Insurance: Top 10 Takeaways from 2021 and Q1 2022

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Introduction

This Debevoise In Depth sets out our thoughts on the key takeaways from what was an incredibly busy last year in the insurance industry—a trend that continued into 2022—ranging from drivers of M&A to developments in COVID-19 litigation, ESG, cybersecurity and artificial intelligence.

Return of Significant Transactions

Over the last 12 months or so, we have seen the return of significant transactional activity across the insurance space after a slowdown in 2020 as a result of COVID-19. Recent standout mega-deals included:

- the acquisition by Covéa of PartnerRe for $9 billion (announced in December 2021);
- Brookfield Asset Management Reinsurance Partners' acquisition of American National for $5.1 billion (announced in August 2021);
- AIG's strategic partnership with Blackstone for its life and retirement business (announced in July 2021);
- the acquisition by Empower of Prudential Financial's full-service retirement business (also announced in July 2021); and
- Chubb's acquisition of Cigna's personal accident, supplemental health and life insurance business across seven Asia-Pacific markets for $5.75 billion (announced in October 2021).

The insurance market also saw a number of substantial reinsurance transactions to de-risk portfolios and release capital, including Enstar's $3.12 billion loss portfolio transfer with Aspen Insurance, Canopius's $780 million loss portfolio transfer with RiverStone

International and Enstar's $2.55 billion adverse development cover agreement with AXA XL.

Although Q1 2022 saw a decrease in the number of insurance M&A transactions globally, we remain confident that 2022 will be another strong year. Three large deals in the United States are particularly worthy of mention. Allianz announced that it had completed its reinsurance agreement with Sixth Street affiliates and Resolution Life for a $35 billion fixed index annuity portfolio. Berkshire Hathaway announced a planned takeover of insurance conglomerate Alleghany Corp for $11.6 billion that is expected to complete in the fourth quarter of 2022. Following on from its strategic partnership with Blackstone for its life and retirement business in July 2021, AIG has filed for the listing of its life and asset management business in what is expected to be the largest IPO of the year in the United States. The new combined unit, to be named Corebridge Financial, is set to reach a valuation of over $20 billion and follows an IPO slowdown resulting from inflation and the war in Ukraine.

In response to the COVID-19 pandemic, insurance companies have shown a renewed focus on their core business and the shoring up of digital capabilities as they seek growth and increased operational and capital efficiency. As firms continue to look to exit non-core, non-profitable and capital-intensive businesses, we expect activity to continue during the rest of 2022 across the market through a combination of traditional M&A, reinsurance structures and portfolio transfers.

Private Equity

A keen private equity appetite drove activity across the sector in 2021, as hardening rates, depressed asset prices and high levels of dry powder have kept private equity buyers and backers interested. 2021 saw private equity-backed Fortitude Re acquire a $31 billion block of legacy variable annuities from Prudential Financial, and Cinven and BCI complete their acquisition of specialist legacy group Compre. Interest in the sector by private equity buyers has continued in Q1 2022. Cinven announced in February 2022 that it will acquire International Financial Group, a life insurance provider. In March 2022, KKR led a consortium of investors in Policygenius's Series E funding round.

Increasingly, we are seeing a growing link between private equity, life insurers and affiliated asset managers, and we expect these relationships to continue to evolve and expand through 2022.

Through their sustained involvement in the insurance space, many private equity players have built up a significant amount of industry expertise and now have specialised teams to deliver multi-pronged approaches to insurance strategies. Yet despite the build-up of much regulatory goodwill, there are still lingering concerns over private equity participation, highlighted by EIOPA's recent supervisory statement on the run-off industry, which also specifically considers investment by private equity. A private equity firm's investment horizon is often shorter than that of other shareholders, causing concerns by regulators that a swift exit from their investment in a target insurer, together with changes typically implemented by private equity, could negatively impact policyholder protection.

Insurance Broker M&A

Transactional activity in the insurance broker and intermediary space remained strong throughout 2021, with broker transactions driving the majority of announced M&A activity worldwide. Insurance brokerage proved to be agile throughout the COVID-19 pandemic, as hardening premium rates increased commissions, and the fragmentation of the UK, European and global broking markets provided attractive roll-up opportunities. In offering a stable source of income and lacking the carrier liability and capital required to be held by pure insurance companies, the brokerage space remained an attractive part of the market, particularly for private equity.

There was a trend in 2021 towards consolidation in the sector. For instance, insurance broker Acrisure announced its acquisition of Italian broker Double S, and AssuredPartners announced its acquisition of PSP Group. Despite increased regulatory scrutiny in the brokerage sector, as evidenced by the collapsed $30 billion mega-merger between Aon and Willis Towers Watson, which was blocked by the U.S. Department of Justice on competition grounds, we still expect consolidation to continue in 2022 as large brokerage aggregators seek acquisitions in this space in order to benefit from economies of scale.

