (63%).

Willis Towers Watson's Head of Insurance Management Consulting for Asia Pacific, Keith Brooks, says that the successful serial multinational acquirers in emerging Asia have proactive management of regulatory relationships. "They invest time prior to deal involvement in senior meetings with regulators, building relationships and providing confidence in the brand of the multinational. At transaction time, they also actively consider the local partner or target and their existing regulatory relationships and carefully plan how and when to involve them in the regulatory discussions about a potential transaction."

Dealing with regulatory approval issues successfully requires insurers to take the initiative early on in the deal, but also to involve specialist advisers with expertise on the ground – third-party legal advisers and consultants will be essential for many deals.

"Ours was a big deal and the market dynamics were affected by it, so we knew right from the start that the deal would come under heavy regulatory scrutiny," said the Director of Corporate Development at a US life insurer. "It wasn't easy but we gave ourselves time to resolve the issues – to consult a number of advisers and to make changes to the deal structure in order to meet the regulators' concerns; eventually we got the approval we needed."

"[The successful serial multinational acquirers in emerging Asia] invest time prior to deal involvement in senior meetings with regulators."

Keith Brooks, Willis Towers Watson

It's not just regulatory approval that insurers must contend with, but also the effect on their business of ongoing regulatory change.

MANAGING COMMON DEAL-BREAKERS: ECONOMIC VOLATILITY

In our survey, concern about economic volatility was a frequently cited challenge when agreeing on a deal – 60% of respondents in the EMEA region saw the challenging environment as a potential deal-breaking challenge, falling to 42% in the Americas and 41% in Asia-Pacific.

At first sight, these figures may seem counter-intuitive, given the greater volatility in developing markets, particularly in Chinese equity markets recently. But it may be that insurers are prepared to overlook this instability given the higher returns still on offer from these regions and the residual economic difficulties in the Eurozone. For example, the Director of Strategy at a European P&C insurer said: "Dealing with low-yielding markets was hampering our transactions and our finances, so we refocused and diverted our attention into our growing markets, increasing our focus on operations there."

Meanwhile, the Chief Strategy Officer at another leading European P&C insurer said that in the face of economic volatility, firms must make a compelling case for any deal, convincing investors of the strategic rationale for the transaction, but also of the company's ability to execute it. "The critical issue related to the economic environment was keeping investors on side," the executive recalled.

"Some of the larger insurers are addressing concerns about economic volatility by becoming more balanced across different regions of the world," says Willis Towers Watson's Jack Gibson. "Several years ago, MetLife and Prudential in the US substantially increased their footprint in other regions of the world, most notably in Japan. Now we are seeing several Japanese insurers looking to the US for geographic diversification."

MANAGING VALUE

Even if deal value isn't always the prime consideration for insurers when they think about what price they are prepared to pay, there is generally a trade-off between risk and return to weigh. In both the life and P&C sectors, insurers expect to earn the highest returns on capital from transactions in emerging markets – particularly emerging Asia and Africa – but mature, developed markets such as North America and Western Europe will naturally offer lower potential returns (see figure 13).

Fig 11. Did you face competition from other buyers when considering this deal?

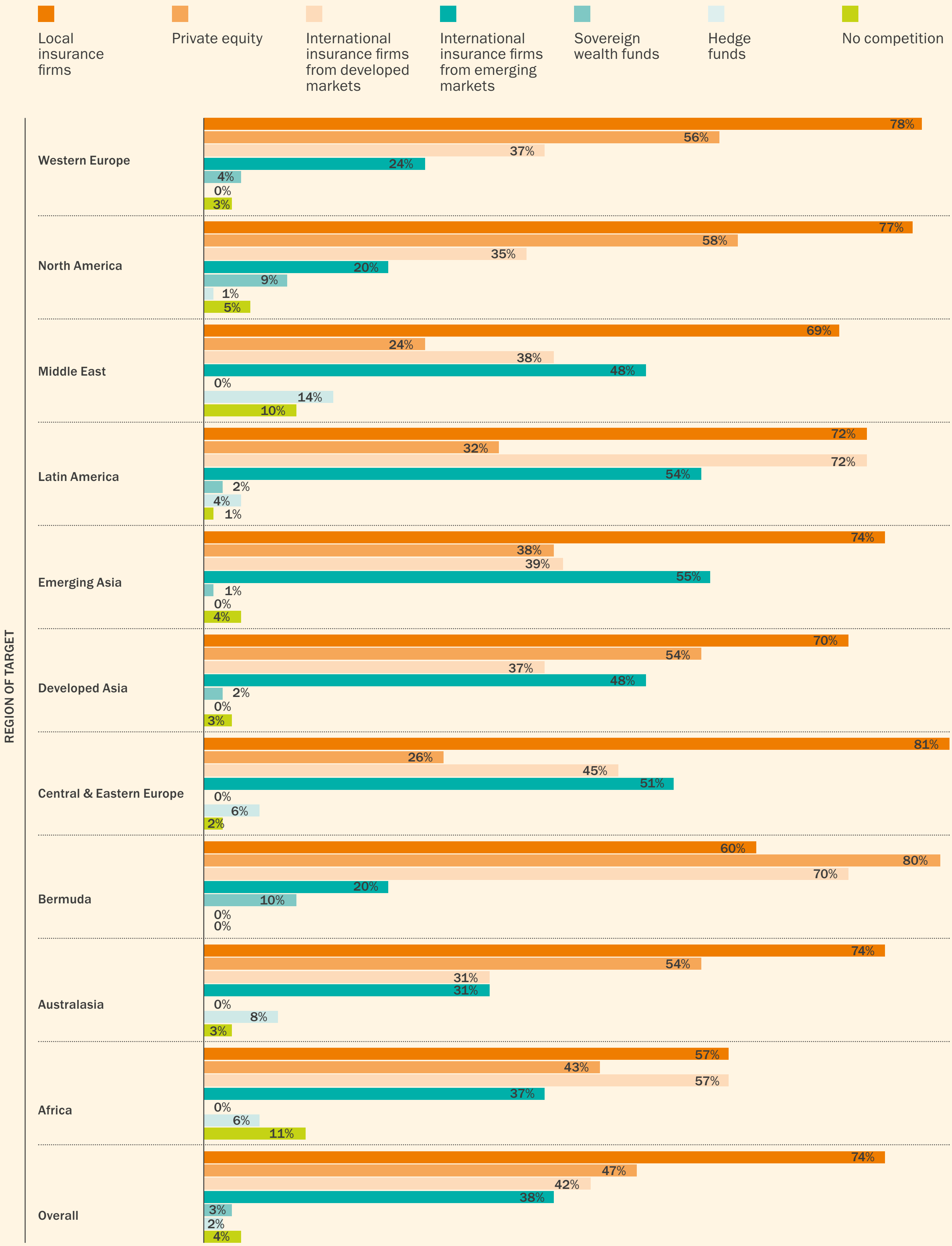
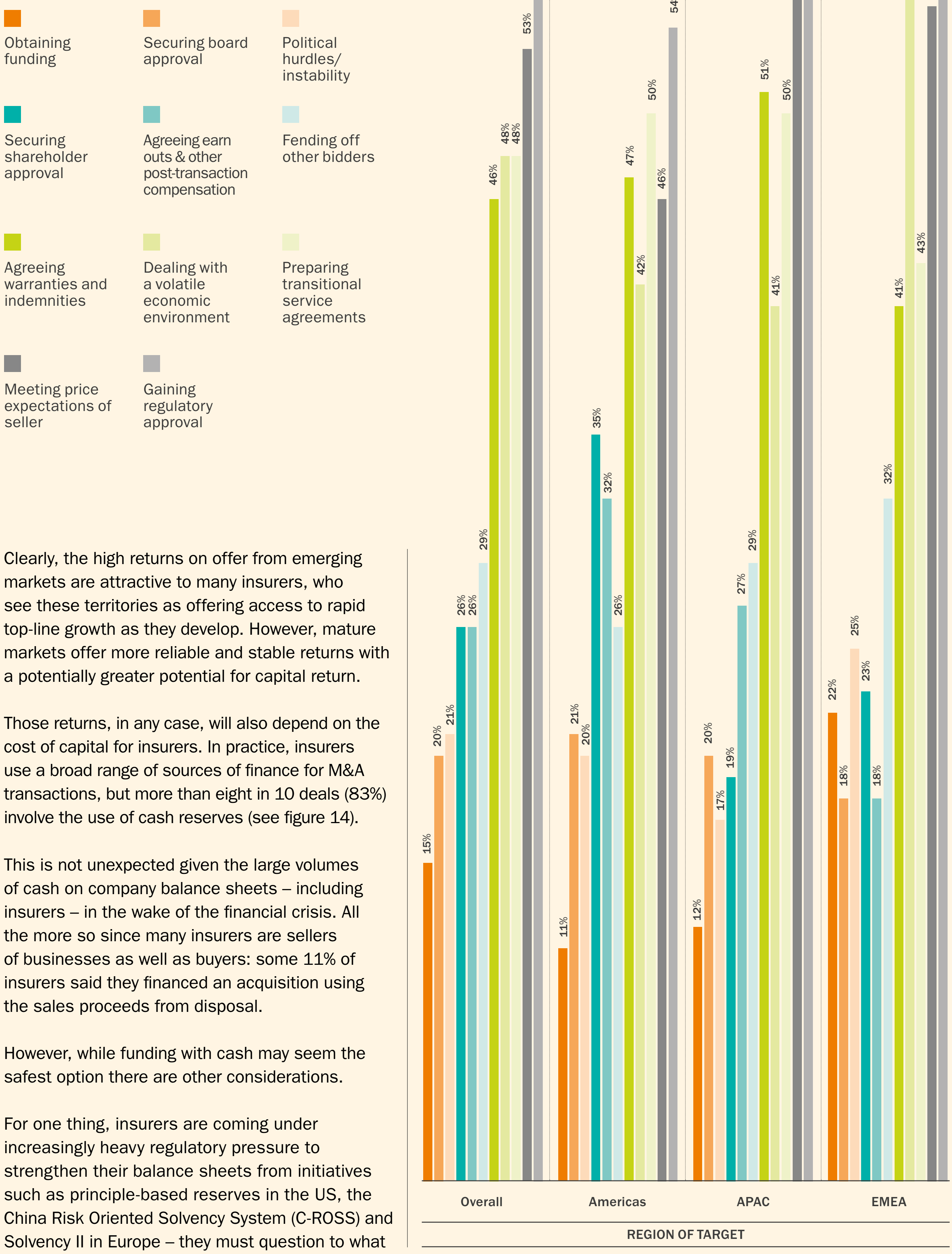


Fig 12. What challenges did you face when agreeing this deal (before closing)?



