SLAUGHTER AND MAY

INSURANCE OUTLOOK 2020

December 2019

2019 has proved to be an extremely varied year for the insurance sector. A number of the trends which we have seen in the market are ones which we expect to see continuing into 2020.

Derisking

Derisking has been a major theme of 2019, with insurers and reinsurers both taking on and divesting themselves of risk.

The market for pension scheme deriskings shows no signs of slowing down. Total buy-in and buy-out volume in H1 2019 was approximately £18 billion, compared to £8 billion in H1 2018. A large proportion of this risk was taken on by the two biggest players in this market, Legal & General and Pension Insurance Corporation. With liabilities under UK defined benefit schemes estimated to still total around £2 trillion, there are clearly more deals to be done in 2020.

Our work in this area included advising Walmart on the buy-in and subsequent buy-out of the Asda Group Pension Scheme by Rothesay Life, expected to be one of the largest full buy-outs ever undertaken in the UK, and a number of transactions for Legal & General including a further buy-in for The Pearson Pension Plan. We anticipate further growth in this market including in transaction size.

Insurers have also sought to derisk their own portfolios, both through the transfer of non-core business and through reinsurance and other risk transfer techniques. There has been an ongoing trend for insurers to transfer liabilities outside of the EEA to take advantage of lower capital requirements for some types of business, although the PRA has raised some concerns.

Insurers in the UK seeking to divest long-term insurance business by way of portfolio transfer will await the expected appeal from the August 2019 Prudential/ Rothesay Life judgement with interest next year. We reported on this case, where Snowden, J. took the unprecedented step of refusing to sanction a Part VII transfer, in our September newsletter. There have been a number of Part VII transfers of life business sanctioned since then, with signs that other judges are inclined to decide cases more in line with previous case law. We expect clients to continue to take a cautious view in structuring portfolio transfers as we head into 2020.

The rise of private equity

Deals this year have shown that private equity houses are here to stay as major investors in the insurance sector. Athora's acquisition of VIVAT's life and asset management business is just one example – and, significantly, it was reported that there were at least three strong private equity backed bids in the process. Other PE backed deals have included the establishment of Convex Group and Inflexion's investment in the Quartz group. Blackstone has built up a portfolio of investments in the sector in recent years in companies such as Lombard, Prima and Rothesay Life. We expect to see this broader trend continue in 2020.

Unlike in the past, regulators appear to have become comfortable with the level of involvement of private equity in the sector, including increasingly in Continental Europe. Some concerns have, however, emerged across Europe in the context of how deals are being structured. In the EIOPA consultation (referred to below) concern is raised about LBO structures where debt is inserted outside the EEA-regulated perimeter. EIOPA's concern is this could create pressure on the insurance undertaking to generate sufficient cash flows to service that debt. Along with concerns about whether the EEA-regulated perimeter captures what are perceived to be the genuine controllers of a group, this may lead to a broader construct in group supervision in private equity backed structures (and, possibly, less leverage).

M&A, demergers and portfolio transfers

With the general election behind us, we anticipate another busy year. 2019 has continued to feature strategic transactions. For example, we advised Allianz on its acquisition of Legal & General's general insurance business, which will establish it as a top 2 general insurer in the UK after it completes its purchase of the rest of LV='s general insurance business.

The transformation of the life sector continues. Prudential has completed its demerger into Prudential plc and M&G plc, Phoenix has moved on from its acquisition of Standard Life to announce its purchase of ReAssure and we have continued to advise Legal & General on its back book portfolio transfer to ReAssure. In Asia, we have advised Aviva on its sale of its interest in its Hong Kong joint venture as well as FWD on its US$3 billion acquisition of Siam Commercial Bank's life insurance business and related bancassurance arrangements.

The consolidation of the broker market continues to be active and has also kept us busy. For example, we advised Marsh on the sale of a broking business to Gallagher following on from its recent acquisition of Jardine Lloyd Thomson.

Financing

From our perspective, the financing diet in 2019 was as diverse as ever. We have seen continued activity in insurer debt capital markets work, including advising Just and Pension Insurance Corporation on issues of regulatory capital instruments. Our transactional practice generated accompanying acquisition finance work.

We have also seen a great deal of innovation in Solvency II internal securitisation repack structures as well as groups revisiting their early Solvency II deals in order to further optimise them. Brexit planning and other transfer work has thrown up a series of challenges regarding derivative portfolios as well as security packages for the related reinsurance. The fluid interest rate environment through the year caused some deals to fail and put pressure on others to close quickly.

