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Takeover and Merger Activity Set to Continue in the London Market

Companies Attempt to Create Scale And Better Returns Via Takeovers.

Lloyd's businesses continue to be potential merger and acquisition (M&A) targets as achieving organic growth independently is a challenge and as insurers seek risk diversification and other benefits.

A.M. Best has noted in a May 2012 briefing that despite 2011's extraordinary catastrophe losses, the capitalisation of most London Market participants proved to be resilient. Overall, the global insurance industry's capitalisation remains robust, which has contributed to the absence of a strong marketwide upturn in rates. These soft market conditions have resulted in limited opportunities for organic growth, prompting insurers to consider growth through acquisition.

The volatile equity markets experienced in the past few years have contributed to a number of Lloyd's vehicles trading at share prices close to their book valuations, causing some shareholders to lose patience. Takeover approaches for Lloyd's businesses and merger discussions have consequently taken place, although many deals have not been forthcoming as sellers and buyers have different perceived values.

The Attractions of a Lloyd's Vehicle

Over the past 12 months, a number of U.S. companies have attempted to buy Lloyd's vehicles. For example, CNA Financial Corp. is in the process of taking control of Hardy Underwriting, and Hanover Insurance Group acquired Chaucer Holdings in 2011 (see **Exhibit 2**).

A.M. Best expects takeover approaches to continue as companies seek risk diversification. Lloyd's provides a platform for London Market risks, as well as overseas exposure through its global infrastructure and its international licences.

Bermudan companies have also been attracted by capital efficiencies and access to the ratings of Lloyd's. The existence of the Central Fund, which partially mutualises capital at a market level, enables all syndicates to benefit from credit ratings assigned to Lloyd's (see **Exhibit 1**). Lloyd's has an A.M. Best Financial Strength Rating of "A" and an Issuer Credit Rating of "a+." The outlook for both ratings is stable.

In the past few years, private equity firms have also shown interest in Lloyd's vehicles. Apollo and CVC formed Achilles Netherlands Holdings to purchase Brit Insurance for GBP 888 million (USD 1.4 billion) in 2011.

Private equity companies are drawn to the London Market in part because Lloyd's vehicles are not viewed as capital intensive, and there is flexibility in the provision of capital to fund underwriting at Lloyd's. For example, letters of credit may be used.

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Mergers Between Lloyd's Participants

Mergers of Lloyd's vehicles can create efficiencies, particularly for the smaller insurers that may struggle to compete within a Solvency II environment. Following the underwriting losses of 2011, and current challenging market conditions with low investment yields, companies may attempt to create scale and better returns through takeovers or mergers.

However, A.M. Best notes that while discussions have taken place regarding intra-Lloyd's consolidation, few deals have been forthcoming, partly as opinions have differed on valuations. There is also the risk that senior management will overlap, there will be cultural differences and key underwriting staff will defect to rivals, taking business with them. Instead, transactions have tended to involve overseas buyers seeking a Lloyd's platform.

Following approaches from a number of suitors, Omega Insurance Holdings is now set to be acquired by private-equity backed Canopius Group. This represents the first major deal involving two Lloyd's vehicles since Wellington and Catlin in 2006.

Key Factors Influencing Mergers and Acquisition Activity

In the past two years, there has been considerable M&A activity. Many of the medium-sized entities that needed to create scale have now successfully concluded transactions and many international insurers seeking to establish a Lloyd's platform have done so.

However, A.M. Best expects further takeover and merger discussions to take place, although M&A deals may not necessarily conclude at the same pace of the past 24 months. Onerous regulatory demands under Solvency II could further hinder new entrants at Lloyd's, making acquisitions of existing players more attractive. Furthermore, the financial and time burdens required to comply with the new standard could lead smaller Lloyd's businesses to consider mergers. Lloyd's is expected to use syndicates' Solvency II capital models to set required capital for 2013.

Takeovers and mergers are likely to appear less appealing to companies should they expect to achieve organic growth independently. However, this shift in sentiment is only likely to occur if there is a significant and widespread upturn in market rates and capacity is utilised or withdrawn.