Clearly, the high returns on offer from emerging markets are attractive to many insurers, who see these territories as offering access to rapid top-line growth as they develop. However, mature markets offer more reliable and stable returns with a potentially greater potential for capital return.

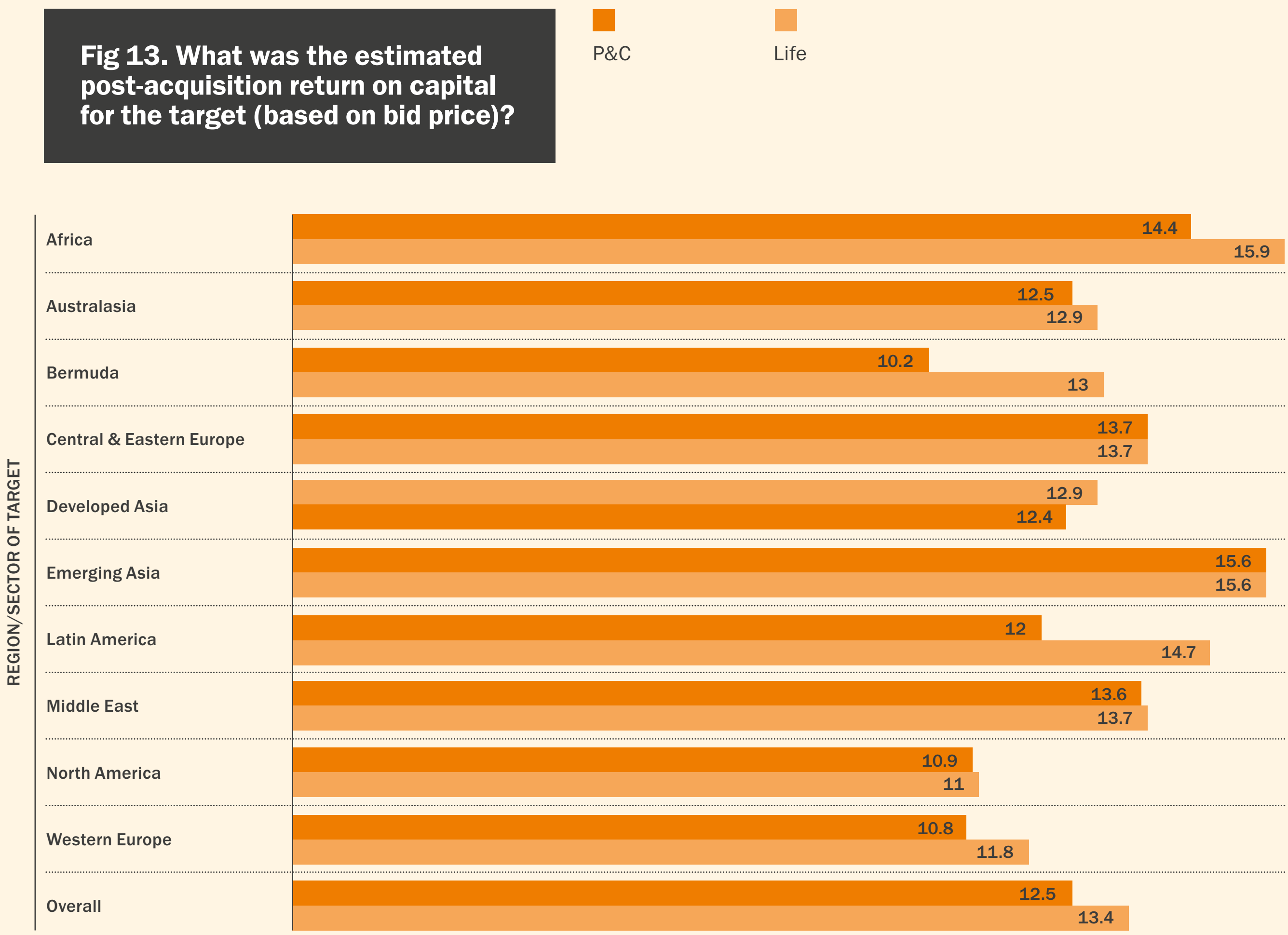
Those returns, in any case, will also depend on the cost of capital for insurers. In practice, insurers use a broad range of sources of finance for M&A transactions, but more than eight in 10 deals (83%) involve the use of cash reserves (see figure 14).

This is not unexpected given the large volumes of cash on company balance sheets – including insurers – in the wake of the financial crisis. All the more so since many insurers are sellers of businesses as well as buyers: some 11% of insurers said they financed an acquisition using the sales proceeds from disposal.

However, while funding with cash may seem the safest option there are other considerations.

For one thing, insurers are coming under increasingly heavy regulatory pressure to strengthen their balance sheets from initiatives such as principle-based reserves in the US, the China Risk Oriented Solvency System (C-ROSS) and Solvency II in Europe – they must question to what

Fig 13. What was the estimated post-acquisition return on capital for the target (based on bid price)?



extent they can run down reserves to fund M&A given the challenges to come. "The challenge of Solvency II has been the huge uncertainty about its implications," says Willis Towers Watson's Fergal O'Shea. "Companies often haven't had a sufficient insight on their own capital position, and they've been thinking about the construction of their own balance sheets, rather than working through more strategic goals."

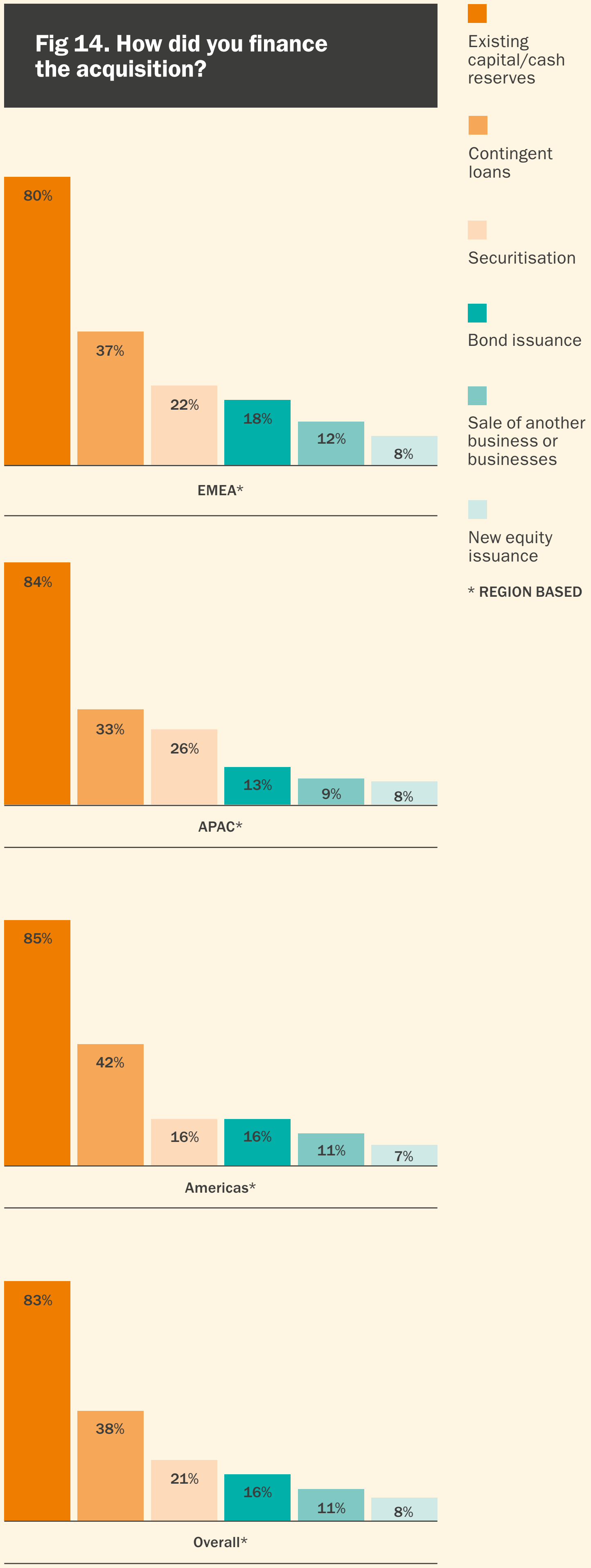
The other question is whether there is a danger that insurers are so determined to secure top-line growth that they are neglecting to consider whether greater shareholder value might be achieved through alternative uses of excess capital – special dividends or share buybacks, for example.

