



**2009 Insurance Economic Summit:  
Navigating the New Business Landscape**

**FOLEY** **ADVISEN** Productivity & Insight for Insurance Professionals **RAYMOND JAMES** **SMART.**  
FOLEY & LARDNER LLP

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**2009 Insurance Economic Summit:  
Navigating the New Business Landscape**

**M&A Opportunities and Capital Formation in a Down Economy**

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**Capital Formation in a Down Market  
Factors Driving Capital Formation**

- **Property & Casualty**
  - Industry cycles
  - Events
    - Andrew
    - September 11, 2001
    - Katrina
    - Ike and Gustav
    - Others
- **Life & Health**
  - Demographics
  - Accounting & regulatory changes
    - XXX and AXXX reserve regulation
- **Overall**
  - Investor interest / disinterest
  - Ratings considerations
  - Changes in cost / availability of Capital
  - Investment portfolio performance
  - Projected economic environment

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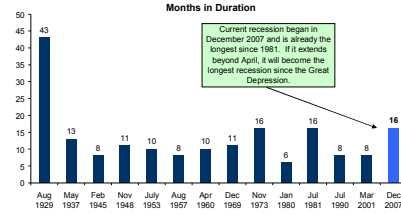
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## Capital Formation in a Down Market Economic Environment

### Length of U.S. Recessions – 1929 through Present

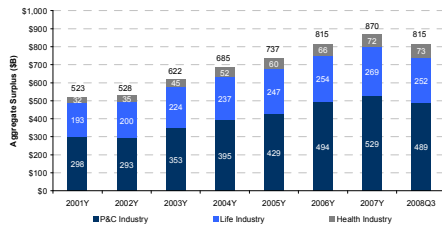
- Real GDP off by 1.7% from 2Q08 peak through 4Q08
- 4Q08 Real GDP dropped at 6.2% annualized rate
- GDP fell 3.7% peak-to-trough in 1973-75 and 2.7% in 1981-82 recessions, each lasted 16 months



Source: National Bureau of Economic Research, Insurance Information Institute  
As of April 1, 2009

## Capital Formation in a Down Market Economic Environment

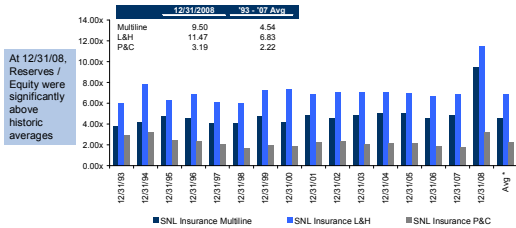
### Insurance Statutory Surplus Aggregates



Note: Data as of 9/11/2008  
Source: SNL Financial

## Capital Formation in a Down Market Economic Environment

### Reserves to Equity

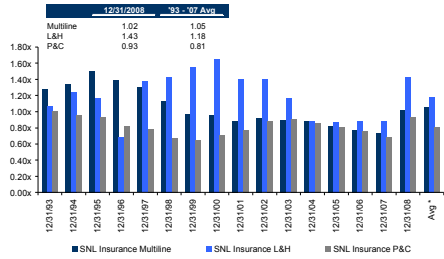


At 12/31/08, Reserves / Equity were significantly above historic averages

Source: SNL Financial  
Note: Average values for the periods 12/31/03 through 12/31/2007

## Capital Formation in a Down Market Economic Environment

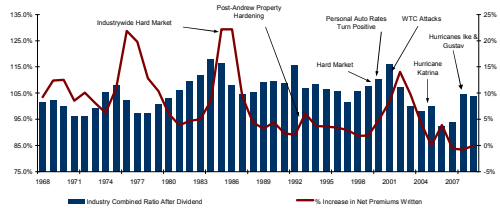
### Premiums Written to Equity



Source: SNL Financial  
Note: Average values for the periods 12/31/93 through 12/31/2007

## Capital Formation in a Down Market Economic Environment

### P&C Industry Net Premiums Written vs. Combined Ratio: 1968 - 2009E

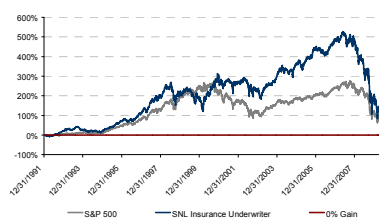


Sources: A.M. Best, Raymond James Research Estimates

## Capital Formation in a Down Market Public Equity

### Insurance Market Performance vs. the S&P 500

Since the end of the last recession around December 1, 2001, the S&P 500 and SNL Insurance Underwriter Index have declined 28.4% and 35.2%, respectively



