KPMG

The New Deal

Driving insurance transformation with strategy-aligned M&A

KPMG International

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> The insurance industry is on the cusp of a new wave of mergers and acquisitions, driven by strategic objectives, portfolio shaping and a new quest for value.

Gary Reader,
Global Head of Insurance
KPMG International

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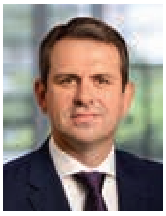
Ram Menon
Global Lead Partner, Insurance Deal Advisory
KPMG in the US



Matthew Smith
Global Strategy Group
Insurance Sector Lead
KPMG in the UK

Disruption is shaking the fundamentals of the insurance industry. This is true structural change, not just a cycle. New technologies, new competitors, new markets, new regulations, and changing consumer behaviors are all creating tremendous opportunities, and posing significant risk to the legacy insurance business model. To succeed in this dynamic environment organizations are reevaluating their portfolio of business and rationalizing their global footprint to strategically determine 'where to play' and 'how to win' in the future. One of the immediate consequences of this trend is the expected rise in deal activity in the global insurance industry.

Industry participants are increasingly getting more strategic about their inorganic growth initiatives. Traditional approaches to mergers and acquisitions (M&A) which have been largely reactive to immediate deal opportunities, are no longer sufficient. Insurance executives and their shareholders expect their investments to drive transformation within their organization over the long term, rather than deals that could be financially accretive in the short term but are not sustainable.

To find out how this shift towards strategy-aligned mergers and acquisitions (M&A) is influencing deal activity in the insurance industry, we commissioned Mergermarket to interview 200 insurance M&A decision-makers across all segments and regions. We asked about their M&A plans for 2017 and beyond; about their alignment with corporate strategy; and about their current capabilities and initiatives to successfully execute deals in this environment.

What we heard suggests that organizations are recognizing the need to reevaluate their business and operating models and, as a result, redefine their M&A ambitions and appetite. To get this right, however, insurers will first need to take pause, look at their overall strategic vision and objectives. They will need a deeper understanding of how they want to serve their customers and what propositions they want to offer. Only then should they consider what role their deal-making activities will play, balancing what they will need to buy or sell, against options to build, rent or collaborate.

In *The New Deal* we explore the trends shaping today's M&A insurance landscape, and the need for greater alignment between corporate development, M&A activities and corporate strategy. Interviews with leading insurers globally confirmed that this approach will be critical to evaluating the 'strategic-fit' of their M&A, partnerships and venture capital investment opportunities. As the research suggests, this will require a different mindset, particularly for those lacking the internal capabilities and an enterprise-wide M&A playbook to enhance and deepen their due diligence, deal evaluation, and post-deal integration/separation processes.

On behalf of KPMG International, we would like to thank all the insurance executives who participated in our research, and a very special thanks to Chris Wei, Global Chairman, Aviva Digital and Executive Chairman, Aviva Asia, who shared his views on how Aviva has evolved its M&A strategy to "deliver a brilliant customer experience", and take advantage of the new opportunities in the industry.

We hope this report provides valuable insights into how strategy-aligned M&A can help the industry drive future growth and establish new relevance with consumers, investors and shareholders. To find out more about these trends — or to discuss your company's specific needs — we encourage you to contact your local KPMG member firm.

The road to strategy-aligned deal-making in 2017

The modern M&A landscape is filled with both opportunities and pitfalls for global insurance companies. To navigate this landscape successfully, acquirers cannot divorce their M&A activities (both target identification and target evaluation) from their broader strategy. They need to pay close attention to their strategic growth objectives, as it relates to transforming their business and operating model, and recognize that not all potential acquisition targets are capable of helping fulfill them.

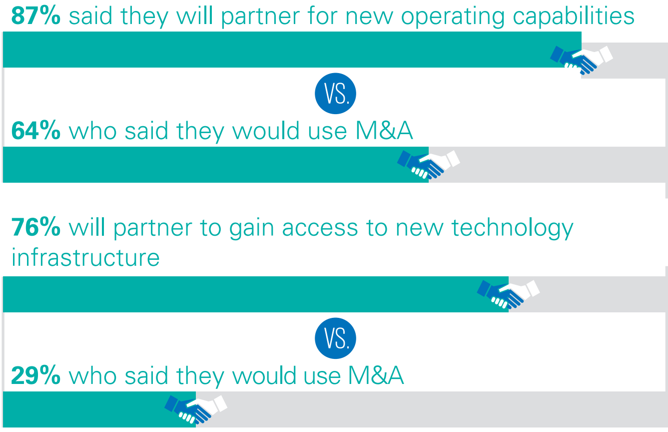
Key findings:

Deal-making shifts into high gear

84% plan to conduct 1-3 acquisitions in 2017

94% plan at least one divestiture

Partnerships are the clear choice for transforming the operating model



87% said they will partner for new operating capabilities

VS.