With loose monetary policy still in force around the world, raising capital has rarely been so cheap. Yet just 38% of insurers say their deals have relied on contingent loans, falling to 21% that have used securitisation and only 16% that have issued bonds. Just 8% of insurers issued new equity in order to fund M&A.

"Across all sectors, market data and industry surveys consistently show that the challenges of aligning organisational culture lie at the heart of successful post-transaction integration, and therefore ultimately delivering the value promised by the deal."

Steve Allan, Willis Towers Watson

Fig 14. How did you finance the acquisition?



That may be a missed opportunity, although there will be regional variation. The Director of Investment at one African P&C insurer, said: "The commercial stability of the target enabled us to raise finances through bond issuance, which better suited the interests of our shareholders."

MANAGING INTEGRATION CHALLENGES

Respondents to our survey pointed to a wide range of potential post-deal challenges, with significant numbers highlighting each of them as a concern. Almost two-thirds of insurers (61%) worry about how they will retain customers following a deal – a commercial imperative given that revenue growth is such a crucial current driver for so much M&A in the sector (see figure 15). Then there are integration challenges such as bringing IT systems and business processes together. Talent management is a major concern too, with 42% of insurers concerned about hiring and retaining employees.

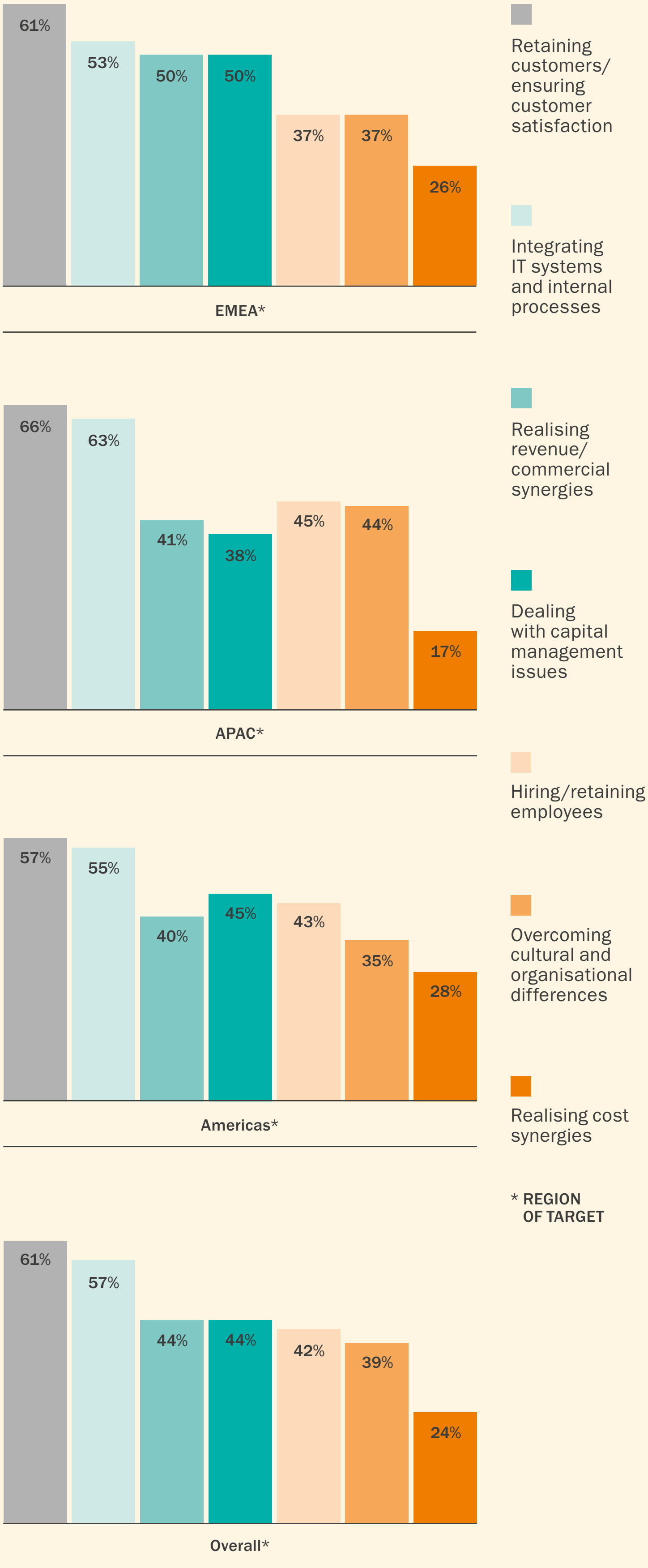
Thinking about all of these issues well in advance, with step-by-step plans for post-deal integration, is vital. For example, the Director of Strategy at a North American life insurer said: "We knew achieving customer satisfaction would be crucial in determining our future profitability, so in the run up to the deal, we redefined our sales strategies so as to offer customers and brokers the most innovative services."

Similarly, the Director of Finance at an Asian life company said business integration was planned well ahead of time during its transaction. "We looked at the strengths of the businesses and assessed efficiency," the executive recalled. "We were then in a position to put the best tools and processes together in order to reach collective business goals."

As for cultural differences and organisational challenges, which 39% saw as challenging, one Director of Underwriting at a North American life business, said it is important to think about how to embed shared values and behaviours throughout the combined organisation right from the start. "We got the business leaders of both organisations together to talk about the culture of the new business," the executive explained. "They acted as the main connection to employees and we used them to share our expectations across the group."

Steve Allan, TW EMEA M&A practice leader for HR consulting says that: "It is no surprise to hear senior insurance company executives commenting on the importance of culture and cultural integration to the success of a deal.

Fig 15. Which of these post-acquisition business issues did you find challenging?



"Across all sectors, market data and industry surveys consistently show that the challenges of aligning organisational culture lie at the heart of successful post-transaction integration, and therefore ultimately delivering the value promised by the deal."

Allan believes that successful dealmakers are able to articulate what they mean by culture and are able to identify areas where an acquired organisation's culture is different from their own. "From there, they go on to structure and roll out a program of interventions, and metrics, to promote cultural integration," he says. "Culture can be hard to define but left unaddressed cultural clashes, epitomised by the inability of teams and leaders to work together, are the most cited reason for deal failure."

MEASURING SUCCESS

Ultimately, insurers will need metrics to assess the extent to which they have successfully overcome such challenges – and, above all, to measure whether the transaction is delivering the anticipated benefits. Such metrics need to be carefully aligned with the original motivations for the deal and as such the success criteria for the deal should be established at the outset of the process (prior to and during due diligence).

There are a variety of possible options for measuring success. Our respondents' focus on top-line growth as a driver for acquisitions is reflected in the fact that the extent of revenue and commercial synergies is the most frequently cited measure of success, with almost two-thirds (62%) picking this out (see figure 16). Worryingly, 44% of firms say that they have found this challenging.

As one Chief Financial Officer of a Middle Eastern life insurer put it: "The potential revenue synergies were clear as our merger partner was a strong player with established distribution networks that could boost sales – but we knew we needed to position ourselves carefully to benefit, even in a rising insurance market."

Interestingly and potentially worryingly, only 12% of firms say that they use employee engagement as a measure of success despite firms recognising the previously mentioned challenges of hiring and retaining employees (42%) and the difficulty of overcoming cultural and organisational differences (39%) in managing integration. One has to be concerned that if firms are not putting in place appropriate measures of success then they are setting themselves up for failure.

Fig 16. How have you/are you measuring the success of this acquisition?

"A significant number of buyers quoted top-line revenue growth as the driver for deal activity and the focus on customer satisfaction would appear to be a natural consequence of this," says Willis Towers Watson's Steve Allan. "However, the relatively low scores for employee engagement would appear to illustrate an opportunity for insurers to apply best practices from other business sectors to improve their deal effectiveness. Across sectors as diverse as retail, pharmaceuticals and financial services there is a clear correlation between employee engagement and customer experience leading to improved financial performance. Transformational transactions, by their very nature, tend to have a detrimental impact on employee engagement. There is a clear opportunity for insurers to take successful business practices from other business sectors to focus on monitoring, maintaining and improving employee engagement levels as a core business priority to support financial deal goals."

"The relatively low scores for employee engagement would appear to illustrate an opportunity for insurers to apply best practices from other business sectors."

Steve Allan, Willis Towers Watson

Indeed, neglecting engagement metrics is potentially a mistake, warned the Vice President for Strategy of a North American life insurer. "In our case, it was employee integration and our collective efforts in getting the businesses together that helped us offer enhanced insurance services and product offerings to customers in our core business region," the executive says.