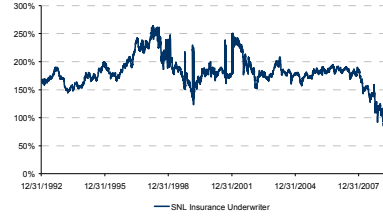
Note: The SNL Insurance Underwriter Index is up 139.74% since SNL December 31, 1991, slightly outperforming the S&P 500. The index reached its maximum on June 4, 2007.  
Source: SNL Financial

## Capital Formation in a Down Market Public Equity

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### Insurance Index Price to Book Value

Insurance stocks are trading at lower levels relative to book value than at any point over the last 16 years



Source: SNL Financial

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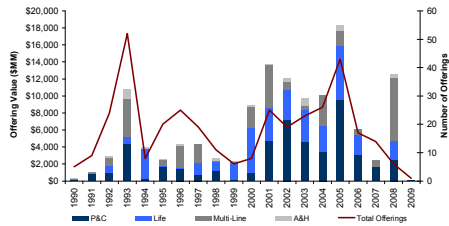
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## Capital Formation in a Down Market Public Equity

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### Insurance Equity Offerings by Segment



Note: Data as of 9/24/2009, excludes financial guarantors, life and managed care companies. Includes AIG's \$7.5 billion follow on from May 2008.

Source: Dealogic

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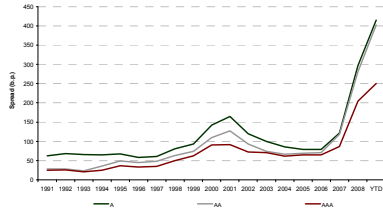
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## Capital Formation in a Down Market Debt

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### 10 Year Credit Spreads to Financials



Note: Credit spreads represent the average of the first and last day of the year. YTD is as of 9/23/09.

Source: Bloomberg

Average Yields - 10 Year Treasury (%)																		
1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD
7.86	7.01	5.88	7.07	6.56	6.43	6.34	5.25	5.63	6.02	5.00	4.58	4.00	4.26	4.28	4.79	4.63	3.65	2.71

Source: Yahoo Finance

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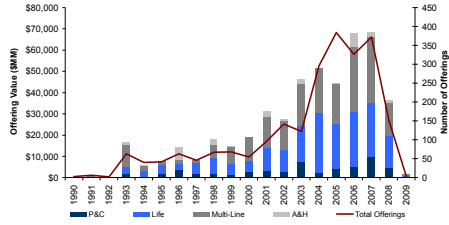
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## Capital Formation in a Down Market Debt

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### Insurance Debt Offerings by Segment



Note: Data as of 3/24/2009, excludes financial guarantors, life and managed care companies  
Source: Dealogic

## Capital Formation in a Down Market Hybrid Capital

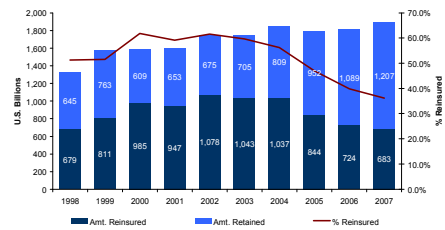
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- Various hybrid capital structures addressed several interests
  - Bridged gap between equity and debt (trust preferreds and long dated preferreds/debt)
  - Allowed smaller issuers access to pooled structures and lower cost financing
  - Facilitated direct investment in insurance risk (catastrophe bonds)
  - Addressed regulatory actions (XXX and AXXX securitizations)
- In August 2007, securitization markets began to freeze
  - Trust preferred market meaningfully slowed in August 2007
  - Throughout remainder of 2007 and 2008, fixed income markets worsened
  - Disruption spread from securitized issuances to corporate and municipal bond markets
- Hybrid markets likely to remain closed for many issuers over the near-term
  - Pooled trust preferreds may not return
  - Life securitizations likely unavailable in near-term
  - Signs that Cat bond market is returning (Allianz, Liberty Mutual, Scor and Chubb)

## Capital Formation in a Down Market Reinsurance

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### U.S. Ordinary Individual Life Insurance Sales



Source: SDA

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## Capital Formation in a Down Market Government Options

- Alphabet soup of new programs
  - **TARP/CPP**, TIP, AGP, **TLGP**, TALF, CAP, PPIF
- Various components accessible by U.S. banks, savings institutions, and insurers
  - Early rush by handful of life insurers to acquire small banks or thrifts for access to TARP
- Relatively low direct debt costs
- Comes with 'strings attached'
- Potential reputational risks

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## Capital Formation in a Down Market Summary

