Insurance M&A
Hot topic: uncertainty in the UK annuity market

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Uncertainty in the UK annuity market driving M&A

Following the annuity reforms in the UK driven by the 2014 and 2015 budget announcements, the annuity market is changing. Policyholders now have much greater freedom over their choices at retirement (which is likely to increase further still with the proposed secondary market for existing annuitants), and this has led to a significant change in consumer behaviour, and subsequently uncertainty about the volume of future annuity sales.

Together with this change in consumer behaviour, the capital requirements of holding annuity portfolios continue to be a challenge for insurers as a result of the requirements arising from Solvency II and whether firms will receive approval for matching adjustment and equity release solutions which are often used to back annuity liabilities.

This has led to insurers disposing of non-core annuity portfolios with 2015 deals involving Equitable Life selling a portfolio of annuities to Canada Life, Zurich UK selling a portfolio to Rothesay Life and much of the Friends Life business recently sold to Aviva being largely retirement and annuity focused.

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Insights

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Deals – Financial due diligence

“For some time we have been waiting for consolidation in the annuity market, driven by long standing economic factors such as operations and scale, capital efficiency and improvement in customer reach. The need for this has been widely accepted but, similar to other insurance markets, M&A often requires a “trigger” to facilitate action. We are now seeing an uptick in M&A activity which looks set to continue for a while.”

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Deals – Valuations

“The March 2014 Budget saw close to 50% wiped off the value of annuity stocks in one day. While the sector has recovered somewhat, annuity providers will need to make significant adjustments to both their operating and strategic models to close the value gap. Acquiring scale is becoming an increasingly attractive option, if not a necessity to achieve this in the face of behavioural changes and a possible reduction in appetite for annuities products. Aviva’s acquisition of Friends Life as well as portfolio sales by Equitable Life and Zurich are a testament to this.”

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Actuarial

"With Solvency II looming ever closer, we have always thought that there are clear buyers and sellers of annuity portfolios and the recent pensions reforms have not changed this although the buyers and sellers may have changed. Despite the uncertainty in the capital requirements for annuities under Solvency II, recent deals demonstrate that the range of outcomes are at least quantifiable enabling buyers to transact. Whilst we have seen some large recent transactions, we believe that more will follow across the whole range of portfolio sizes."

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Regulatory

"The commercial impact the 2014 Budget had on the annuity market has been very significant, but the regulatory environment has also contributed to increased M&A activity. Annuity providers are finding their regulatory capital position under strain due to the lack of new business, and with Solvency II now so close, some firms are struggling to be ready, including obtaining regulator approval for Internal Models and Matching Adjuster."

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Risk and Capital

"A key aspect of any consolidation in the annuity market will be asset strategy to back the liabilities. Solvency II and the matching adjustment ensure that investment strategy cannot simply be plain vanilla corporate bonds. Restructuring of assets and finding innovative investment solutions that provide yield, conserve capital and fit the rules will become essential."

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Tax

"There seems no doubt that annuity deals are heating up. The deals which this drives can present a range of material tax issues for life companies, not least whether the M&A disturbs or alters the tax value within the selling or buying group or indeed the target, and this should now be considered not only in the central deal pricing scenario but in the Solvency II scenario as well."

Insights

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Delivering Deal Value

"As M&A activity in the annuity market increases, a key challenge for buyers will be to assess and realise the synergies that arise from an annuity portfolio acquisition. Buyers will need to develop a view of the capital, tax and operational synergies that will arise from migrating the portfolio to their administration platform, and develop a robust plan to execute the integration once the deal is complete."

For further insights, data and blogs into the M&A insurance sphere, please visit our Deal Talk page below

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