Regulatory themes

On the regulatory side, it looks like Brexit will certainly happen – at the very least a withdrawal agreement early next year. This should be a fairly safe prediction and, as we write, there are proposals to move onto future arrangements by the end of 2020. Let us hope that suitable arrangements are made to protect this sector. At least most providers completed their contingency planning and Brexit Part VII transfers early in 2019.

The FCA continues to focus on concerns around general insurance pricing, in particular focusing on the pricing of home and motor insurance. The interim report of its market study, published in October, found that consumers who do not switch or negotiate with their provider pay higher prices for insurance. A final report and consultation on remedies is expected in Q1 2020. The market study is part of a wider package of work in the general insurance sector, including looking at value in the general insurance distribution chain.

Enforcement

There has been more significant FCA Enforcement activity in 2019 than in recent years, with fines so far totalling over £390 million. The number of open investigations and new cases being taken on also remains high. Several of the final notices issued in 2019 relate to the insurance sector: Carphone Warehouse, Standard Life Assurance and Prudential Assurance. Carphone Warehouse was fined for mis-selling "Geek Squad", its mobile phone insurance and technical support product. Standard Life and Prudential were each fined in relation to non-advised annuities sales. In both those cases, the firms were given credit by the FCA for voluntarily undertaking past business reviews and establishing redress programmes. This underscores the potential benefits to firms of dealing proactively with issues when they arise.

Carphone Warehouse is an example of use being made by firms of the recently introduced partly contested cases process. In that case, Carphone Warehouse accepted Enforcement's findings on the facts and breaches, but contested the level of the fine before the internal FCA decision-making body, the RDC. The partly contested cases process was also used during the year by Standard Chartered Bank in relation to its AML fine. We expect over time to see greater use being made of this process and, as a result, a greater willingness by FCA Enforcement to show flexibility during the stage 1 settlement phase in relation to the appropriate fining level.

We do not expect to see any let up in the activities of FCA Enforcement during 2020, with continued focus on priority areas such as AML, cybersecurity/data breaches, MAR, mis-selling, Principle 11 (open dealings with regulators) and senior management responsibility.

EIOPA consultation on the 2020 review of Solvency II

In October EIOPA published a lengthy consultation paper on its proposed advice for the 2020 review of Solvency II. Comments are requested by 15 January 2020. EIOPA will then provide its final advice to the Commission. Any legislative proposals following that advice will be put forward by the end of 2020.

We have produced a detailed note on the consultation – The EIOPA Consultation. Some key points are:

- a revised calculation methodology is proposed for the volatility adjustment
- EIOPA proposes adopting a "look-through" approach for restructures of assets for matching adjustment purposes
- no changes are proposed to the risk margin
- there is a proposed increase to the calibration of the interest rate risk sub-module (previously advised by EIOPA in the context of the review of the standard formula but deferred by the Commission)
- increased threshholds for Solvency II exemptions are proposed
- a number of changes to the group supervision rules and guidance are proposed to resolve inconsistencies and uncertainties, including clarifying the definition of an insurance holding company and the treatment of related undertakings in other financial sectors
- new rules are proposed in relation to macroprudential policy and recovery and resolution planning.

News from The Netherlands (De Brauw Blackstone Westbroek)

A gradual remodelling of the Dutch insurance market is generally anticipated following the announced acquisition in 2019 of large Dutch insurer VIVAT by a consortium of Athora and Nationale Nederlanden, mentioned above. The VIVAT transaction is already regarded as having opened the doors to the Dutch market for private equity and PE-backed life insurance consolidators looking at a variety of life and pension opportunities. This follows the trend seen in other large western European markets in recent years. Consolidation among the existing players in the Netherlands (large and small) may occur in conjunction with the potential fragmentation / refocusing of their businesses arising from the entry of private equity into the market.

Insights into Ireland (A&L Goodbody)

Current and future market trends include:

- continuing interest in insurer acquisitions, with PE buyers focusing on opportunities for closed book consolidators and trade buyers focusing on increasing critical mass
- an increase in acquisitions and in consolidation in the intermediary/broker sector (partially Brexit driven)
- Irish insurers impacted by integration projects arising out of global acquisitions and mergers

Regulatory developments and trends include:

- an increased focus by the Central Bank of Ireland on culture i.e. conduct that delivers fair outcomes for consumers
- insurers needing to plan for the proposed new "senior executive accountability regime" which is currently taking shape
- new rules on permitted commission arrangements and on commission disclosure requirements due to come into effect on 1 April 2020

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