Get ready for M&A

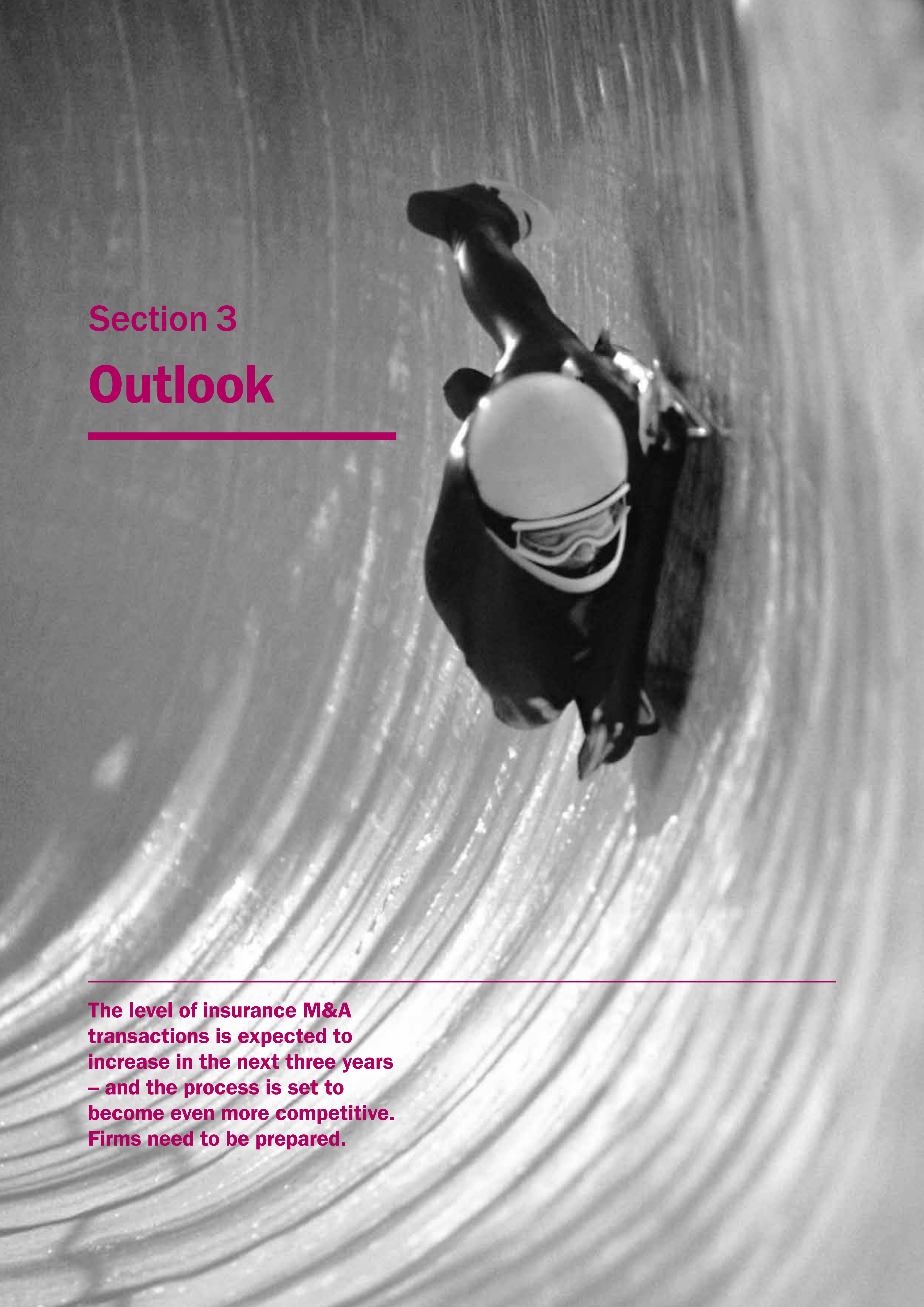
Successful dealmaking is as much a science as an art, and the best acquirers put significant efforts into being thoroughly prepared to conduct deals

Clearly not every transaction is a business success. Plenty of column inches are dedicated to deals that, with the benefit of hindsight, should never have seen the light of day. There are also a wealth of more dispassionate academic and consultant-led studies that highlight the significant business risk inherent in M&A. Notwithstanding these headwinds, boards and shareholders continue to approve M&A activity and there is evidence that, in aggregate, deals deliver economic performance.

Indeed, one ongoing longitudinal study run by Cass Business School with Willis Towers Watson has shown that, across business sectors and across deals in aggregate, dealmakers tend to outperform. The study has also shown that compared to previous merger waves, dealmakers' performance has improved, and notably, that serial acquirers tend to outperform occasional buyers.

Readiness means having robust processes in place to both minimise the possibility of buyer's remorse and to optimise the deal implementation process. The hallmarks of M&A readiness include:

- A diverse cross-discipline M&A team that extends beyond the finance and legal function to include broader roles such as HR that are crucial to both talent retention and the successful integration of the target post-acquisition.
- An established discipline of defining deal objectives pre-close and setting relevant and practical internal metrics that will apply throughout the integration process.
- A business leadership team that understands the disruption that a transaction causes to the business, and the leadership expectations of them past deal-close and throughout the integration process.
- A willingness to accept that an acquisition can require significant changes within both the target and the buyer's organisations, from key roles to business structures and the underlying culture of the company, and a process to identify what this means in practice.
- A culture of learning from experience and prior deals, and to build continuous improvement into the deal process.



Section 3

Outlook

The level of insurance M&A transactions is expected to increase in the next three years – and the process is set to become even more competitive. Firms need to be prepared.

The increasing activity in the M&A market during 2015 looks set to continue for the near term at least. Overall, more than four in five (82%) insurers expect to make at least one acquisition in the next three years, while 36% expect to enter into at least one joint venture and 35% expect to carry out at least one divestment (see figure 17). However, only 5% expect to undertake a merger, though this low figure may reflect the nature of such deals – executives are less likely to plan ahead for mergers, particularly since these are transactions which may see them lose control of their businesses.

INSURERS BACK ON THE M&A TRAIL

Insurers based in Bermuda are the most acquisitive respondents in our survey, with 100% expecting to make at least one acquisition (see figure 18). This partly reflects the ongoing consolidation activity in the Bermuda marketplace, which looks set to continue.

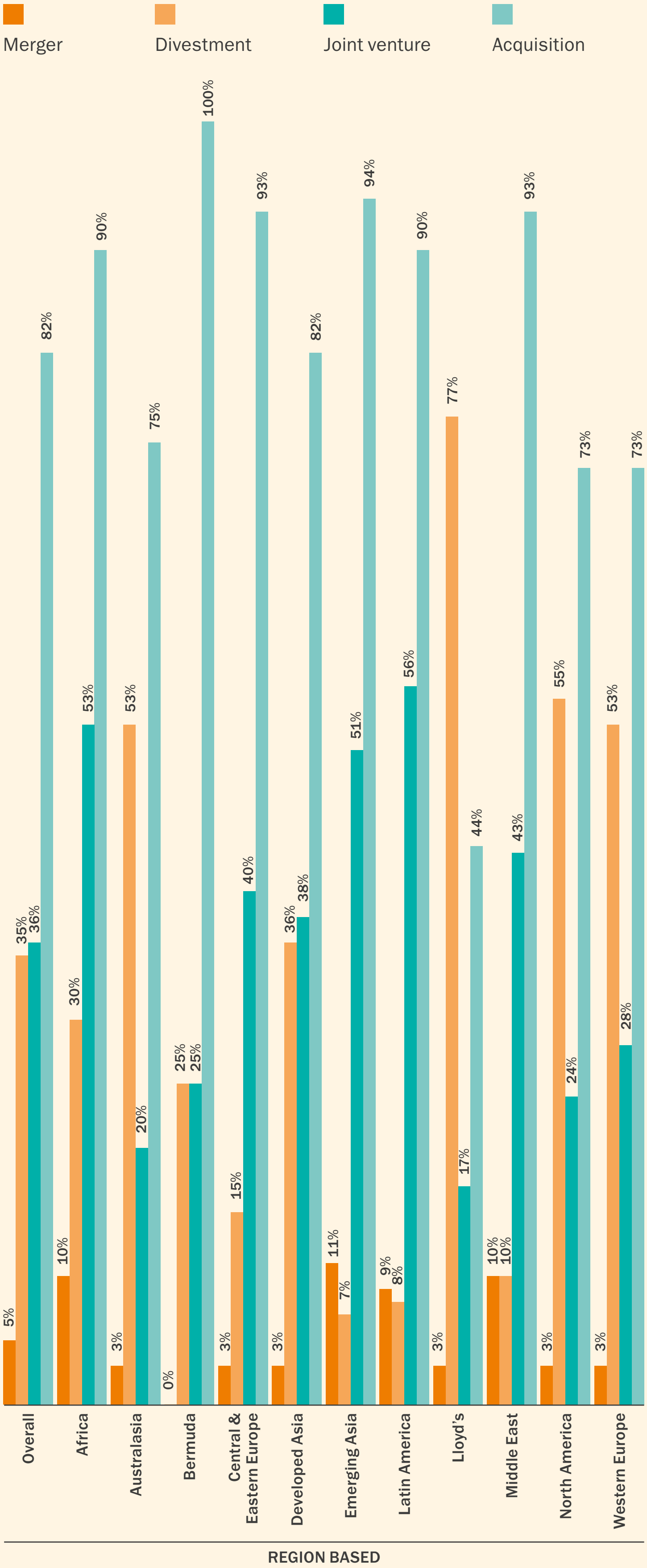
However, insurers in other markets also show a marked appetite for dealmaking – at least 90% of insurers in emerging Asia, Central and Eastern Europe, the Middle East, Latin America and Africa are planning deals. Meanwhile, Lloyd's firms are most cautious, with only 44% expecting to make at least one acquisition.