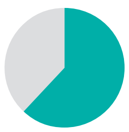
64% who said they would use M&A

76% will partner to gain access to new technology infrastructure

VS.

29% who said they would use M&A

Corporate venture capital (CVC) fuels the engine



62% of insurers are either active or setting up a corporate venture capability

26% of those with VC activities have more than US$1b in allocated funding

Strategy-aligned M&A requires a different mindset and renewed execution focus

39% said that aligning the deal evaluation process to corporate strategy objectives was the most important factor for M&A success

Yet 37% of the respondents said their priority is to be reactive to market opportunities

A gap emerges in strategic alignment

47% with dedicated M&A teams believe their deal identification objectives are aligned to corporate strategy

Yet, 50% believe they are less aligned when it comes to evaluating potential risks associated with integrating/separating the target's operating model

Better at home than abroad

92% ranked their capabilities to execute domestic transactions as high

While 77% ranked their capabilities to execute cross-border acquisitions as moderate to low

92% ranked their capabilities to execute cross-border divestitures as moderate to low

Source: KPMG International, 2017

A strategy-aligned M&A focus will bring greater clarity on which markets, geographies, products and channels insurers wish to 'play in' or 'exit out of'; and the relevant operating processes, technology infrastructure, talent and culture they will need in order to win and transform their operating model.

Startups with powerful software tools and innovative technologies are increasingly seen as attractive targets, as evidenced by recent high multiples and valuations of such technology enabled platform based business models. In this market, insurers will need to be equipped with holistic data and analytics-enabled deal evaluation capabilities. Particularly in the areas of due diligence, integration and separation activities to fully understand how they can extract maximum value, and how the target's operating capabilities complement or supplement their own.

As insurers formulate their M&A strategies for the year ahead, we believe the following trends will shape deal activity:

— **Cross-border activity will increase as insurers worldwide seek to diversify their geographic risks and earnings profile.** With stagnation in global economic growth and changing geo-political risks across the mature and emerging markets, insurers will look beyond their domestic borders to buy or sell assets abroad.

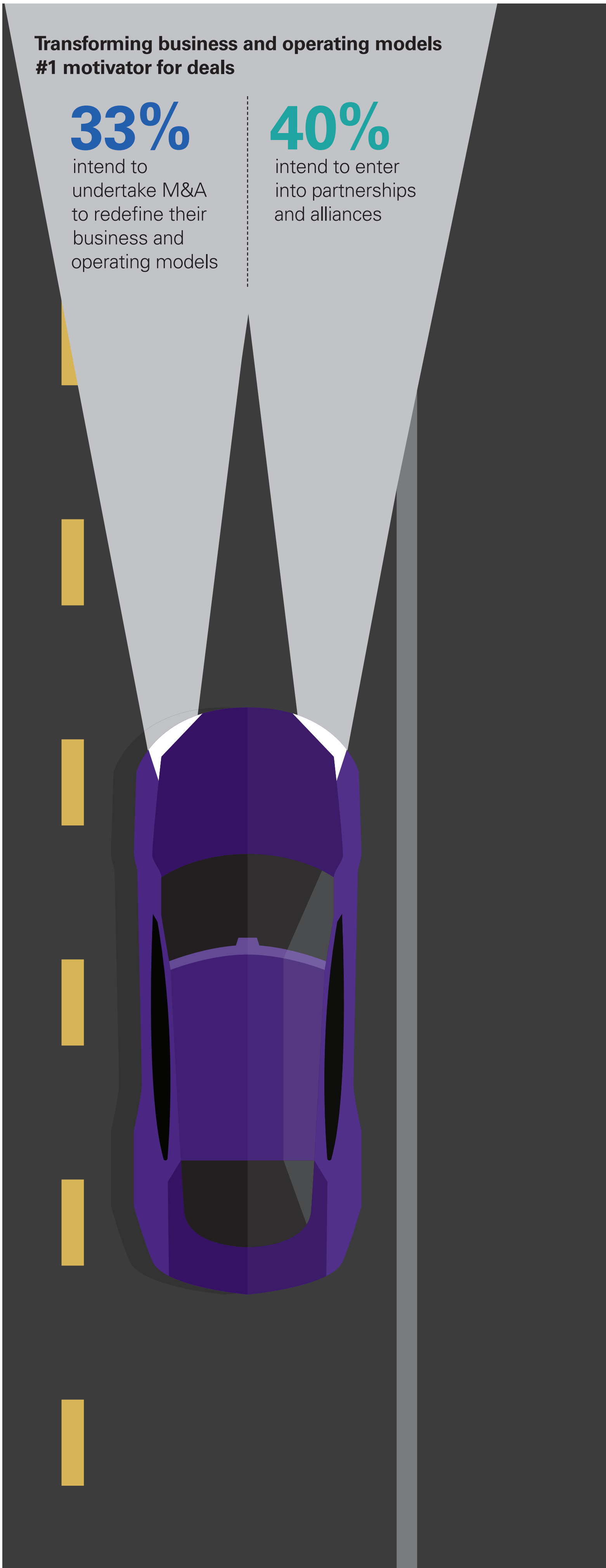
— **Portfolio rationalization and strategic repositioning of businesses by larger insurers is expected to drive global M&A activity.** Divestiture of non-core business segments in strategically non-core geographies is expected to be a key driver for increased deal activity.