It remains to be seen in 2022 if Odyssey Partners will sell the broker Tysers. AUB Group has recently confirmed that discussions with Tysers are ongoing, but no agreement has so far been reached as to the potential transaction. The formal auction for Tysers began in June 2021, with Xenia buying its trade credit and surety business in January 2022.

Lloyd's of London

Strong transactional activity at Lloyd's resulted in a significant year of deals for the market in 2021. Pure M&A remained busy alongside a slew of capital raisings and deal activity, particularly in the run-off space. The high volume of legacy deals in 2021 is expected to continue in 2022, as are deals for start-ups and insurtech at Lloyd's. Lloyd's first fully digital and algorithmically driven syndicate, Ki, began trading in January 2021, while in January 2022, the acquisition by Corvus Insurance of Tarian marked the first move by a cyber insurtech to acquire a Lloyd's underwriting platform. Also in January 2022, Lloyd's approved the launch by MIC Global and Greenlight Re of two new syndicates focused on micro-insurance products and insurtech respectively. Both are operating through the Lloyd's syndicate-in-a-box framework, which is proving to be an increasingly attractive mode of entry for new and innovative clients and products.

Since the announcement of Blueprint Two in November 2020 and the ambitious Future at Lloyd's programme in May 2019, implementation of the strategy to create a new digital architecture for the market has been marred by delays. However, Lloyd's showed a renewed vigour heading into 2022, with four of its "market milestones" for Blueprint Two achieved, and this trend continued into Q1 2022. In January 2022, Lloyd's announced the signing of a joint venture with DXC Technology and the International Underwriting Association in a move to automate key processes of the Lloyd's market and, also in January 2022, published the second edition of its Blueprint Two Interactive Guide. This guide charts over 50 milestones to be achieved in the next two years and targets a 40% reduction in the costs of doing business—one of the key complaints about operating in the Lloyd's market.

From a financial standpoint, the publication of Lloyd's latest results signalled a strong return to profitability in 2021 compared with 2020 as Lloyd's reported a £2.3 billion profit. Gross written premiums climbed to £39.2 billion for 2021 after a year-end figure of £35.5 billion for 2020. With strong financials and an active legacy market, we consider that the Lloyd's market is strongly positioned for 2022.

European Books in Run-Off

There has been a continuing increase in the number of European books in run-off coming to market. The onset of the COVID-19 pandemic and associated market headwinds have seen insurers looking for relief from non-core, capital-intensive businesses as a means of releasing capital to fund growth elsewhere. Reinsurance structures and legacy deals have continued to allow for the freeing up of capital and have helped in achieving finality for past lines of business.

Mid-2021, Allianz and Monument Re announced the completion of the sale of part of Allianz's closed-book life portfolio in Belgium, while in November, Athora Belgium announced its acquisition of a €3.3 billion closed-book life portfolio from NN Insurance Belgium. 2022 looks set to also be a busy year for European run-off deals. For example, AXA SA, Assicurazioni Generali and Zurich Insurance Group have indicated that they intend to sell run-off portfolios so as to increase their working capital.

As the run-off market has continued to attract new capital and new entrants, both the PRA and EIOPA have shown an increased interest in the sector. Following a consultation process on the supervision of run-off undertakings under Solvency II, EIOPA published a supervisory statement in April 2022 with recommendations to national regulators covering the issues to be considered in approving transactions with run-off undertakings/portfolios and ongoing supervision relating to both prudential and conduct issues. The PRA in 2021 also launched a consultation on proposed updates to its approach to run-off portfolios in respect of insurance business transfers and outlined its amended approach in a policy statement published in January 2022.

Regulatory Focus

2021 saw a heightened regulatory and political focus on transactions generally that continued in Q1 2022. This scrutiny, in conjunction with the large volume of UK M&A deals, has caused change-in-control approvals from UK regulators to take longer than usual. Among other things, regulators also remain wary of the new crop of private equity acquirors, and competition authorities are showing signs of becoming more active in reviewing transactions, most notably with the U.S. Department of Justice moving to block the Aon and Willis Towers Watson merger.

The House of Lords opened an inquiry in January 2022 into the regulation of the (re)insurance industry, focused on assessing the appropriateness of the United Kingdom's regulatory framework and the UK insurance market's global competitiveness. The House of Lords Industry and Regulators Committee will explore the extent to which regulatory policy is well-designed and proportionately applied, and the possibilities for improving policy post-Brexit.