Lloyd's businesses are particularly likely to be considering divestments, as are firms in developed markets, with more than half of firms based in Western Europe, North America, Australasia and Lloyd's expecting to make at least one divestment in the next three years. Given the prevailing themes of consolidation and efficiency in these markets, this is to be expected.

Firms based in emerging markets are most open to joint ventures, with more than half of insurers based in Latin America, Emerging Asia and Africa expecting to enter into at least one such deal in the next three years. This is encouraging for international businesses seeking access to these markets, which are often off-limits to foreign investors unless they have local partners.

In many cases, insurers are planning not just one transaction, but anticipating entering into a number of transactions in the years ahead. In Bermuda, emerging Asia and the Middle East, more than two-thirds of insurers expect to do two to three deals over the next three years. In Central and Eastern Europe, 9% of insurers expect to do four or five deals.

Fig 17. What M&A activity is your company likely to consider over the next three years?



Serial acquirers – those that have completed three or more deals over the past two years – are also set to remain active, with 41% planning at least three deals in the next three years and 75% planning at least two deals.

The 18% of firms that are not planning any acquisitions were most likely to say that this was because they were focused on their existing operations – this was particularly the case in the Asia Pacific region (64%) (see figure 19). Alternatively, many insurers said their appetite for deals had been curtailed by their concern about economic volatility – this was particularly so in the Americas (66%) and in the EMEA region (50%), where ongoing possibilities of countries exiting the Eurozone and the UK splitting from the EU may have played a part in this conservatism.

INSURERS TAILOR THEIR PLANS

Insurers continue to target top-line growth, but appear keener to secure it from markets they know well, rather than from expansion into new territories. In an era of continuing volatility, advances into less familiar markets are potentially too risky, though 55% of insurers are considering expanding into new sectors or products in the market (see figure 21).

Overall, four in five (80%) of insurers that are planning acquisitions say they expect to focus on consolidation in core markets while 56% are planning expansion into new geographies. Although, our study suggests that the majority of respondents will focus their expansion efforts on neighbouring countries within the same region,

Fig 18. How many acquisitions would you expect to make over the next three years?

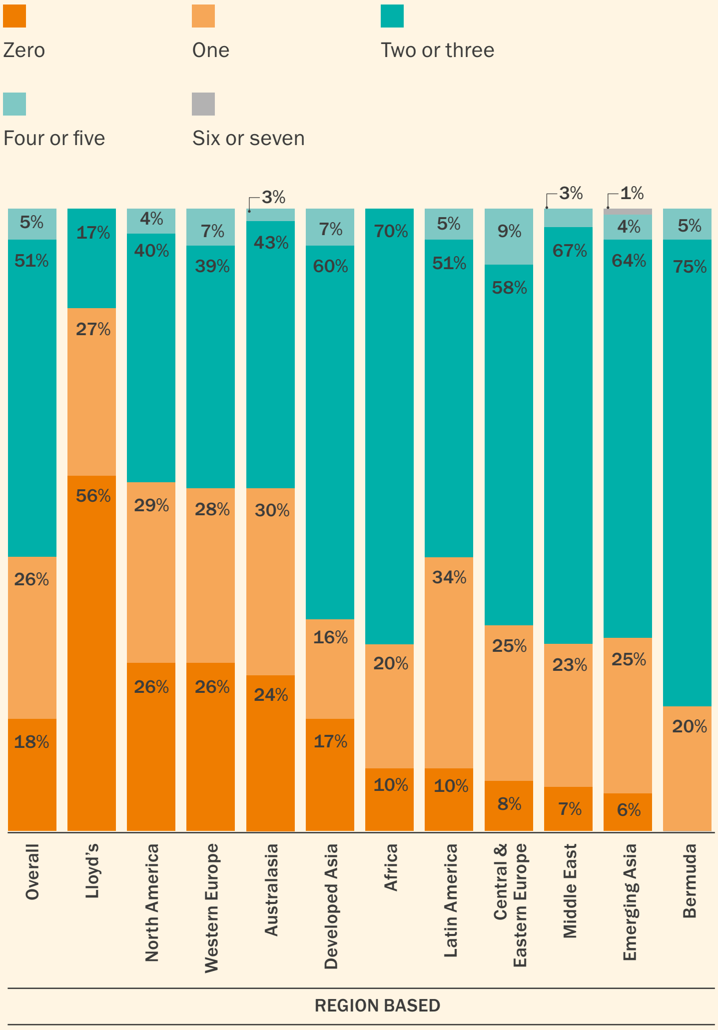


Fig 19. Why are you not likely to consider acquisitions?

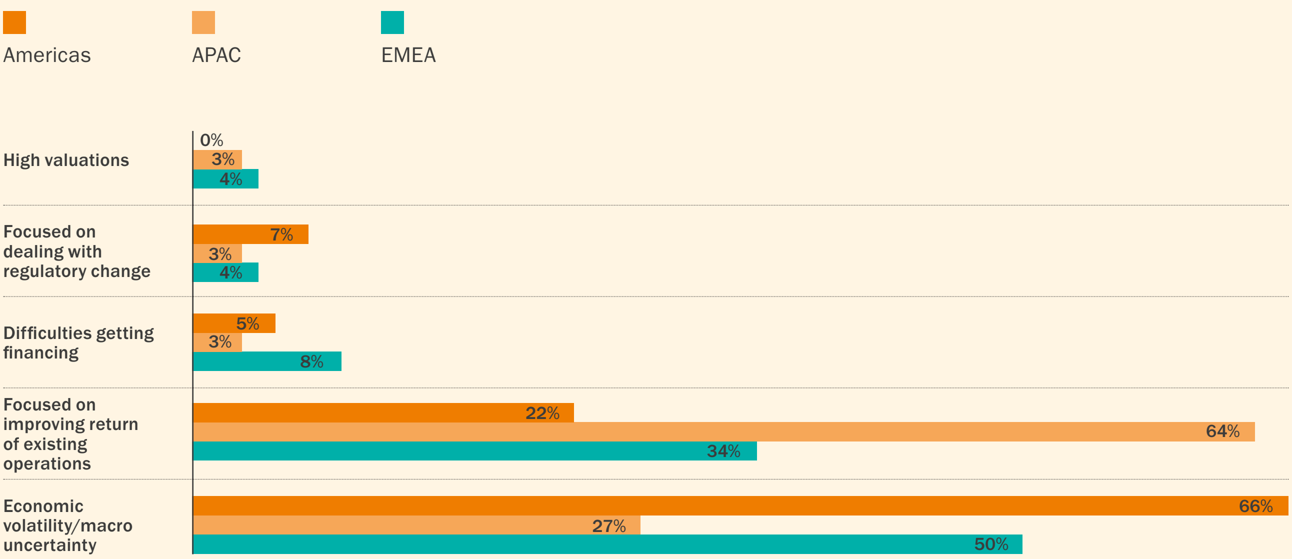


Fig 20. In which regions/markets is your acquisition strategy likely to be focused?

REGION OF ACQUISITION TARGET

REGION BASED	Africa	Australasia	Bermuda	Central & Eastern Europe	Developed Asia	Emerging Asia	Latin America	Lloyd's	Middle East	North America	Western Europe
Overall	11%	5%	3%	9%	24%	38%	18%	1%	6%	26%	25%
Africa	85%	0%	0%	0%	7%	11%	4%	0%	7%	11%	7%
Australasia	0%	67%	0%	0%	47%	53%	0%	0%	0%	7%	0%
Bermuda	5%	0%	30%	0%	10%	35%	45%	0%	0%	80%	45%
Central & Eastern Europe	8%	0%	0%	97%	3%	3%	0%	0%	5%	0%	24%
Developed Asia	5%	11%	1%	0%	88%	91%	7%	0%	1%	5%	16%
Emerging Asia	12%	4%	1%	1%	39%	98%	0%	0%	4%	4%	5%
Latin America	0%	0%	0%	0%	1%	0%	99%	0%	0%	14%	0%
Lloyd's	0%	0%	23%	0%	15%	8%	8%	54%	0%	38%	38%
Middle East	68%	0%	0%	4%	4%	0%	0%	0%	100%	0%	0%
North America	2%	0%	3%	2%	6%	12%	15%	1%	0%	91%	23%
Western Europe	5%	0%	2%	17%	6%	17%	8%	0%	0%	17%	97%

Fig 21. What is likely to be the focus of your acquisition strategy?