— **Greater alignment of corporate strategy and M&A objectives will provide an edge to buyers as competition for deals rises.** Creating a robust, strategy-aligned M&A plan of action would provide rationale for pursuing strategic-fit targets with higher deal premiums. This will result in better deal outcomes over the long-term, versus a reactive approach to pursuing any or all deal opportunities that present themselves.

— **The hunt for innovation will increasingly shape insurers' rationale for doing deals.** Companies with a strong digital model and startups with advanced technology will attract a multitude of willing suitors as legacy companies seek to transform their business models through acquisitions.

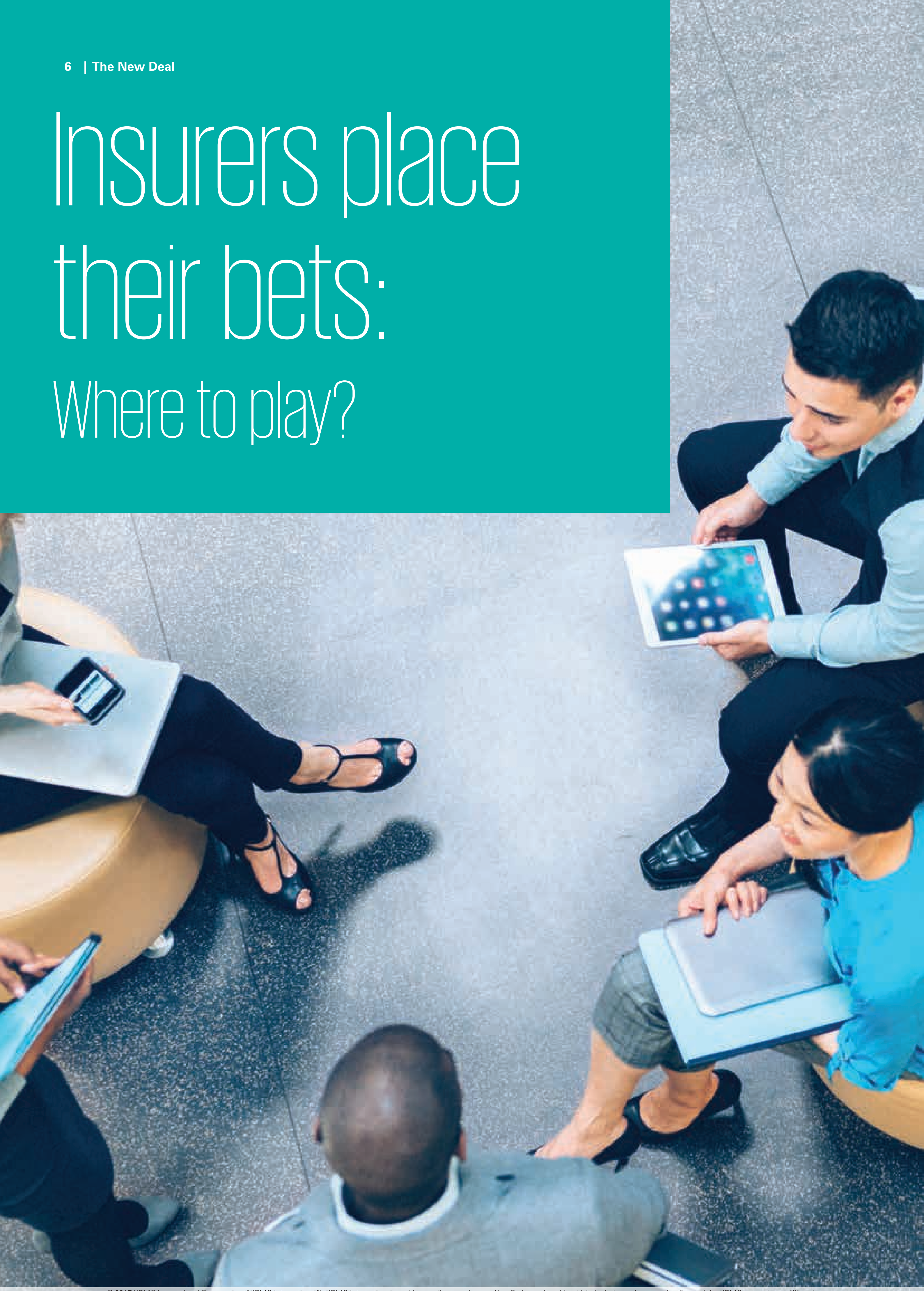
Survey methodology

In Q4 2016, KPMG commissioned a survey of 200 global insurance executives to learn about their perspectives and outlook for M&A, corporate strategy and innovation over the coming 12 months. Survey respondents were divided regionally among firms in the **Americas (33%), Asia-Pacific (33%), and Europe, Middle East + Africa (33%) and by segments: Life (25%), Non-Life (25%), Reinsurance (25%), and Other (25%)**, consisting of Insurance Brokers and Services. Companies needed to have a minimum of US$1.5b in annual revenue to qualify for participation.



Insurers place their bets:

Where to play?



Many insurance companies are at a crossroad when it comes to setting their M&A goals. On the one hand, insurer's balance sheets are generally strong, with ample funds to make opportunistic acquisitions. On the other, returns on deal investment are declining as growing competition pushes valuations up. Deals are evolving with an increase in partnership opportunities.

According to our research, 84 percent of insurers plan to target 1-3 acquisitions in 2017. And 94 percent said they would undertake at least one divestiture this year, suggesting an encouraging environment for deal-making overall.

