M&A Activity and Consolidation in the U.S. Insurance Industry

By Hiroshi Matsuoka
Life Management Research Dept.

Introduction

Mergers and acquisitions have been rampant in the insurance industries of both Europe and the U.S. These activities are reshaping the industry landscape not only locally but globally. While this paper's aim is to report on M&A activity in the U.S. insurance industry, we begin with a brief discussion of major M&A developments in Europe last year.

January 1997 saw the merger of AXA and UAP, two of France's largest insurance groups, forming the world's largest private insurance group in assets under management. More specifically, AXA had acquired UAP. UAP was France's leading insurance firm and until recently had been wholly owned by the national government. AXA, on the other hand, was growing rapidly through acquisitions both at home and abroad. Its acquisition of UAP, a much larger entity, demonstrates the changing power structure in the insurance market as smaller newcomers overpower larger and older industry leaders. From October 1997 to early 1998, Italy's largest insurance group, Generali, and Germany's largest, Allianz, fought to acquire AGF, France's second largest insurer. Ultimately, AGF's core business was acquired by Allianz, while its German subsidiary and other businesses were acquired by Generali. Allianz does not rank as high globally as AXA, who has a vast presence throughout Europe, North America, and Asia. However, Allianz regained its top ranking in Europe through the recent acquisition. Other major companies in Switzerland, Holland, and the U.K. have also been active.

These developments are occurring against the backdrop of EU market integration and emergence of the single currency. Since market integration will allow insurers to sell insurance products throughout the region, all major players are jockeying for position in the integrated European market.

Meanwhile, smaller companies are not waiting around to be devoured. They too are implementing survival strategies by entering into mergers and alliances, and seeking out niche markets.

M&A activities, along with structural changes in the market, are pressuring insurers to formulate clear strategies. Despite differences in degree, the same conditions exist in the U.S. Below we look more closely at M&A trends in the U.S. insurance industry.

1. Flourishing M&A Activities in the U.S. Insurance Industry

(1) Ongoing Market Consolidation

M&A activity in the U.S. insurance industry remains at all-time high levels. The ratio of M&A value to the industry's total equity capital is approximately 5 percent for life insurance. The ratio for property-casualty insurance is lower at 3 percent but gradually rising.

Table 1 M&A Activity in the U.S. Insurance Industry

	1992		1994		1996	
	M&A's	Value ($ mil.)	M&A's	Value ($ mil.)	M&A's	Value ($ mil.)
Life insurance	39	3,052	61	5,942	61	7,276
Health	28	329	25	2,772	27	10,053
Property-casualty, reinsurance	40	2,660	42	2,950	47	7,091
Total	107	6,041	128	11,663	135	24,420
Agents, brokers	37	—	43	—	55	—
M&A value/Total capital & surplus(Life)	3.2%		3.2%		3.2%	
M&A value/Total capital & surplus(P/C)	0.1%		0.1%		0.1%	

The term that best describes the is occurring is consolidation. The U.S. is a global insurance powerhouse, comprising 22 percent of life insurance premiums worldwide, and 40 percent of property-casualty premiums (by comparison, the shares for Japan are 42 percent for life insurance premiums and 15 percent for property-casualty). On the other hand, there are an astonishing 1,695 life insurers in the U.S. (compared to 44 in Japan).

The U.S. insurance market is thus undergoing restructuring and consolidation. The top tier has increased its market share. The assets under management of the top 100 life insurance groups rose from 86 percent of the industry total at the end of 1992 to 93 percent at the end of 1996. In addition, the number of companies has declined from 2,343 at the end of 1988 to 1,695 at the end of 1996.

(2) Conditions by Market Segment

Recent M&A activity has been characterized by large deals. Among life insurers, individual annuities have been the most popular target because of their high growth potential. Among property-casualty insurers, who have been lagging slightly behind, many M&A's are targeted at expanding geographical presence and market share.

