INSURANCE OUTLOOK 2019

January 2019

Looking back, looking forward

I thought that it would be timely to share some thoughts on what we expect to see cross your desk in the year ahead.

2018 provided to be extremely busy on the M&A front with stand-out transactions across the sector.

- Some of them are transformational either for the company concerned or the sector.

  Just take a few examples in which we were involved: Phoenix's purchase of Standard Life Assurance for £3.24 bn, esure's recently closed takeover by Bain Capital for £1.2 bn and the ongoing Marsh & McLennan's ongoing offer for Jardine Lloyd Thompson for approx. £4.3 bn.

- There have also been a number of other transactions involving portfolio refinement or in-fill development for larger groups. As well as a host of mid-market transactions too. For example, Right Choice Insurance Brokers' sale of a minority stake to Lloyds Development Capital and Inflexion's minority investment in Quartz group.

- And, of course, M&A has not been the only approach available. Witness Prudential's proposed demerger of its UK & Europe business (M&G Prudential).

We see further significant deal-making in the year ahead. There are already press reports of a potential combination with ReAssure as an alternative to its IPO as work continues on the Part VII to complete its purchase of L&G's mature savings business.

And we know that a number of insurance consolidator platforms are active in looking for suitable continental platforms.

Much of the last 12 months has seen us supporting our clients in Brexit preparations. Some of them have now got Court sanction for their Part VII scheme. And there are others to follow in the next few months. More generally Brexit continues to generate a flow of technically interesting queries with the approach to those UK customers who have retired abroad being a current hot topic (as well as the need to get to grips with the ongoing announcements of Brexit related legislative change).

Perhaps this activity will tail off if a transitional arrangement is agreed but otherwise we continue to expect the sector will continue to be occupied with Brexit related issues for some months to come. So far Brexit has not had a material impact on transactional activity but a hard Brexit could potentially change this particularly if accompanied by significant market turbulence.

Certainly it has not just been M&A that has been active from a transactional perspective. The pensions de-risking market has continued to be active with a number of headline deals involving household names. Subject to the potential impact of market volatility, we expect the key UK players - including the likes of Aviva, L&G, PIC and Rothesay Life - to continue to be keen to expand in this area (including in other jurisdictions) with competition from others such as Phoenix and Scottish Widows. And the client facing transactions will continue to bring with them significant relating activity including asset management and reinsurance.

Debt capital markets insurance activity in 2018 has reflected the trends outlined in insurance M&A activity. The supply of bonds has been driven by firms merging (including Axa's EUR 2 bn tier two related to its acquisition of XL Group and Phoenix Group's RTI related to its Standard Life Assurance acquisition), demerging (including Prudential's triple-tranche tier two to recapitalise its newly demerged entity, M&G Prudential) and reorienting. It is likely that the desire to diversify, realise capital efficiencies and meet investors' demanding expectations will fuel similar activity in 2019, albeit against a backdrop of less benign market conditions than in recent years.

On the regulatory front, although the number of FCA final notices and overall fine levels have been relatively low in the past few years, the number of open investigations and new cases being taken on remains high. We therefore do not expect to see any let up in the activities of FCA Enforcement during 2019, with continued focus on priority areas such as AML, cybersecurity/data breaches, MAR, mis-selling and senior management responsibility. The increased use by firms and individuals of the recently introduced right to contest cases in part only (for example, the fine level) is likely to lead to more contested proceedings and hence judgments from the Upper Tribunal. Other expected areas of potential regulatory intervention in the insurance sector include retail insurance pricing, sales practices and data protection.

Hopefully it will be possible for the regulators to tread lightly where there is a risk to market stability, learning from the reaction to its proposals on the capital treatment of equity release mortgages.

One way or another it very much looks like it will be another exciting year ahead! Across a number of fronts.

Jonathan Marks
Head of Insurance

Brexit

As discussed above, in the absence of any definitive deal insurers are seeking to complete any Brexit restructuring plans by 29 March 2019. A small amount of breathing space has been offered by HM Treasury, which has stated that legislation will be introduced allowing Part VII transfers which have been initiated before exit day to be completed within the following two years. In the interim, however, insurers would potentially be in breach of local law requirements in the EU27 member states. There is also no guarantee that relevant EU27 member states would recognise the transfer post-Brexit.

The position for contracts written into the EU on a cross-border basis which are not transferred to EU27 entities remains unresolved. Although Germany has proposed legislation allowing a degree of run off of existing contracts there has been no EU-wide proposal to address the issue. The UK has proposed legislation to allow continuity of contracts written into the UK from the EU, although only for a period of up to fifteen years for insurance contracts.

For EU insurers currently operating in the UK, the temporary permissions regime will allow a transitional period of up to three years before full authorisation is required. No equivalent has been offered to UK insurers by EU member states.

Views from the continent

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<td>Spain

Market trends include:

• a rise in the use by insurance groups of joint ventures for the operation of non-life insurance business
• an increased appetite for risk-transfer transactions
• a continuing trend towards diversification, including the acquisition of asset management businesses by insurance groups.

On the legal and regulatory front, (late) implementation of the Insurance Distribution Directive is expected in 2019, as well as provisions to transpose IORPs II.</td>
<td>Germany

Market trends include:

• acquisitions of run-off portfolios of life insurance companies by specialised run-off platforms, often in the form of reinsurance structures, to transfer economic risk without the need for a formal sale

• the establishment or acquisition of asset management capabilities by insurance groups and increasing professionalization of these operations to include management of third party assets.</td>
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<td>The Netherlands

Consolidation in the insurance sector is expected to continue in 2019, partly driven by the ongoing low interest rate environment.

Regulatory developments include:

• the implementation from 1 January of new rules for recovery and resolution of financially distressed insurers
• increased regulatory scrutiny of historic mortgage loans offered by banks and insurers.</td>
<td>Italy

New digital technologies are having an impact on the insurance market, in particular the motor insurance market. There is also interest in blockchain and smart contracts, which may lead to changes in insurer business models and relationships with brokers and customers.

New rules implementing Solvency II corporate governance requirements are expected to lead to changes in some insurer's governance arrangements, including responsibilities and reporting lines.</td>
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Jonathan Marks
T +44 (0)20 7090 3056
E jonathan.marks@slaughterandmay.com

Beth Dobson
T +44 (0)20 7090 3070
E beth.dobson@slaughterandmay.com

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