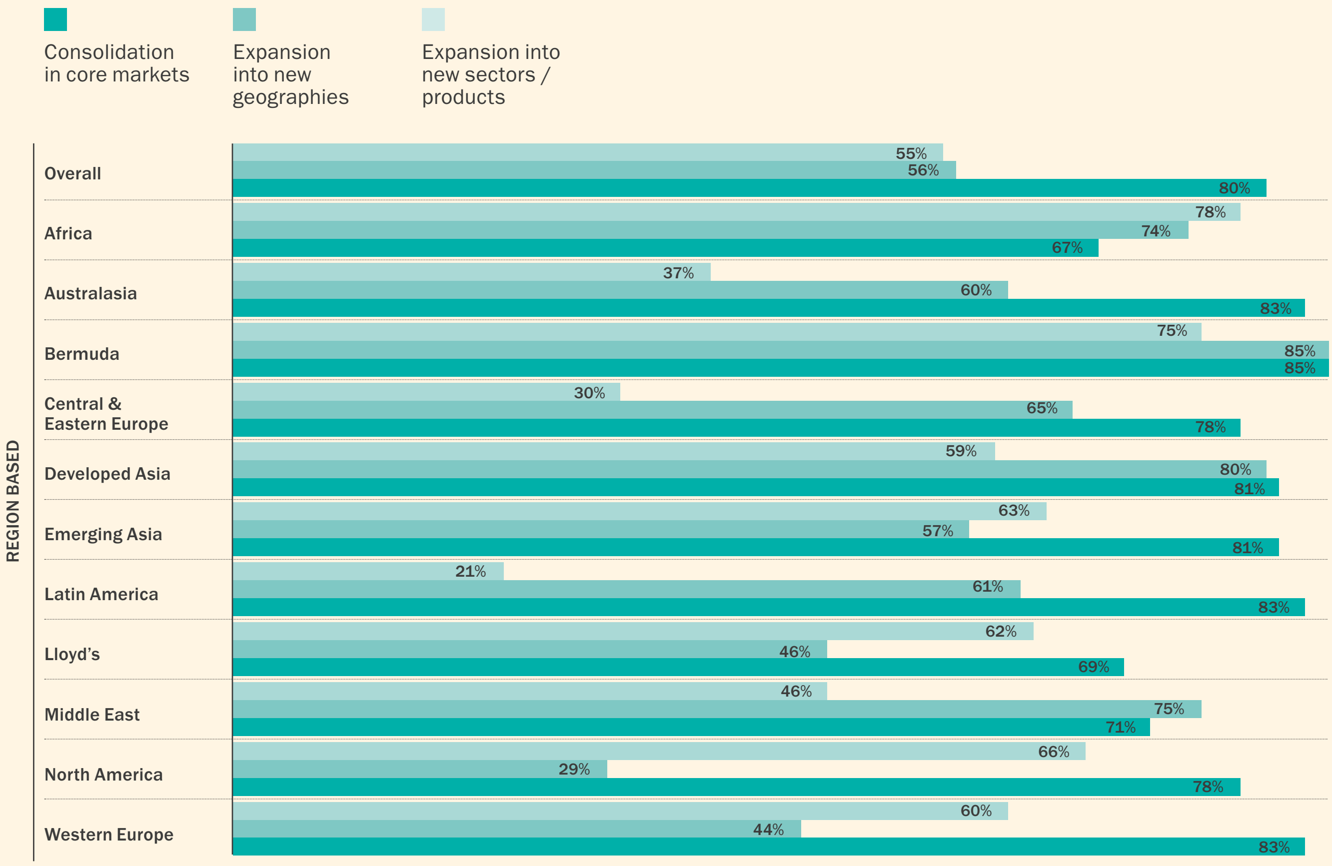
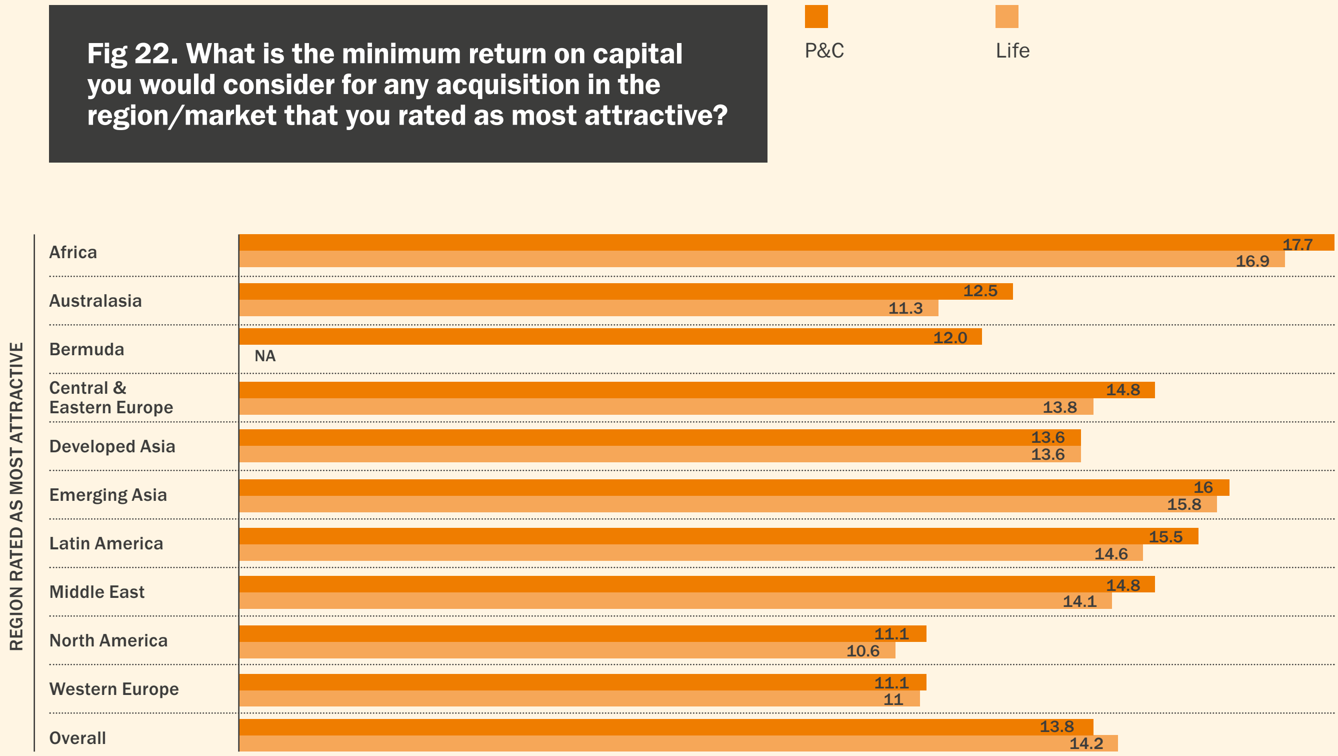


Fig 22. What is the minimum return on capital you would consider for any acquisition in the region/market that you rated as most attractive?



a significant minority of those surveyed report a strong appetite for cross-regional transactions. Firms domiciled in Bermuda or at Lloyd's are prominent in that minority, reflecting the international nature of their business models.

The overriding consolidation theme is apparent, however, even where firms may be looking outside their home territory (see figure 20). For example, Australasian insurers' affinity for Asian businesses and the reciprocal interest of many West European and Central and East European companies in each other's assets are indicative of established and growing commercial links. Equally, the relatively low interest expressed in acquiring North American and Western European assets from Emerging Asia may, we believe, mask strong Chinese interest in selected markets within those regions.

Insurers see different markets as offering different attributes and therefore have different ambitions for deals according to where they take place. For deals targeting Western Europe and developed Asia, for example, insurers are currently focused, in particular, on attractive valuations. For deals targeting North America, Australasia and the Middle East, insurers cite the positive economic environment. And in a number of emerging economies, they are particularly excited about the pace at which local insurance markets are growing.

The attributes insurers say they are looking for in target companies suggest that the desire to secure top-line growth is likely to continue to dominate the M&A environment. Almost two-thirds (62%) of insurers say they are most often focused on companies which offer them an opportunity for market positioning or increasing the customer base (see figure 24). Growth rates (34%) and distribution platforms (32%) are also important to many insurers.