In Europe, a review of Solvency II is underway, following the publication by the European Commission of its proposed amendments to the Solvency II Directive in September 2021. The legislative package is set to be discussed by the European Parliament and Council over the course of this year. EIOPA recently submitted to the European Commission for endorsement its draft amendments to the Implementing Technical Standards under Solvency II. A package of reforms to the UK's retained Solvency II regime was issued for consultation by HM Treasury on 28 April this year. In a speech in February 2022, John Glen, the Economic Secretary to the Treasury & City Minister, indicated that these reforms would be wide-ranging and would target the risk margin and matching adjustment mechanisms of Solvency II in addition to measures designed to reduce the reporting and administrative burden of regulation.

The UK and EU regulators have also remained active in their roles of monitoring and updating their own regulatory frameworks for (re)insurers and the industry more widely. Continuing on from its work in 2021, in Q1 2022, the PRA issued updates with regard to a variety of issues, including third-country branch undertakings, outsourcing and third-party risk management.

As always, it remains imperative for insurance companies to maintain a strong understanding of the regulatory environment in what will be another busy year for regulators.

COVID-19 Litigation

One year on from the UK Supreme Court handing down its judgment in the FCA's business interruption "test case", the courts remain busy with complex business interruption disputes, despite insurers already having paid almost £1.3 billion in settlement to around 40,000 policyholders affected by the test case decision. As the COVID-19 pandemic evolved and businesses were subjected to a number of new lockdowns and other measures throughout 2021, a raft of complex claims, ranging from disputes around the limits of liability and aggregation issues to the question of quantum, have and will continue to make their way through the UK courts.

The Commercial Court is currently monitoring and managing a sub-list of seven cases relating to COVID-19 business interruption under the direction of Butcher J. Most recently, in February 2022, the Commercial Court found in favour of restaurant group Corbin & King in a judgment against AXA concerning the scope of denial of access coverage. AXA has indicated that it will not be appealing this judgment. Elsewhere, hospitality group Stonegate has brought an £845 million case against MS Amlin, Zurich and Liberty Mutual that brings the Marsh Resilience policy wording under the microscope and, in particular, questions around the aggregation of claims and deductibility of government support payments (including furlough payments and business rates relief). The court hearing is scheduled to take place in June 2022. Hearings are scheduled in July 2022 for further claims by UK companies against Zurich and Allianz.

ESG and Sustainability

ESG and sustainability have increasingly become issues of primary concern for carriers and regulators alike. In the UK, the PRA conducted its 2021 Biennial Exploratory Scenario stress test, designed to assess the resilience of the UK financial system to the risks posed by climate change, the results of which are expected to be published in May 2022. In the EU, a focus on the importance of ESG-linked reporting was illustrated through the implementation in March 2021 of the Sustainable Finance Disclosure Regulation, which imposed new obligations on (re)insurers as well as other financial market participants to report on the integration of ESG risks into their due diligence and investment decision-making process. In addition, new recommendations come into force from April 2022 under which insurers must disclose climate-related financial information in line with the Task Force on Climate-Related Financial Disclosures. The European Commission has stated that it will expect insurers to perform a climate change scenario analysis under its proposed reforms to Solvency II. One of the goals of the UK's Solvency II reform is to support investments consistent with the government's climate change objectives.

A heightened focus on (re)insurers' practices and operations has seen many (re)insurers place tighter restrictions on the risks being underwritten, bring investment portfolios in line with ESG considerations and formally commit to reach net-zero greenhouse gas emissions targets. In 2021, eight of the world's largest insurance companies launched a net-zero climate alliance that brings decarbonisation into their risk management frameworks. Mark Carney, the UN Special Envoy for Climate Action and Finance, has stated that this alliance will aim to make underwriting contingent on underlying companies having credible net-zero transition strategies. With sustainability and climate risk now key areas of concern, insurers must continue to be proactive in managing ESG issues across all aspects of their business. Diversity matters also continue to receive regulatory attention. In July 2021, the PRA and FCA issued a discussion paper setting out policy options on diversity and inclusion. The FCA published a policy statement in April 2022 setting out measures to improve transparency on the diversity of company boards and their executive management, and promoted diversity in its Business Plan for 2022 to 2023. Also, in 2022, the NAIC established a special committee on race and insurance to promote diversity within the insurance sector.

Cybersecurity

Cybersecurity has established itself as a key area of risk for both (re)insurers and global businesses. Indeed, the Allianz Risk Barometer 2022 lists cybersecurity breaches as the biggest concern for companies globally. With (re)insurers handling large amounts of personal and commercially sensitive data, historic under-investment in (re)insurers' operational resilience and increasing pressure to modernise and digitise services at pace, the industry has become a particular target for threat actors. Cybersecurity (re)insurers are set to benefit in 2022 from an increase in demand from policyholders, as the number and cost of cyber incidents globally keeps increasing. However, with such a dynamic cyber-threat landscape (new cyber risks appear all the time, via new attack vectors that expose new vulnerabilities), cyber insurers will need to minimise their coverage of certain risks and tighten the terms of their policies.

