Viewpoint: Lloyd's M&A is steadfast in face of Brexit headwinds

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The factors driving mergers and acquisitions activity at Lloyd’s over the first six months of this year are different from last year

M&A ACTIVITY HAS SLOWED DOWN IN THE UK, THANKS TO UNCERTAINTY ABOUT THE UK’S WITHDRAWAL FROM THE EU

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After intense levels of activity in global insurance sector mergers and acquisitions (M&A) in 2018, there has been something of a slowdown, in relative terms, through the first half of 2019. This has been particularly pronounced in the UK, with the continuing uncertainty about the UK’s withdrawal from the EU undoubtedly casting a shadow over M&A transaction volumes.

Although it is anticipated activity will bounce back after the uncertainty has been removed – possibly, but by no means certainly, by October 31 this year – in the interim there have still been notable segments of the UK and London markets that have seen vibrant M&A activity through the first six months of this year and are expected to remain active into 2020.

On the basis of announced transactions so far in 2019 and with regard to deals in the pipeline, the areas of insurance M&A that have stood up well to the Brexit headwinds include mid-market broker distribution and managing general agent (MGA) deals, insurtech transactions and, in particular, Lloyd’s market M&A.

In addition to those Lloyd's transactions already announced in 2019, there are several active processes for the acquisition of Lloyd's businesses and we anticipate that there will be several more changing ownership in the second half of the year.

Historically, many Lloyd's M&A deals have been driven by buyers drawn by one or more of the advantages of operating a Lloyd's platform (including Lloyd's international licences, reputation of the market, financial rating and Lloyd's Brussels as a Brexit solution).

However, this more traditional Lloyd's M&A play of acquiring a managing agency to help drive international expansion has seen something of a slowdown this year, with no deals thus far to compete with the headline transactions of 2018, notably China Re's acquisition of Chaucer.

Instead, we have seen other factors driving the transactions announced and in the pipeline in 2019, with buyers and bidders tending to fall into one or more of the following three categories:

First is scaling up. Several smaller and mid-sized Lloyd's managing agencies (and insurance groups with Lloyd's platforms) have been looking to acquire other Lloyd's businesses to increase size, drive better economies of scale and, ultimately, reduce costs.

Run-off consolidation is another category. Against a backdrop of the Lloyd's performance review, there has been an increase in Lloyd's syndicates entering into run-off. Coupled with the fact that many syndicates have also been required to stop writing or reduce exposure to certain lines of business, this is creating opportunities for those looking to establish a managing agency run- off platform to aggregate blocks of discontinued Lloyd's business through M&A, Part VII or reinsurance to close transactions.

Finally, private equity interest is behind a number of deals. With valuations for Lloyd's targets generally somewhat depressed in comparison to recent years, and less competition currently from insurance and reinsurance group trade buyers, there is interest in Lloyd's from a private equity perspective as a pure value play around the more distressed targets, potentially as an aggregator of other Lloyd's businesses and not necessarily restricted to the run off space. In addition, for those private equity groups with existing insurance or insurance distribution platforms, there exist opportunities to acquire established Lloyd's platforms which are potentially synergistic, for example, by providing capacity to MGAs.

Looking forward, there is a question whether Lloyd's M&A deal activity might be impacted by the far-reaching market reforms contemplated in The Future at Lloyd's prospectus.

Currently, the long lead time and associated costs of establishing a Lloyd's platform organically via a turnkey operation has meant that M&A has, for many, been a preferable route to market entry, and has added some level of "market access" premium to the valuations of Lloyd's entities. The Lloyd's prospectus envisages both simplified methods for enabling third parties to deploy capital in Lloyd's and the concept of a "syndicate in a box" for bringing new products and business into the market.

This might, in the medium to longer term, provide viable alternatives to acquisition for some who might otherwise have looked to acquire a Lloyd's platform. That said, given Lloyd's is still consulting on the outline plans in the prospectus, and it remains to be seen exactly how these major structural reforms to the market might be implemented, it is perhaps unlikely that this will have any meaningful impact on Lloyd's M&A deal volumes or valuations (for better or worse) for quite some time.

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