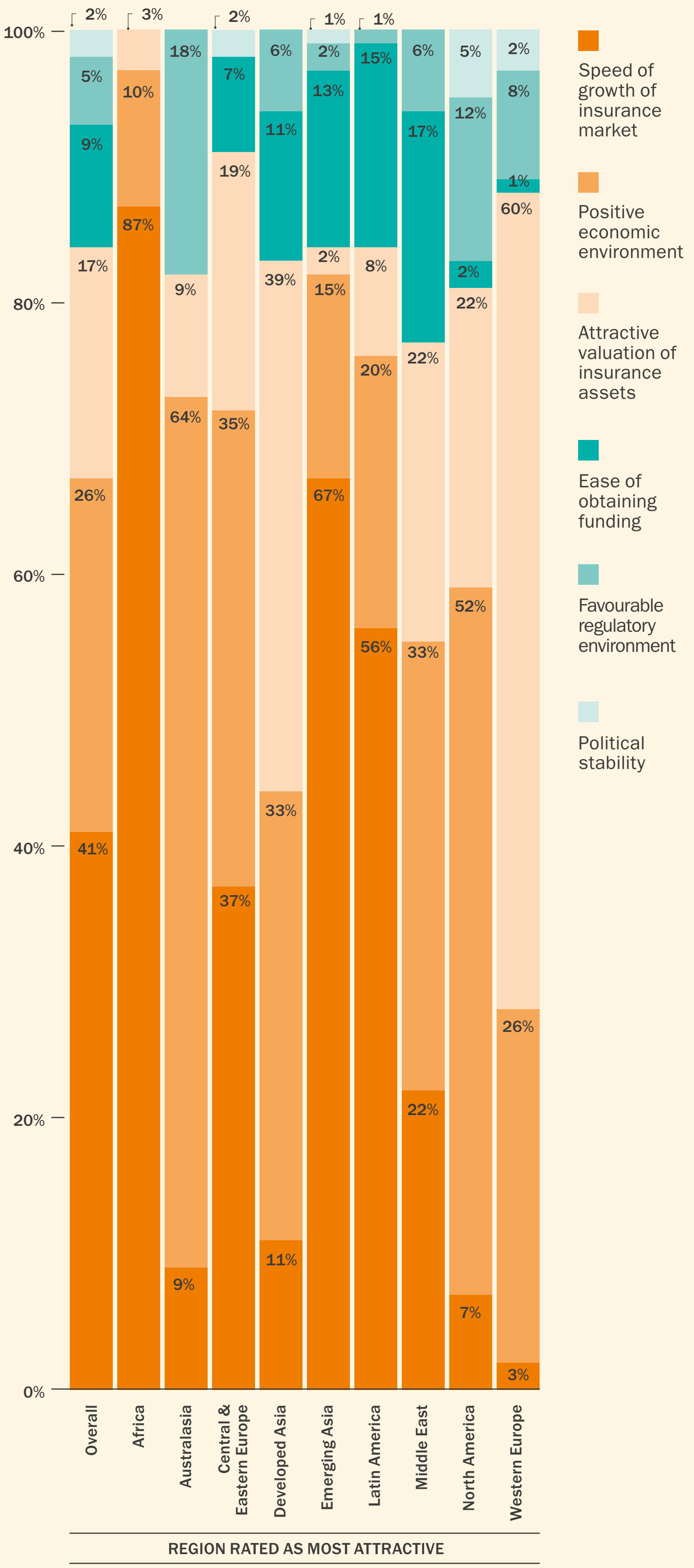
It is clear, however, that insurers are becoming more demanding in their deal criteria. In the P&C sector, insurers say they will not consider a deal offering a return of capital of less than 13.8% in the years ahead, rising to 14.2% in the life sector (see figure 22). That compares to the 12.5% and 13.4% they have been seeking in the two sectors respectively in recent times (based on reported targets for recent transactions).

If insurers are to stick to those higher minimum returns on capital, they may have to be more selective in the transactions they chase – in a market where competition for deals is set to intensify, that will add to the pressure on M&A teams.

THE OUTLOOK FOR THE MARKET

Insurers have very clear views about where the next phase of M&A in their sector is set to be played out: 34% expect North America to see the greatest amount of M&A activity over the next three years, while 32% say emerging Asia. The third choice, Latin America, picked by

Fig 23. What attracts you to the region/market rated as most attractive?



15% of insurers, is less than half as popular as its rivals.

"In North America, firms across the US and Canada are considering inter-regional deals to diversify their product offerings and to underwrite risks in the pipeline," said the Director of Underwriting at a North American P&C insurer of this prediction. "North America has a huge insurance market that is well structured and firms outside of the US will look to target the sector more aggressively to get access to its customer base, technology and licenses," added the Vice President of Underwriting at another North American P&C.

As for emerging Asia, the Director of Underwriting at a European P&C insurer predicted: "Attractive assets and innovative business models will attract buyers while increasing cash reserves and aggressive management rationales will trigger outbound activities."

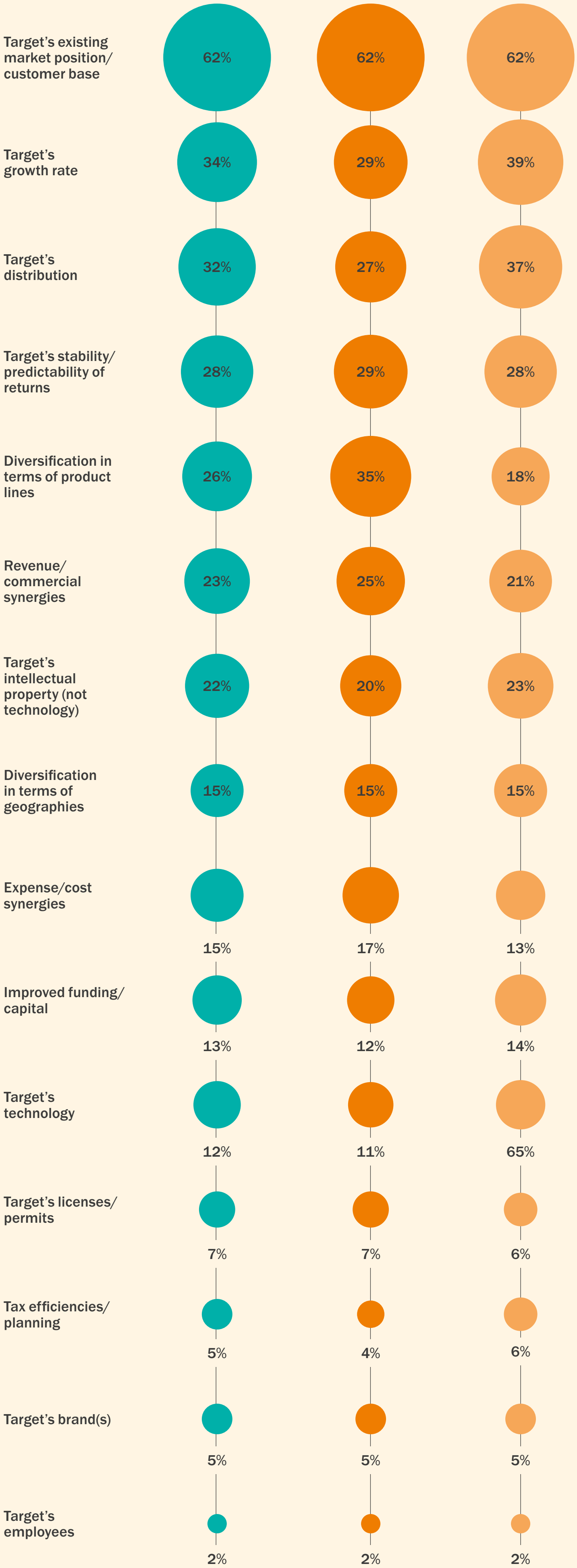
Emerging Asia also stands out as the market expected to see the biggest increase in M&A activity over the next three years. And this could be inbound and outbound – the Director of Underwriting at a North American P&C argued: "The Chinese Government is encouraging domestic businesses to invest overseas to gain experience of international business standards and the Asian region should benefit from this commitment to international exposure."

In Europe, Willis Towers Watson's Fergal O'Shea expects the formal launch of Solvency II to provide insurers with greater certainty. "Generally, I think companies will apply a greater discipline as to how they manage and look at their businesses, particularly from a capital perspective and I think capital allocation will become a greater focus," he says. "That will increase activity levels in M&A as companies seek to manage their portfolio of assets more effectively."

"Changing Solvency regulation globally will have an impact on future deals, whether or not regulation leads to increased capital requirements," adds Willis Towers Watson's Alessandro Santoni. "It will lead companies to rethink the capital efficacy of their products and optimise their portfolio. In addition, the compliance cost for many of the smaller players may encourage further consolidation."

Fig 24. What features are you likely to prioritise in any target company?