Exhibit 1
London Market – Best's Ratings for Lloyd's and Lloyd's Syndicates
(as of June 14, 2012)

Name	Financial Strength	Long-Term Issuer Credit
Lloyd's	A	a+
Lloyd's Syndicate 33 (Hiscox Syndicates Ltd)	A	a+
Lloyd's Syndicate 510 (RJ Kiln & Co Ltd)	A	a+
Lloyd's Syndicate 609 (Atrium Underwriters Ltd)	A	a+
Lloyd's Syndicate 958 (Omega Underwriting Agents)	A	a+
Lloyd's Syndicate 1225 (AEGIS Managing Agency Ltd)	A	a+
Lloyd's Syndicate 2001 (Amlin Underwriting Ltd)	A+	aa-
Lloyd's Syndicate 2003 (Catlin Underwriting Agencies Ltd)	A	a+
Lloyd's Syndicate 2010 (Cathedral Underwriting Ltd)	A	a+
Lloyd's Syndicate 623 (Beazley Furlonge Ltd)	A	a+
Lloyd's Syndicate 3000 (Markel Syndicate Management Ltd)	A	a+
Lloyd's Syndicate 2623 (Beazley Furlonge Ltd)	A	a+
Lloyd's Syndicate 3623 (Beazley Furlonge Ltd)	A	a+
Lloyd's Syndicate 3622 (Beazley Furlonge Ltd)	A	a+

Source: BestLink®

Exhibit 2
London Market – Key Mergers and Acquisition Transactions Involving Lloyd's Vehicles
(2011 - 2012)

Participants	Details	Deal Value
• Hardy Underwriting Bermuda Ltd. • CNA Financial Corp.	CNA's offer was accepted by Hardy's shareholders on 26 April 2012. On 16 May 2012, Hardy stated that "completion of the acquisition now remains subject only to the receipt of necessary regulatory consents."	GBP 143.0 million
• Omega Insurance Holdings Ltd. • Canopius Group Ltd.	In 2011, Omega said that it had received unsolicited approaches. Suitors included Haverford (Bermuda) Ltd. and Barbican Insurance Group Ltd. On 7 June 2012, Omega stated that shareholder approval of the acquisition by Canopius was passed at a special general meeting.	GBP 163.6 million
• Hyperion Insurance Group Ltd. • CFC Underwriting Ltd.	On 12 April 2012, Hyperion announced it had agreed to sell its majority stake in CFC to a consortium of private investors and the management team.	Not Disclosed
• Flagstone Reinsurance Holdings • ANV Holdings BV	On 3 April 2012, ANV entered into a "definitive agreement" to acquire Flagstone Re's Lloyd's operations.	GBP 31.0 million
• Whittington Insurance Markets Ltd. • Tawa Plc • Icat Managers (a principal operating business of Paraline Group) • Skuld Group	On 18 September 2011, Tawa announced that the consortium comprising itself, Skuld and Paraline had reached a "definitive agreement" to purchase the London Market operations of Whittington. The deal was completed on 26 January 2012.	Not Disclosed
• TSM Agencies Ltd. • ProSight Specialty Insurance	ProSight confirmed that it had completed its acquisition of TSM on 30 November 2011. ProSight's acquisition gave it access to 100% of the capacity rights to Lloyd's Syndicate 1110.	Not Disclosed
• Jubilee Group Holdings Ltd. • Ryan Specialty Group, LLC	Ryan completed its acquisition of Jubilee on 23 September 2011.	GBP 35.0 million
• Chaucer Holdings Plc • 440 Tessera Ltd (a wholly-owned subsidiary of Hanover Insurance Group)	Chaucer's shareholders approved the acquisition on 7 June 2011. The acquisition was completed on 1 July 2011, with Chaucer shares cancelled on 4 July 2011.	GBP 313.0 million
• Brit Insurance Holdings NV • Achilles Netherlands Holdings BV	Private equity firms, Apollo Management and CVC Capital Partners Ltd., formed Achilles to purchase Brit Insurance. The acquisition was declared wholly unconditional on 9 March 2011.	GBP 888.0 million

Source: A.M. Best research

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