"Insurers took 2016 to understand how major events — particularly Brexit and the US election — will influence the business and investment climate around the world. And while there are still many unknowns, we expect insurers to return to the market and start to take advantage of the new realities that have been created as we move into the second half of 2017", forecasted Ram Menon, Global Lead Partner, Insurance Deal Advisory with KPMG in the US.

In this section we take a closer look at regional activity and valuations underpinning deal activity.

An appetite for acquisitions

Insurers are clearly hungry for good M&A opportunities. And the vast majority reported that they expect to undertake domestic acquisitions over the coming year. A significant number also seem keen to use the current environment to expand their foreign operations and footprint.

Two-thirds of insurers said they expect to undertake a cross-border acquisition. Given that 55 percent of our respondents currently operate in five markets or less, this suggests that some insurers will be looking at opportunities in new markets and regions.

Not surprisingly, the US remains the top national market where insurers expect the most deal activity. Almost a quarter ranked the US as their top national destination, versus 12 percent who said they were focused on Greater China (the second top national target market).

> **47 percent**
> ranked Asia Pacific as their focus for acquisitions, followed by North America

Asia in the acquisition cross-hairs

On a regional basis, however, our data suggests that insurers are much more focused on finding potential acquisitions in Asia Pacific than North America as a region. Almost half of our respondents said they are most focused on Asia Pacific, more than twice the number that are highly focused on North America as a region.