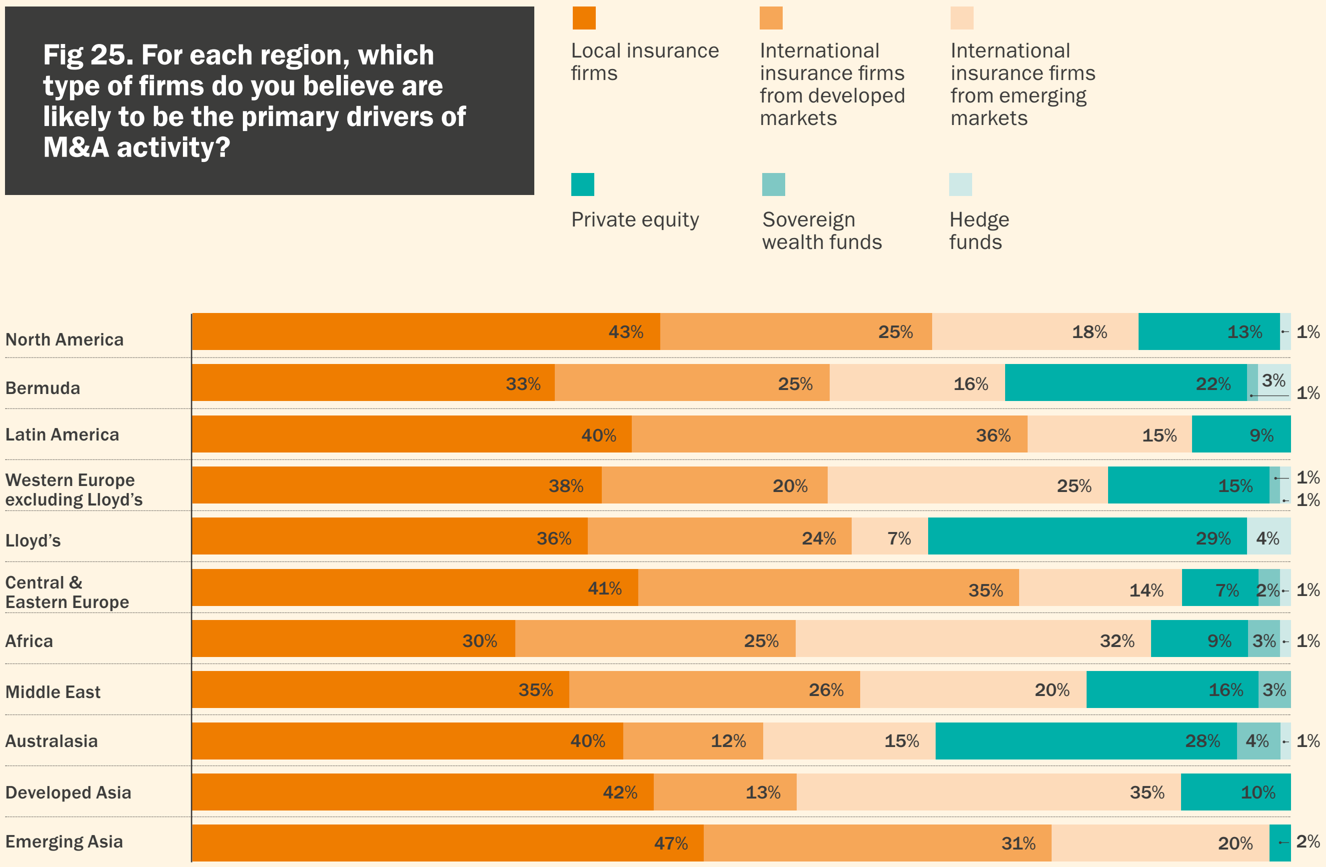
Overall P&C Life



"Changing Solvency regulation around the world will have an impact on future deals, whether or not regulation leads to increased capital requirements. It will lead companies to rethink the capital efficacy of their products and optimise their portfolio. In addition, the compliance cost for many of the smaller players may encourage further market consolidation."

Alessandro Santoni, Towers Watson

Fig 25. For each region, which type of firms do you believe are likely to be the primary drivers of M&A activity?

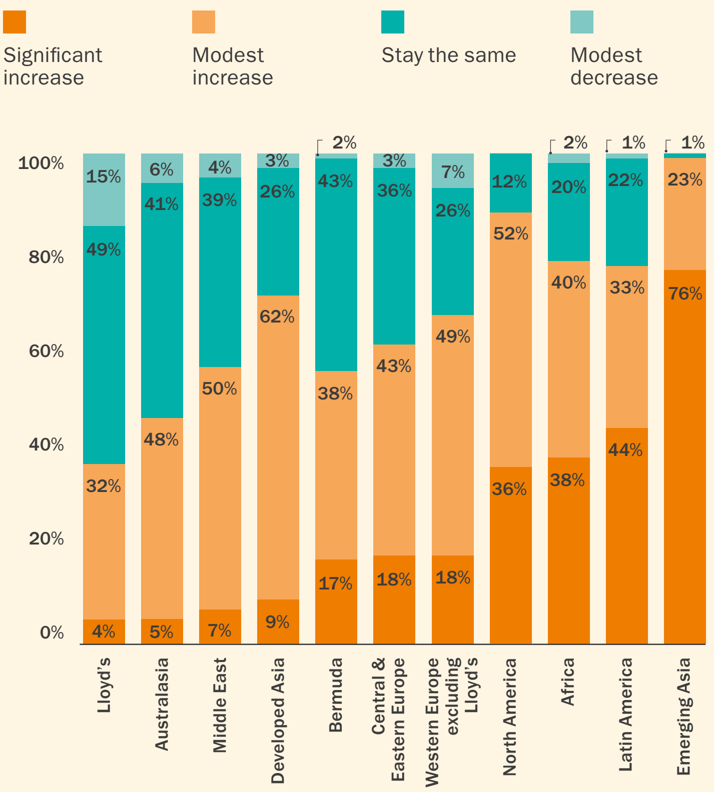


In every region, insurers predict local firms will be the leading proponents of M&A activity, though the second most important predicted player in the market varies by region (see figure 25). International insurers from developed markets are expected to play the second most important role in Emerging Asia, Central and Eastern Europe, Bermuda, the Middle East and Latin America. International firms from emerging markets are expected to play the second most important role in developed Asia, Africa, and Western Europe.

This represents an interesting dichotomy, with evidence that insurers expect developed nation firms that are facing competition from emerging markets firms in their own marketplaces to make more of a move into emerging markets (even though many firms profess themselves more cautious about new territories in the current environment).

Meanwhile, the PE sector is set to continue to make further in-roads in many regions – and in Australasia and Lloyd's, it is seen as the second most likely driver of deals.

Fig 26. For each of these regions what are your expectations for the level of M&A activity in the insurance sector over the coming three years?



Conclusion: Soaring expectations

The large number of insurers planning M&A activity over the next three years underlines how crucial dealmaking has become to the strategic ambitions of many firms. Our research suggests some important lessons for insurers to learn if they are to successfully execute deals and achieve their ambitions. These takeaways include:

In the search for top-line growth, distribution innovation is a key challenge. With insurers now focused on M&A as a route to higher revenues, reinventing distribution so that it is fit for purpose in the evolving marketplace is a key challenge. This does not necessarily mean that traditional platforms should be abandoned, but new tools and technologies, including digital options, will become increasingly important in both emerging and developed markets. M&A is one way to obtain such an advantage.

Getting a deal over the line requires careful planning. The relatively high number of bids that did not lead to a successful deal is a consequence of the broad range of threats to successful completion, including price challenges, integration/cultural challenges, competition, regulatory issues and economic uncertainty. Insurers that do not have strategies in place for confronting all of these difficulties may find their M&A ambitions thwarted.

Completion is where the really hard work begins. The real test of M&A success is the benefits that a deal delivers for the business. Insurers need to begin post-completion integration planning at the earliest possible stage in the deal process and to consider a broad set of challenges – ranging from more technical issues such as systems integration, to commercial imperatives such as strategic direction, to softer questions such as cultural fit. Similarly, those insurers that fail to apply a disciplined set of metrics for measuring success broadly will not maximise the benefits of a deal and may fail.

The M&A market will only become more competitive. The upswing in M&A activity seen in 2015 is likely to be only the beginning, with insurers planning many more deals in the years ahead and the sector continuing to prove attractive to new capital from PE and non-traditional sources. Demand for good-quality assets is set to run ahead of supply, leading to upward pressure on valuations and pricing. Insurers will need to compete hard for the deals they want to pursue, while remaining conscious of the danger of overpaying.

Insurers want more from M&A. Investors have set their sights on higher minimum returns on capital from M&A. But if this ambition is to be met, they will have to think harder about where and how they focus their M&A efforts – and improve post-deal performance. And while insurers have relied on buoyant cash reserves to finance much of the 2015 M&A spree, they may need to be more imaginative about funding in the years ahead if they are to achieve their higher targets.

World-leading M&A experts

At Willis Towers Watson we know and understand our clients' need to identify, evaluate and execute M&A and other corporate transactions quickly, effectively and rigorously. We know that your strategic and financial objectives need to be clearly defined, understood and met at every stage of the process.

We have a skilled and knowledgeable pool of experienced consultants, combining global best practice and local expertise to support clients in the strategic, financial and people-related issues associated with buying and selling companies.

Our expertise spans the complete deal cycle

1 Before the deal
Strategy and planning

- Strategy formulation and international/regional market understanding
- Initial assessment and review of alternative options
- Robust and documented windshield appraisals of potential targets
- Managing stakeholders
- Team and process organisation/education

2 During the deal
Due diligence

- Financial and risk due diligence
- Investment/ALM due diligence
- Distribution and strategic due diligence
- Reserve adequacy and claims
- Pricing and underwriting capability
- Capital management and modelling
- Operational efficiency
- Transaction structuring
- Negotiation support

3 After the deal
Implementation

- Regulatory support
- Integration planning
- Post-merger integration/ execution
- Financial modelling
- Distribution
- Restructuring
- Underwriting strategy
- Deal debrief – what went well?
- Post-deal evaluation
- Purchase accounting

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We have advised on M&A assignments (both buy-side and sell-side) in over 50 countries – some of these include:

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- Canada
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- Croatia
- Finland
- France
- Germany
- Greece
- Hong Kong
- Hungary
- Indonesia
- Ireland
- Italy
- Japan
- Luxembourg
- Malaysia
- Mexico
- Netherlands
- Philippines
- Poland
- Portugal
- Russia
- Singapore
- Slovakia
- South Korea
- South Africa
- Spain
- Sri Lanka
- Taiwan
- Thailand
- Turkey
- United Kingdom
- United States
- Vietnam

Contacts

Fergal O'Shea
Life M&A Leader, EMEA
fergal.o'shea@willistowerswatson.com
+353 1 614 6820

Andy Staudt
P&C M&A Leader, EMEA
andy.staudt@willistowerswatson.com
+44 20 7170 3476

Jack Gibson
Managing Director, Global M&A, Americas
jack.gibson@willistowerswatson.com
+1 212 309 3922

Alessandro Santoni
Director, P&C M&A, Americas
alessandro.santoni@willistowerswatson.com
+1 212 309 3533

Isabelle Kerneuzet
Life M&A leader, APAC
isabelle.kerneuzet@willistowerswatson.com
+852 2593 4528

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For more information regarding this report, please contact:

Jeanne Gautron
Publisher, Remark EMEA, The Mergermarket Group
Tel: +44 (0)20 7059 6262
Email: jeanne.gautron@mergermarket.com

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