Does your integration playbook tackle tomorrow’s M&A challenges?

Insurance

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Insurance: M&A synergy means transformation

After years of low interest rates, stagnant pricing and regulatory changes, insurers are pivoting towards growth. Now more than ever it is imperative for companies to find and capture deal synergies. How can they adopt new business models and capitalize on InsurTech opportunities?

The competitive insurance landscape is shifting. While the sector is sitting on a lot of capital, new technologies are putting pressure on traditional business models, opening doors to new players, including private equity firms building out platforms and consolidating them in the brokerage space.

Insurance carriers are responding in kind, divesting risky assets or non-core businesses and pursuing deals to strengthen and scale their core businesses and boost profitability. French insurer AXA’s US$15.3b acquisition of Bermuda-based XL Group underlines the direction of travel: AXA expects the merger to realize deal synergies worth approximately US$400m per year pre-tax.¹

Similarly, Marsh & McLennan Companies (MMC) acquisition of British rival Jardine Lloyd Thompson (JLT) for US$5.6b was designed to accelerate “MMC’s strategy to be the preeminent global firm in the areas of risk, strategy and people” in their search for specialty and scale.²

About this report

This report is part of the EY 2018 Buy and Integrate series of sector-specific reports that encourage CFOs, CDOs and transaction leaders to take a fresh look at how they identify and capture synergies during M&A. In the reports, we suggest leading strategies to improve your M&A and integration playbook.

For more EY Buy and Integrate perspectives, see the reports at ey.com/synergies:

• Advanced manufacturing
• Health care
• Life sciences
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¹ "AXA to acquire XL Group: Creating the #1 global P&C commercial lines insurance platform,” Axa press release, 5 March 2018.
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Insurers are also looking for new revenue streams and growth opportunities through technology: EY research shows deal values in InsurTech rising 32% year over year since 2012, with large insurers taking the lead as investors in InsurTech firms.³

Within InsurTech investments, a majority (61%) were aimed at “enabling the insurance value chain” - rather than to disrupt (9%) or disintermediate (30%) - with large insurers emerging as the leading investors.⁴

In addition to looking for new revenue streams, insurers are increasingly moving from protection to prevention and driving higher and more continuous customer engagement beyond the traditional “moments of truth.” This allows them to better understand, segment and serve their customers, and more importantly, to influence and drive behavior that will prevent or reduce risk, as well as offering new opportunities to sell services and products. And all of this will be underpinned by digital capabilities that allow customers to search, buy and be served in a way that suits them.

These shifts are taking place against a backdrop of US tax reforms freeing up capital and record levels of dry powder along PE acquirers, creating a favorable deal environment.

Given the rising complexity of the insurance landscape, what steps should acquirers be taking to identify and capture long-term growth synergies? And how can they get the greatest value out of their acquisitions?

Define sources of synergy early to articulate the deal rationale

Insurance businesses are comfortable with long-term strategies and risk mitigation, and they are not afraid of data – all positive traits when it comes to considering an acquisition.

At the same time, the sector is not quick to change. Business models are well-established, which means deal-making decisions do not to happen overnight, and opportunities may be missed. Where should insurers look for growth synergies?

- **Expand risk appetite and/or deepen expertise in certain industries:** Carriers can benefit from opportunities to tap into high-growth specialty capabilities (e.g., cyber) to improve their value proposition and drive market penetration, including increased shared of wallet.

- **Expand distribution capabilities:** Distribution can drive synergy opportunities in insurance acquisitions through growth in different regions, businesses or markets. This may involve restructuring market-facing teams, developing integrated client plans and cross-selling.

- **Enhance underwriting capabilities:** This is critical to insurance acquisitions - it can often be the largest source of synergy optimization, but the most difficult to realize. Management needs to make hard decisions around portfolio priorities, underwriting governance, authority and processes, and pricing strategy. This will improve underwriting performance and help realize value targets following integration.

- **Identify and retain key underwriting talent:** Underwriters are at the heart of any insurance synergy plan. The role is tasked with making challenging decisions early in the deal life cycle, to identify and quantify key underwriting talent - which also makes them prime candidates for poaching. Defining a clear retention plan, incentives and a long-term value proposition will be key to retaining these key individuals.

- **Leverage best-of-breed practices in operations:** Synergies may arise from streamlining processes in front- and back-office operations, whether consolidating operations teams (such as underwriting operations, policy administration and claims) or adopting best pricing models from the combined entity and lowering reinsurance costs.

- **Improve investment management capabilities:** One of the key value drivers in recent transactions is to increase management income and reduce management costs by leveraging investment management capabilities from the buyer, especially private equity investors.

- **Reduce capital investment:** Buying the right target can provide access to ready-made technology solutions, reducing or eliminating the need for new capital investment. Examples include assets and capabilities in areas such as InsurTech, advanced policy administration and distribution platforms.