Reinsurance and brokering sectors are experiencing a global wave of consolidation extending as far away as Europe. In one 3-month period during 1996, European interests made three massive acquisitions of major U.S. reinsurance companies such as American Reinsurance and General Reinsurance. Meanwhile, leading U.S. brokers such as AON Corporation and Marsh & McLennan are continuing their European buying spree and pursuing plans to restructure the industry at the global level.

In health insurance, managed care and HMO institutions are gaining strength. To provide comprehensive health services as efficiently as possible, their top priority for survival is to achieve economies of scale. Thus in recent years HMOs have become massive players in the M&A market. Since providing comprehensive health services requires both expertise and financial strength, health insurance companies will have difficulty surviving on their own.

2. Background and Objectives of M&A Activity

In M&A deals, the objective of buyers is to buy time. They seek to expand their sales power and market share by supplementing their management resources such as business base, products, and sales expertise. In addition, they seek to restructure their business by increasing their financial strength and cost competitiveness.

Sellers have objectives as well. Sell-offs are sometimes necessitated by financial problems. Some sellers hope to survive tough times by tapping the financial strength of major players while their market valuation is still high.

In the insurance industry, M&A activity is being propelled not only by the objectives of buyers and sellers, but by the following structural changes in the insurance market.

(1) Business Instability

As growth slows in the maturing insurance market, earnings volatility is also increasing.

(2) Change in the Nature and Intensity of Competition

Today’s consumers are choosing their insurance companies more carefully. Thus the areas of competition are shifting to financial strength and quality of service.

As economies become borderless, size competition in the reinsurance and brokering sectors has spread beyond Europe to the U.S.

More over, in response to aging trends, the life insurance business has shifted in emphasis from traditional life insurance to investment products such as individual annuities. Since these products have clearly posted yields and are quite similar to financial products offered by banks and mutual funds, competition has intensified with other financial sectors.

(3) Size Advantage

In providing savings products, support from advanced information technology is critical. This entails constantly upgrading operations with massive investments in software and hardware systems. Survival in the health services sector also depends on maintaining substantial service networks and leading-edge support technologies. Such investments require that companies attain a certain size.

In the property-casualty insurance sector, disasters such as hurricanes and earthquakes can cause earnings volatility. To absorb this volatility, size again is important.

(4) Capital Efficiency as a Measure of Quality

The above considerations make it increasingly difficult to survive without adequate capital. Equity capital ratio regulations were introduced in 1993 (1994 for life and property-casualty insurance). In addition, ratings issued by ratings agencies have come to significantly affect the insurance purchasing decisions of consumers. These factors have shifted the decision-making priorities of insurers to increasingly emphasize capital efficiency.

(5) Return to Core Businesses

Insurers thus began adopting a strategy of concentrating capital in strategic core businesses with high earnings strength. The general trend has been to expand core areas through internal growth and acquisitions, while selling off subsidiaries and business lines with deteriorating competitiveness and profitability.

3. Case Studies

Although people generally assume that M&A activity leads to drastic layoffs, this seems not to be the case among U.S. insurance companies. Some companies have grown through a conspicuous M&A strategy sometimes described as “merger mania.”

Table 2 Growth by Acquisition and Life Insurance Ranking

	1993	1994	1995	1996
Conseco	Below 100	Below 100	84	47
GE Capital	Below 100	Below 100	36	18

Source: *Best's Aggregates & Averages.*

(1) Conseco

Practically unknown in Japan, Conseco has been one of the most prominent insurance companies in M&A activity. Established in 1982, this relatively young company has adopted an external growth strategy in the belief that acquisitions are easier, less costly, and more beneficial to stockholders than internal growth.

Through repeated acquisitions, Conseco has managed to expand and diversify its insurance business in a short period. Financing is obtained through capital markets. The high stock price is the driving force behind the acquisitions, and the acquisition strategy in turn keeps the stock price high.

Prospective acquisition candidates must satisfy three conditions: (1) the acquisition price must be less than the sum of expected earnings from policies and equity capital, (2) the company must have healthy business operations and sales channels, and (3) opportunities must exist to cut operating costs to improve investment efficiency and profit margins.