"This is a bit of a short-term/long-term strategy. With the largest market share in the global insurance industry, the US continues to provide a great opportunity for acquirers and investors looking for global diversification of risks and earnings, and those seeking fast access to traditional and innovative operating capabilities. Asia, on the other hand, represents an emerging mass market where insurers can find varied long-term strategic growth opportunities," added Ram Menon.

As Paul Melody, Head of Actuarial Services for Asia Pacific with KPMG China explains, the opportunity in Asian markets could be tremendous. "The emerging markets of Indonesia, India, China, and other countries remain largely untapped in terms of their premium density — low levels of insurance premium per capita combined with large domestic populations present significant opportunity for additional scale in the medium-long term," he noted. "There are significant coverage gaps across the region, making these markets prime targets for insurers looking to diversify and grow." Given current expectations for regional urbanization, poverty reduction and innovation, many expect the region to become a hot-bed of M&A activity over the next few years.

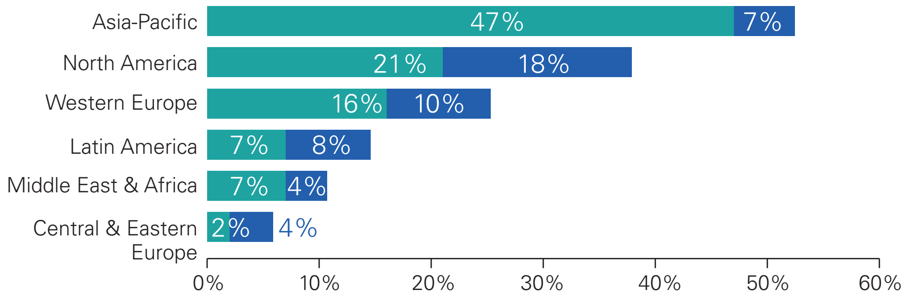
Players from different Asian markets will respond to the new market dynamics in different ways. The more mature Asian economies, including China and Japan, will likely continue to buy growth through outbound investments in North American and European markets. Japanese insurers, on the other hand, who are challenged with domestic growth, will continue to seek cross-boarder acquisition opportunities in order to diversify their earnings and risks.

Chinese insurers are also beginning to look to the US and other mature markets to gain access to know-how and capabilities for expanding their domestic insurance infrastructure that

> **84 percent** of insurers plan to target 1-3 acquisitions in 2017.

What's hot?

Respondents were asked to select and rank two regions that present the most acquisition opportunities for their company in 2017.



Source: KPMG International, 2017

is still behind the curve, considering the country's growth rate in recent decades. In many cases, companies in China are looking to acquire products and services that they can take back home and leverage to the wider mass market.

However, identifying cross-border acquisition targets that provide strategic-fit is not easy. As David Bunce, Head of Corporate Finance, KPMG in Brazil, noted, just because you want to enter a new market does not mean there are suitable targets available. "There are many international insurers looking to expand their footprint in an emerging market like Latin America, but — to date — there have been few targets that match their requirements," he added. "Everyone recognizes that the growth opportunity is high but M&A opportunities remain constricted. Furthermore, deal evaluation and execution in many of these emerging markets are extremely challenging." As our research reveals, insurers are struggling with their cross-border execution capabilities, with 77 percent ranking their capabilities for cross-border acquisitions as moderate to low.

Western Europe up for sale

While acquirers may be looking to Asia and North America for targets, our data suggests that Western Europe will be the region with the most assets up for sale, led by the UK, Italy and Spain.

As the head of investment for one mid-sized Asia-Pacific-based life insurer noted, "Central, Eastern and Western Europe will see the majority of divestitures, mostly driven by Solvency II. Those insurers that cannot raise the required capital under the regulation may choose to get rid of businesses if they believe that resulting capital charges could otherwise negatively impact returns."

This *grow or go* decision[1] is driving many of the decisions for insurers with operations in Western Europe. "If you exclude the big elephants, all the other players in the single markets are rethinking or reviewing their strategies," said Giuseppe Latorre, Partner with KPMG in Italy. "Many are deciding that they must either grow or exit the market."

However, there continues to be ongoing concerns about the prospects for economic recovery in the region. Some expect to see slower growth, lower business investment rates and, as a result, heightened competition. "European insurance companies will continue to be challenged on both sides of the balance sheet in 2017," suggested a strategy leader at a large US-based reinsurer.