- **Pursue corporate expense synergies:** These include vendor and infrastructure consolidation, property rationalization and optimization of head-office costs.

Create a robust synergy framework

Deal execution teams in the sector must design a very clear path to capture those synergies, integrate the new business and build collaborative value once the deal is done. Identifying, quantifying, measuring and realizing real synergies requires a robust synergy framework - but where should they start?

- **Define deal hypotheses and sources of value up front:** Acquirers need to ask what a deal needs in order to be accretive and identify sources of value as early as possible. This can include access to new distribution channels such as direct-to-consumer or worksite benefits, access to new technology platforms to better engage customers and increase depth of wallet, data, and telematics capabilities. For each source of value, key hypotheses need to be developed that articulate the anticipated high-level value capture.

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4 ibid
**Case study**

**How do you build a better synergy model?**

**The challenge**

The insurance business was working toward a transformational acquisition with substantial synergy targets. Ernst & Young LLP (EY US) was engaged to conduct an independent assessment of the reasonability and achievability of the estimated synergies. The client needed a practical framework to validate the opportunities identified and confirm the feasibility of the synergy plans.

**Our approach**

We took a bottom-up approach to review revenue, cost and capital synergy opportunities across different functions. For each synergy, we assessed management’s estimates of the anticipated value, cost to achieve, synergy plan and execution risk. Our insurance practitioners were involved in reviewing key areas (such as underwriting productivity and scale benefits) with the client to verify execution risks and identify additional synergy opportunities. The end-state functional expenses were compared to our insurance benchmarks to assess reasonability of the synergy targets.

**The transformational result**

We identified opportunities to further optimize the target operating model and improve the end-state cost competitiveness. The board took synergy governance and execution management advice on mitigating key risks (such as interdependency management) and realizing the estimated synergies.

As a result, the insurer reported to the SEC a synergy run rate target that was more than double the annual synergy target that was initially announced.

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- **Identify synergies from the start of the deal life cycle:** Identify, quantify and assess top-down synergy sources during due diligence so they can be included accurately in the deal valuation. Understand interrelation between distribution and product (e.g., a worksite product from the target requiring a direct-to-consumer platform from the acquirer). Leverage practical synergy frameworks throughout the integration program using a bottom-up approach to plan for synergy opportunities across functions and identify the costs to achieve these synergies.

- **Appoint synergy champions:** Leadership support, sponsorship and appropriate resourcing are critical for achieving synergy realization. Start with a robust program governance structure and articulate a clear plan for achieving synergy value. Identify business owners for each synergy area to ensure ownership and accountability, and rally the organization.

- **Monitor, review and report on the synergy program continuously:** Include this as part of the overall integration management responsibilities to drive execution efforts.

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**Know your limits in cross-sector convergence**

Cross-sector convergence—from life and wellness to prevention services for connected homes and cars, and nontraditional players either distributing or underwriting insurance—is redesigning traditional value chains and producing partnerships that may take insurance companies out of their comfort zones.

Insurers are also increasingly seeking access to disruptive business models, such as investing in InsurTech via venture-fund-type vehicles. This can add complexity to synergy capture and value protection activities.

For example, insufficient know-how to perform earnings analysis focused on cash burn and the business plan (e.g., without a past track record of revenue and earnings growth) makes it more difficult for insurers to quantify, assess and understand the risks involved in identified sources of value.

Traditional insurers may struggle to differentiate between game-changer and simply “nice to have” capabilities in the target and properly assess the scalability, time to maturity and sustainability of the new product or value proposition, all of which are needed for an accurate valuation and investment thesis. They may be uncertain about how the target’s new technologies (e.g., distributed ledger) and capabilities (e.g., supply chain for usage-based insurance devices) should be integrated into the established business to fully tap into the synergies potential.
To maximize value and minimize risk, insurers will need even more effective management of the process from end to end.

- **Capitalize on culture.** Cross-sector acquisitions can produce unforeseen cultural differences. Retaining talent within an acquisition – particularly with high-demand skills, such as data science – hinges on managing and accommodating positive cultural differences. Analyze what makes a target organization attractive at an early stage and retain the elements that work. Traditional insurers need to devise a game plan to preserve and sustain the target’s entrepreneurialism, identifying and mitigating culture clashes, and establishing the right incentives to drive desired behaviors. A key source of value will be elements that can be embedded into the established business, such as a mindset that focuses on innovation.

- **Consider a phased integration approach to manage change in the target business.** Refresh the business strategy for the combined entity and clearly spell out the core capabilities of the new business.

### Conclusion

**Successful acquisitions in the insurance industry hinge on identifying the steps to take to identify and capture synergies which will create long term value. As an industry undergoing change due to digital disruption and industry convergence, it is imperative that insurance companies identify synergy opportunities as early as possible in a deal, decide on how to integrate the target into the existing business and encourage buy-in from key talent they wish to retain.**

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