- Capital raising markets are difficult to access right now
  - Low equity valuations and historically high credit spreads
  - Some hybrid structures may not return
- Private equity likely sidelined
  - Focused on managing current investments through down cycle
  - Finding potential exits for current investments
- External factors may drive need for new capital despite current trends
  - Hardening P&C market
  - Recent industry-wide rating downgrades and/or 'negative outlook'
  - Replenish capital lost in investment portfolio write-downs
- Cost of capital will be much higher (if capital is available)
- Capital may be available for identified high return acquisitions or specific growth opportunities
- Government programs

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## Deal or No Deal? Pursuing M&A Strategies in a Down Market

- History Lesson: Rationale vs Reality
  - Rationale
    - Studies show that M&A activity in the insurance industry creates significant value for shareholders and/or greater efficiency gains over the long term
      - Source: Soubaker, Dionne and Triki, *Consolidation and Value Creation in the Insurance Industry: The Role of Governance*, June, 2006, CIRPEE Working Paper 06-26.
      - Source: Cummins, Tenyson, and Weiss, *Consolidation and Efficiency in the U.S. Life Insurance Industry*, May, 1998, Wharton Financial Institutions Center, 98-08-B.
    - Studies further show that value creation through an effective acquisition strategy is particularly significant during economic downturns
      - Source: Baghai, Smit and Viguierie, *M&A Strategies in a Down Market*, August, 2008, The McKinsey Quarterly.
      - Source: Gell, Kengelbach, and Roos, *The Return of the Strategist: Creating Value with M&A in Downturns*, May, 2008, Boston Consulting Group.

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## Deal or No Deal? Pursuing M&A Strategies in a Down Market

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- History Lesson: Rationale vs Reality
  - Rationale
    - Opportunities for buyers are abundant, competition is scarce, and valuations are low
    - Buyers can be strategic and deliberate
    - This could be a transformational moment/year for the insurance industry as a whole or your company in particular

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## Deal or No Deal? Pursuing M&A Strategies in a Down Market

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- History Lesson: Rationale vs Reality
  - Reality
    - Studies show business executives tend to “freeze” during downturns
    - Down market vs illiquid market
      - Capital shrinking
      - Debt financing dried up
      - Equity valuation of most potential buyers is depressed
      - Credit ratings declining or under watch
    - Lack of visibility
      - Many potential buyers who thought they had excess capital are sidelined as portfolio values drop
    - Share buy-back vs acquisitions

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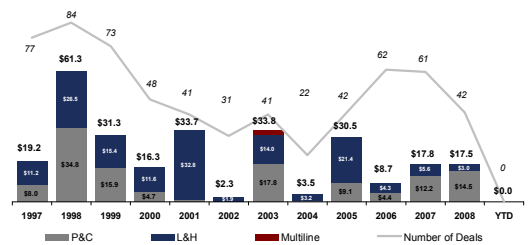
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## Pursuing M&A Strategies in a Down Market Insurance M&A History

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All US Insurance Deal Volume by Year Since 1997 (\$ billions)



Year	Average Deal Size (\$ billions)
1997	\$0.3
1998	\$0.7
1999	\$0.4
2000	\$0.3
2001	\$0.8
2002	\$0.1
2003	\$0.8
2004	\$0.2
2005	\$0.7
2006	\$0.1
2007	\$0.3
2008	\$0.4
YTD	NA

Source: S&P, Financial Data as of 3/18/2009.  
Note: Chart includes P&C, L&H and Multiline Insurance Companies. Excludes transactions for which deal value is unavailable.

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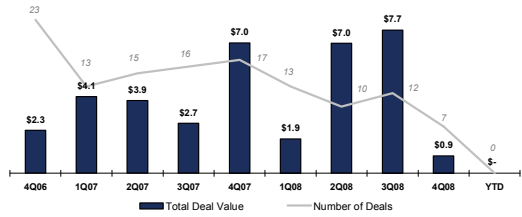
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## Pursuing M&A Strategies in a Down Market Insurance M&A History

All US Insurance Deal Volume by Quarter Since 4Q06 (\$ billions)



Average Deal Size (\$ billions)										
4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	YTD	
\$0.1	\$0.3	\$0.3	\$0.2	\$0.4	\$0.1	\$0.7	\$0.6	\$0.1	NA	

Source: S&P Financial Data as of 3/15/2009.  
Note: Excludes transactions for which deal value is unavailable.

## Pursuing M&A Strategies in a Down Market Insurance M&A History – Valuation Migration

Median US Insurance Deal Valuations by Year Since 1997



Source: S&P Financial Data as of 3/15/2009.  
Note: Excludes transactions for which deal value is unavailable. "NA" indicates there was no valuation data available.

## Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Crystal Ball: What Types of Deals Will Dominate this Insurance M&A Cycle
  - Distress deals will be largest driver of activity, particularly on Life side of industry
  - Restructuring to “core”
  - Strategic “gap-filling”
  - Scale acquisitions, particularly on P&C and Health sides of industry
  - Subsidiary carve-outs
  - Going private?



Deal or No Deal? Pursuing M&A Strategies in a Down Market

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■ Crystal Ball: What Types of Players Will Dominate this Insurance M&A Cycle

- Corporates vs Private Equity
- Foreign vs Domestic Buyers
- Large insurance brokerages
- Mutuals

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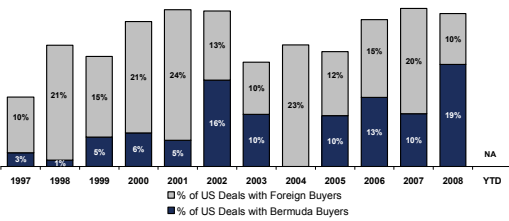
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Pursuing M&A Strategies in a Down Market  
Insurance M&A History – Foreign Buyer Trends

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US Insurance Acquisition Buyer Composition by Year Since 1997

US Insurance M&A - Foreign Buyers



Source: SNL Financial. Data as of 3/18/2009.  
Note: Excludes transactions for which deal value is unavailable. Bermuda Buyers not included in Foreign Buyers.

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Deal or No Deal? Pursuing M&A Strategies in a Down Market

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■ Crystal Ball: What Types of Players Will Dominate this Insurance M&A Cycle

- Corporates vs Private Equity
- Foreign vs Domestic Buyers
- Large insurance brokerages
- Mutuals

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Once more to the studies: Tips for Value Creation
    - Size matters and smaller is better
    - Target lower profitability/minimal debt
    - Tender offers vs mergers
    - Pure insurance plays vs cross-industry deals
    - Experience counts

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Due Diligence: Patience and Planning
    - Sellers should recognize it's a buyer's market and get ready for the probe
    - Buyers should exercise their leverage and take the time and make the effort necessary to be thorough

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Deal term considerations in a Down or Buyer's market – what is "market"?
    - We can expect to see deal terms becoming more buyer-friendly/protective
      - Sellers need not fold on all fronts, but pick and choose your deal points and manage towards those
      - Claiming something is "market" is not enough
    - There will likely be more reliance upon post-close purchase price adjustments and earn-out clauses
    - Seller financing

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**Deal or No Deal? Pursuing M&A Strategies in a Down Market**

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Deal term considerations in a Down or Buyer’s market – what is “market”?
    - Material Adverse Change (“MAC”) clauses may swing back to more buyer-friendly provisions
    - Buyers will push for reps and warranties that survive longer and have fewer or no qualifiers
    - Buyers will push for higher or no indemnity caps, smaller or no indemnity baskets or deductibles, fewer carve-outs from these limitations, and larger holdbacks/escrows to secure these potential liabilities

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**Deal or No Deal? Pursuing M&A Strategies in a Down Market**

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Distress Deal Nuances
    - Timelines more compressed in distress deals and buyers will likely need to make quicker decisions
    - Find and assess the holes
    - Find and assess the key personnel
    - Regulatory involvement is more direct and highly focused, and the approval process is often expedited

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**Deal or No Deal? Pursuing M&A Strategies in a Down Market**

- Execution, Execution, Execution: Nuances for Successful M&A in a Down Market
  - Regulatory considerations
    - Higher scrutiny?
    - Hot-button issues
      - Source of Funds/Buyer’s Post-Close Capital
      - Elephant-in-the-Room
      - Regulatory simplification going forward
      - Preference for familiar ownership structures

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Keeping It Real: Comments and Q&A
  - Recent comments from industry participants
    - "Nearly 25% of our portfolio is invested in equities, we are not exploring M&A opportunities at this time."
    - "Why would I pay multiples that high when the public companies trade near book?"
    - "We have excess capital and want to pursue strategic acquisitions."
    - "You find me the debt financing and I am interested."
    - "Reinsurance capital is expensive capital."
    - "This is a once-in-a-generation opportunity to acquire businesses.... We really are seeing an unprecedented number of properties coming to market at a time when valuations are under severe stress. This makes for a very interesting situation."
  - David Schieldrop, Barclays Capital

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

- Keeping It Real: Comments and Q&A
  - Comments/questions from the audience

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### Deal or No Deal? Pursuing M&A Strategies in a Down Market

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