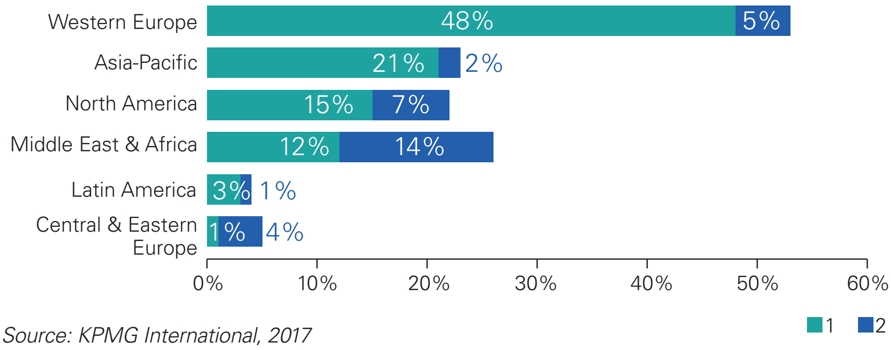
Valuations remain relatively palatable

According to our interviews, buyers and sellers should find common ground for deal-making. Indeed, 66 percent of sellers are hoping to divest businesses valued at between US$250 million and US$1 billion and, at the same time, 70 percent of potential buyers are hoping to buy businesses of that size. Similarly, 18 percent said they want to sell businesses valued at more than US$1 billion, compared to the 13 percent who said they want to make those really big deals.

[1] Grow or Go, KPMG International 2016

On the block

Respondents were asked to select and rank two regions that present the most divestiture opportunities for their company in 2017.



Source: KPMG International, 2017

> “**Europe** will see the **majority of divestitures**, primarily driven by Solvency II.”

While respondents seemed fairly happy with current valuations in the life and reinsurance segments (only around a third said that valuations are high in these segments), almost two-thirds of respondents said current valuations in the non-life sector may be too high.

As the head of strategy at a large UK-based property and casualty (P&C) insurer noted, the high valuations in the non-life segment are indicative of the chances for high rewards. “New products and increased sales of policies in the non-life insurance sector are having a tremendously positive impact on premiums, and this is favorable for business valuations in the sector,” he said. “There is also a lot of room for growth through technological adaptations and the rise of new distribution channels.”

“The general insurance market remains attractive due to on-going sector convergence, with the emergence of new risks and the opportunity to provide prevention as well as protection solutions. While standard insurance products may become commoditized, the value-added prevention services and solutions will enable stronger performance and profitability. Furthermore, sector convergence is also shifting the commercial market, with some player’s buying prevention capabilities and others selling bad books to improve their reserve positions,” said Matthew Smith, Global Strategy Group, Insurance Sector Lead with KPMG in the UK.

Overall, the majority of respondents (73 percent) said that current valuations are largely sustainable for the overall industry. Paul Melody, with KPMG China, agreed that “across both life and non-life sectors in Asia, the premium-flow projections are set to be positive over the next few years. The industry as a whole is set for rapid transformation, and P&C could be at the forefront of that change. Things like motor, home, travel and indeed health insurance, can increasingly become intertwined with risk management and risk prevention techniques, and also be more commoditized.”

On a regional basis, valuations continue to vary significantly. “In Western Europe, valuations have been high due to a general lack of targets in the growth markets in spite of slow organic growth expectations,” noted Giuseppe Latorre with KPMG in Italy. “There are few signs that this situation will change any time soon.”

A similar story is emerging in Asia. “The limited number of licenses available is driving high valuation multiples in some Asian jurisdictions. Hong Kong, for example, is currently a sellers’ market as Chinese companies look to pick up licenses to gain entry,” added Joan Wong.

While valuation looms high on many respondents priorities, just 8 percent named it the top element for deal execution success. One reason for this may be a recognition that valuation can only be properly assessed in the context of a deals alignment with the company’s strategic goals. After all, a target’s price tag must be weighed against the unique benefits it will bring to the acquirer, and the availability of equally relevant and high quality assets.