Table 3 Conseco's Acquisitions

	(Value of acquisition)
1982	Security National Life ($1 mil.)
1983	Consolidated National Life ($4 mil.)
1985	Lincoln American Life ($25 mil.)
1986	Lincoln Income Life ($32 mil.)
1986	Bankers National Life ($118 mil.)
1987	Western National Life ($262 mil.)
1989	National Fidelity Life ($68 mil.)
1990	Great American Reserve ($135 mil.)
	Jefferson National Group ($171 mil.)
1991	Beneficial Standard Life ($141 mil.)
1992	Bankers Life Holding ($600 mil.)
1994	American Life Holdings, Inc. ($344 mil.)
1996	Life Partners Group Inc. ($840 mil.)
	American Travelers Corp. ($880 mil.)
	Transport Holdings, Inc. ($228 mil.)
1997	Capitol American Financial Corp. ($696 mil.)
	Pioneer Financial Services ($505 mil.)
	Colonial Penn Group ($460 mil.)
	Washington National Corp. ($410 mil.)

Source: Conseco web site (http:/www.conseco.com/default.htm)

Operational management is consolidated at Conseco's headquarters. Redundant personnel are trimmed, operating costs are halved in the first year, and products that conflict with the company's objectives are no longer sold. In addition, investment are made more aggressively in pursuit of higher returns.

(2) GE Capital

GE Capital, another strategic merger specialist, has become known in Japan through its recent tie-up with Toho Mutual Life Insurance Co. The company has a long history dating back to 1932 as the finance subsidiary of GE. In the 1960s, the company began diversifying with the aim of decreasing its dependence on the GE group. It is engaged in a wide range of businesses including mortgages, leasing, loans and insurance, and accounts for approximately 40 percent of GE's total earnings. Known as a top nonbank financial institution, it has a higher credit rating and more funds than most banks, and uses them to expand its businesses through impressive M&A activities around the world.

Its insurance business was also expanded rapidly through acquisitions. Its acquisitions have been particularly aggressive since 1993. As a result, GE Capital's individual life insurance division rose to eighth place in the U.S. by the end of 1996. A characteristic of the company's acquisition strategy is to select insurance companies that have a strong position in their particular specialization. It sometimes acquires with different business areas, and unlike Conseco, does not drastically restructure businesses or trim personnel in acquired companies.

Table 4 Major Acquisitions by GE Capital

	(Specialization in parentheses)
1989	Financial Guaranty Insurance (debt securities guarantee)
1993	Great Northern Insured Annuity Corp., or GNA (fixed and variable annuities sold through financial institutions)
	United Pacific Life, now GE Capital Assurance (single premium deferred annuities, or SPDA)
1994	Heritage Insurance Group (credit life insurance)
	Harcourt Insurance Group (health insurance, annuities)
1995	AMEX Life Assurance (long term care insurance)
1996	Life of Virginia (universal life, variable universal life, interest sensitive whole life, variable annuities)
	First Colony Life (structured settlements, fixed term life insurance)
1997	Colonial Penn (auto insurance)

Source: Media reports

(3) Travelers Group

Travelers Group, the financial conglomerate headed by Sanford Weill, attracted attention with the acquisition of Salomon Inc. in December 1997. Conning & Co., a well known observer of the U.S. insurance industry, notes that recent M&A activities in the insurance industry have featured companies with charismatic leaders such as Jack Welch of GE Capital and Weill of Travelers.

Weill founded Shearson, a brokerage firm, in the 1970s. In 1981 he sold his company to American Express and became the new president, but was pushed out soon after by the chairman. He then began building a financial conglomerate that would be superior to American Express. In 1988, he acquired Primerica, of which the Smith Barney brokerage firm was an affiliate. In July 1993, he finally reacquired Shearson from American Express, and created a massive brokerage firm, Smith Barney Shearson.

In December 1993, Weill acquired Travelers, a life insurer (ranked ninth in life insurance premiums) ailing from unsuccessful real estate investments. Primerica then adopted the better known Travelers name.

Travelers underwent restructuring to focus its business. In January 1995, together with Metropolitan Life, the second largest life insurer, it formed MetraHealth and spun off its unprofitable group health division. MetraHealth was acquired by United HealthCare Corp. in October 1995.