The importance of operational resilience in the face of increased cyber risk has also been an issue raised by regulators. In March 2021, the FCA, PRA and Bank of England issued a joint statement setting out that "*many firms and FMIs [Financial Market Infrastructures] currently may not sufficiently plan on the basis that disruptions will occur, and therefore would not be able to manage effectively when they do*". As the industry continues to move into the digital age and cyber threats evolve further, (re)insurers must keep abreast of the changing regulatory and technology landscape and take steps to bolster their operational resilience. At a fundamental level, important business services should be identified, impact tolerances set and compliance monitored.

So serious is the threat of cyber-attacks that the European Systemic Risk Board published a Recommendation for the establishment of a pan-European systemic cyber incident coordination framework in December 2021. This is to strengthen coordination among supervisory authorities at a national level (including supervisors of insurers) so as to help insurers counter cyber threats.

Sanctions

Over the past two months, there has been an unprecedented rise in the scope and scale of UK, EU and U.S. sanctions targeting Russia in response to the war in Ukraine. There are trade restrictions on various categories of critical industry goods, luxury goods and Russian-origin imports. The (re)insurance industry generally has a sophisticated approach to mitigating the sanctions risks involved in its business. Sanctions against Russia are not new for the industry, with restrictions having been in place since the 2014 annexation of Crimea. However, the new sanctions have been introduced very rapidly and create novel risks and issues that will test insurers' policies and procedures.

Due to the divergence between UK, EU and U.S. sanctions regimes, insurers must develop increasingly tailored approaches to their sanctions screening processes. Compliance obligations may arise on the basis of citizenship, which means that insurers may need to not only consider their own obligations but also those of their employees. The EU and UK have applied asset freezes to the Insurance Company of the Gas Industry ("SOGAZ"), the largest insurer in the Russian corporate sector. Insurers must test the scope of any existing (re)insurance coverage with SOGAZ and account for asset freezes on those obligations.

Trade restrictions on Russia and the breakaway regions extend to providing (re)insurance coverage. Insurers will likely need to undertake additional diligence before providing cargo insurance for Russia-destined freight, or freight coming from Russia (or carrying goods of Russian origin). In March 2022, the UK introduced legislation which will enable the Office of Financial Sanctions Implementation ("OFSI") to impose civil fines for breaches of UK financial sanctions on a strict liability basis, *i.e.*, without having to show that the person "*knew, suspected or believed*" that they were breaching financial sanctions. This will make it easier for OFSI to prosecute financial sanctions breaches by insurers navigating the Russian sanctions landscape.

Technology

The continued adoption of innovative technologies has driven efficiencies and offerings across the industry. Operationally, the automation of processes has enabled the streamlining of back-office functions and customisation of services, while from a product perspective, digitisation and the opening up of new data and insights have allowed for the development of increasingly tailored insurance solutions.

Insurtech had another bumper year in 2021 as new start-ups led by experienced executives and backed by private equity continued to reshape existing industry models, and insurtech funding reached a new high of €8.7 billion. For instance, the UK-based pet insurance start-up Bought By Many raised a $350 million Series D funding round, attracting funding from EQT. Vermont-based DealerPolicy raised $110 million from a Series C funding round that was led by Goldman Sachs Asset Management. Across various jurisdictions we are seeing a heightened appetite for insurtech acquisitions as participants look to expand their digital capabilities and bring in technology and experience. Growth of insurtechs typically used to be achieved organically by insurtechs hiring consultancy firms to build their growth strategy. Insurtechs are now also looking to M&A to scale up their own businesses; in February 2022, insurtech company Lemonade, an insurtech focused on reinventing the traditional insurance carrier model, acquired Metromile. As new and established companies in the insurtech space continue to grow, they will not only become more attractive targets but will further fuel expansion through both organic and inorganic growth. There are still some challenges faced by insurtech participants due to wider issues in the insurance industry. Most notably, it remains to be seen how artificial intelligence algorithms used by insurtechs prevent bias and discrimination when customers sign up to policies.

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While 2021 was an important year for the insurance industry, we expect that 2022 will continue to see the spectre of inflation and rising interest rates after a decade of low rates driving M&A and regulatory focus. If interest rates do continue to move significantly, we expect life insurers to become more attractive targets and to see (re)insurers rebalancing their investment and product portfolios. We expect deal activity to remain strong across the market, regulatory and political interest to intensify as the market continues to harden, and the key issues of ESG, cyber, sanctions and technology to continue to remain at the top of the agenda for (re)insurance companies, their boards and senior executives.

Please do not hesitate to contact us with any questions.

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