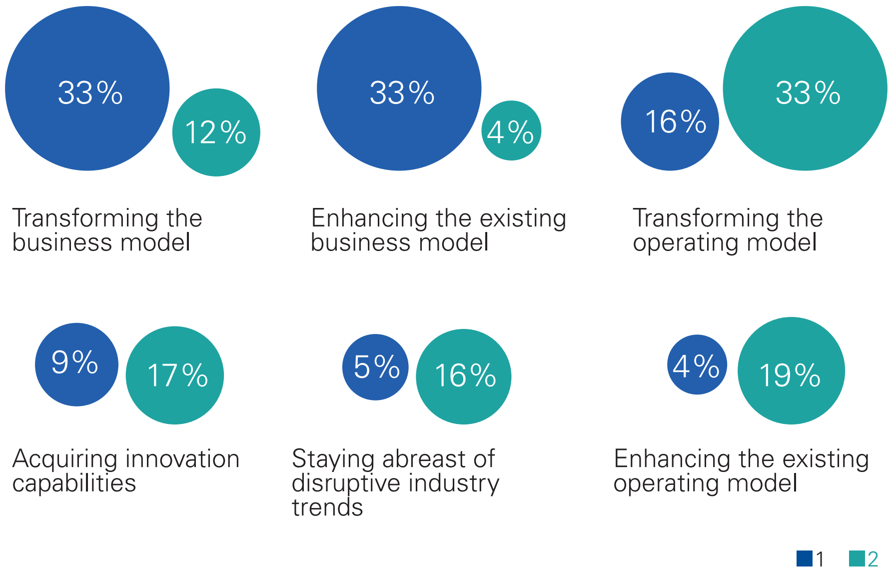
Transformation:

A driving force behind deal activity in 2017

While deal volumes on both the buy and sell side are expected to continue to rise, we are seeing a continued shift in the motivations for deal activity.

“Two-thirds of all respondents noted **strong demand for acquisitions** that would help enhance or transform their business models.”

Respondents were asked to select and rank two key motivators that will drive acquisitions in their company in 2017.



Source: KPMG International, 2017

Companies seeking to expedite growth, address new market conditions and improve their bottom line may need to change course and rework their core financial, business and operating model. Making a well-considered move to acquire a non-traditional insurance firm or forge a strategic partnership can be the key to meeting critical strategic goals and outperforming industry competitors and new market entrants. The stakes have never been higher, as new, more agile and technically-savvy entrants firmly take their place in the hearts and minds of customers.

Acquiring for business model transformation

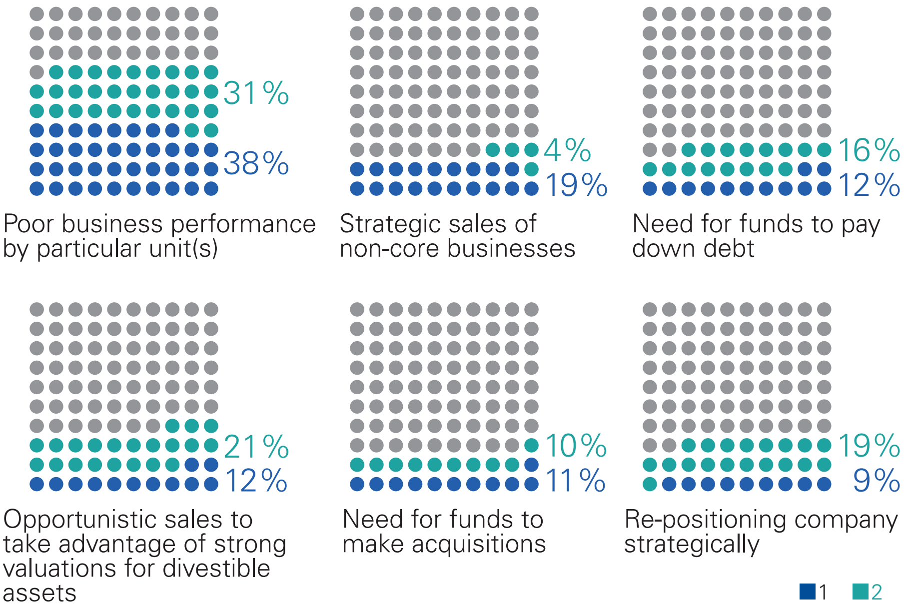
Transformation outcomes are now top of the agenda for most insurers. In particular, two-thirds of respondents noted strong demand for acquisitions that would help enhance or transform their business models (i.e. where they play), while just one-in-five said they were looking for acquisitions that could improve their operating models (i.e. how they win).