In 1996, Travelers acquired Aetna's property-casualty subsidiary(ranked 11th in casualty insurance premiums in 1995), and consolidated it with its own casualty insurance group (ranked 15th), forming the Travelers-Aetna Property Casualty Insurance Group (ranked 7th). The company listed its stock, which has performed well as the market apparently likes Traveler's corporate strategy.

(4) Prudential Insurance (Unsuccessful case)

Not all companies engaging in M&A activity have been successful. Prudential, America's largest life insurer, pursued an aggressive M&A strategy in the 1980s with acquisitions such as Bache Securities (now Prudential Securities), and stood at the vanguard of the financial revolution along with Sears and American Express. However, in the 1990s, problems surfaced with the propriety of Prudential Securities' sales methods, and growth ground to a halt. While the acquisition was well conceived, the serious problems that later arose are attributed to mishandling and poor management.

Extensive sales improprieties later surfaced with Prudential's own insurance sales methods. Severely penalized with compensation payments, loss of confidence by the market, and credit downgradings, the company was forced to sell off unprofitable divisions. In addition to listing its reinsurance subsidiary on the stock market in 1994, it sold off its mortgage subsidiary (1995) and Canadian subsidiary (1996). Thus while the M&A boom saw other companies making acquisitions, Prudential was forced to sell.

Aetna, who sold its property and casualty insurance subsidiary to Travelers, used the sale proceeds to acquire a health care company and move into the health industry. However, in stark contrast to Travelers, Aetna's stock was punished by a cynical market. As these failure cases show, M&A strategies must pay close attention to market reactions as well as carefully implement management following acquisitions.

4. Future Trends

According to a seminar organized by the U.S. Life Insurance Association in September 1997, to succeed in the future life insurance market, companies must either be innovators or consolidators. Innovators aggressively develop new sales methods and products, and consolidators engage in M&A activity to expand their scale of business and improve efficiency. Surveys of insurance company managers and credit rating agencies indicate that practically no one expects the level of M&A activity to decrease in the insurance industry.

According to interviews we conducted with state insurance regulators in the U.S., regulators regard M&A activity favorably because it improves the health of insurance companies. Thus as long as jobs are protected and methods are fair, M&A activity will be warmly welcomed.

Following market consolidation, major U.S. insurance companies are expected to eventually enter a dynamic process of joining and separating, similar to Europe. Where will the global super powers arise from? While common sense says that the top ranked companies are the most likely candidates, at present none except for AIG (ranked no. 4) are moving decisively. It remains to be seen whether present major players will make a comeback, or whether M&A activists such as Travelers or GE Capital will prevail.

Conclusion

The backdrop to M&A activities in the U.S. also apply to Japan's life insurance industry —the bias toward investment products, growing competition, and increasing importance of capital. Because the U.S. has a large land area divided into states, geographical expansion makes sense. In addition, since many companies are specialized in certain regions and business areas, companies can complement each other. The situation is quite different in Japan, where the land area is small, and companies that are large by international standards have a nationwide presence. Excluding the merging of life and property-casualty insurers into groups, it is difficult to imagine aggressive M&A activity occurring among Japanese companies.

However, it would be impractical for all companies to conduct a full line of business. As companies eventually specialize their businesses, they will resort to spinoffs and sell-offs.

On the other hand, there is a strong possibility for foreign companies to use M&A activity to enter the Japanese market. Since many Japanese life insurers are mutual companies, this was seen as an obstacle to acquisitions. However, it is not unusual overseas for mutual companies to be converted into stock companies and then acquired. The tie-up between GE Capital and Toho Mutual Life Insurance, while somewhat awkward, is a start in this direction.

M&A activity is a useful management strategy for strengthening a company's health and competitiveness. For insurance companies to use M&A strategies effectively, the Basic Insurance Law will need to be revised in the following ways: simplifying policy transfer procedures, establishing a holding company system and consolidated supervision system so that insurance companies can be divided into business units while maintaining the group's integrity, and setting up realistic procedures for demutualization.