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Private equity 'ready, willing and able' to do insurance deals

By Katie Darden

Private equity players will remain active in insurance M&A while strategic players hold back, said panelists at the SNL Insurance M&A Symposium on Oct. 16.

Private equity capital is "ready, willing and able" to do deals, according to Keefe Bruyette & Woods Managing Director Joseph Beebe. He said private equity firms have probably been the most active acquirers in both the life and P&C space over the last 10 years. He and others expect to see even more activity.

Filling a vacuum

Sandler O'Neill & Partners Managing Director John Hendrix said private equity and hedge fund capital has filled a "vacuum" and met a "very significant market need" in the absence of strategic acquirers in the insurance space.

"To this day I don't think those natural buyers are there," he said.

This relative absence from the M&A scene is despite some advantages on the part of insurance companies. It is safe to say that the cost of capital "at a major, SIFI-style strategic domestic life insurance company" is lower than at a firm like Apollo Global Management LLC or Guggenheim Capital LLC, Hendrix said later in the panel discussion. Such insurers have another advantage in their "tons of resources and presumably good systems," he said. So the question is: Why have strategic players stayed on the sidelines?

One reason, Hendrix said, is a lack of confidence on the part of such large companies in their ability to acquire businesses and operate them any more efficiently than a firm such as Guggenheim or Apollo-backed Athene Holding Ltd.

Many large financial institutions have not really moved out of a financial crisis mindset and face a very uncertain regulatory environment that is not conducive to large company deals, said David Schamis, founding partner at financial services-focused Atlas Merchant Capital.

"Hands are tied" at the largest U.S. insurance companies, Grace Vandecruze, managing director of Grace Global Capital, told SNL. American International Group Inc. and Prudential Financial Inc. have been designated as nonbank SIFIs. MetLife Inc. is expected to challenge its preliminary SIFI designation.

"The regulatory uncertainty surrounding SIFI will preclude any large transformational deals amongst the top U.S. companies," she said. "Until rules of required capital are defined, it is hard to embark on a major strategic transaction."

Annuity deals

Fixed annuity blocks have been particularly attractive to private equity acquirers, but several panelists agreed that more deals involving variable annuity business could be on the way.

Hendrix said the market need could migrate from fixed annuities to variable annuities, although activity will be largely driven by where the easier opportunities are at first. As such, variable annuity deal activity will probably come later since they are more difficult to execute.

Schamis expects private equity firms to do some variable annuity deals but does not think they are likely to compare to fixed annuity deals in terms of size. Before joining Atlas in January, Schamis was a managing director and management committee member at J.C. Flowers & Co., which specializes in financial services investments.

BMO Capital Markets Managing Director Scott Littlejohn agreed that deal activity could grow beyond fixed annuities and noted that some deals have already done so.

"They're hard, but you can get them done," Mark Socha, head of enterprise M&A at The Hartford Financial Services Group Inc., said of variable annuity deals more generally on another panel later in the day. He highlighted The Hartford's recent sales of variable annuity businesses in the UK to Berkshire Hathaway Inc. and in Japan to ORIX Corp.

P&C and brokerage

On the P&C side, the panelists discussed private equity interest in specialty businesses. Beebe noted that growth characteristics for specialty products "tend to be a little more innovative" than long-standing P&C offerings.

"P&C is a great example of capitalism at work," Schamis said. Every time there is opportunity to generate a couple more points of return on equity, such as in specialty lines, the capital comes right in to take advantage and then ROE goes down.

"On the question of run-off versus new business, I personally think that over cycles of five-plus years it's really hard to argue that you don't get better returns on equity in the run-off business than you do on the actual underwriting business," he said. Schamis added that expertise in the run-off space is scarcer than underwriting expertise, so run-off deals could represent real opportunity.

The challenge for private equity in the insurance brokerage and services segment is that the market is "so picked over" and prices are high, Hendrix said. Private equity players that do not already have a platform in the space might do better to look at the underwriting side, even though it is harder to generate a private equity-type return with a regulated entity.

Exit strategy

With respect to exit strategies for alternative asset managers invested in insurance, Hendrix said the IPO market is a very viable alternative. But he is not ruling out the possibility of strategic M&A exits.

"I hate the IPO process as a seller," Schamis quipped. "…Everything about it is terrible, except for maybe the price sometimes."

Schamis said he has done IPOs and hopes to do more in the future, but "as a potential private equity-style seller one day, I'm much more interested in a strategic sale."

Schamis acknowledged that going the strategic M&A route requires more patience when it comes to finding the right buyer at the right price.

Harbinger Group Inc., Guggenheim and Apollo timed deals right and now have platforms they can use for future consolidation and acquisitions, according to Littlejohn. Because of that timing, it is hard for other alternative asset managers to play catch-up, although they would like to.

Hendrix said, in response to a question about private equity firms selling insurance intermediary businesses to other private equity buyers, that the market has greatly transformed over the last 15 years. There are probably now at least 50 private equity firms that really understand how insurance works and have studied it.

"Private equity now has become such an insurance-savvy marketplace that it's able to facilitate entry and exit points sort of as a self-contained world, and I don't see that phenomenon changing anytime soon," Hendrix said.