Many executives noted the catalyzing effect that new business models could have on their organization. "We are looking to introduce new products and new channels that would improve as well as transform our business model," said the head of strategy at a large diversified European insurer. "This would be our main attraction for acquisitions."

In many cases, insurers are looking for opportunities to capture new capabilities to address gaps in their current business, or completely transform the organization. "In the US, insurers are increasingly targeting small and medium-sized enterprises that offer something they currently do not have," noted the director of corporate development and strategy at one large American life insurer. This is giving rise to new acquisitions.

Regardless of geography, current trends clearly indicate that an organic approach alone will not be sufficient to drive long-term growth. Insurers are increasingly reliant on in-organic growth strategies to drive market expectations.

Respondents were asked to select and rank two key motivators that will drive insurance divestitures in 2017.



Source: KPMG International, 2017

> Rather than jumping at opportunistic deals — many insurers are starting to think much more strategically about the rationale behind the deals they make.

"We recognize that we're not going to achieve our goals without focusing our investment fund on strategic M&A opportunities, often taking minority stakes in new markets and segments to gain a foothold or a new capability," added the head of investment at a large global reinsurer.

Divesting in portfolio rationalization

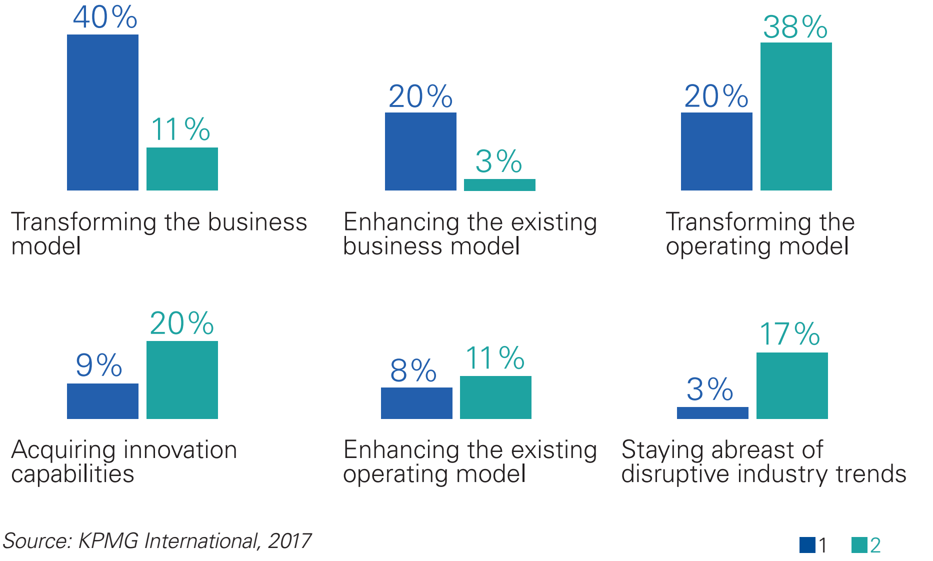
According to our research, 94 percent of respondents are planning at least one divestiture in 2017. While those seeking to sell businesses report being largely motivated by the performance of the specific business unit, there are indications that some insurers are taking a more strategic view of their divestment decisions. Twenty-eight percent of respondents suggested they would make strategic changes in their portfolio to sell non-core assets and reposition their organization. Twenty-three percent said they were looking to restock their treasury, either to pay down debt or to make new acquisitions. Interestingly, only 12 percent intend to undertake opportunistic divestitures to take advantage of strong valuations.

Ram Menon with KPMG in the US, noted that this type of portfolio shaping will continue through 2017 and beyond. "Given the on-going challenges with organic growth, insurers are starting to rethink their strategies and are rationalizing their portfolio of businesses as they look to streamline operations, reallocate their capital and optimize their operating cost structure. This isn't a short-term exercise."

However, there is clearly work to do. Notably, only 9 percent of our respondents said their key motivation for divestitures was repositioning the company strategically. Furthermore, 92 percent of respondents ranked their capabilities to execute cross-border divestitures as just moderate to low.

> **40 percent** said business model transformation is the key motivator driving partnerships in 2017.

Respondents were asked to select and rank two key motivators that will drive insurance partnerships and alliances in 2017.



Source: KPMG International, 2017

Partnerships rise up the agenda

Another indication of evolving M&A strategies is the continued focus on partnerships and alliances as a catalyst to transformation. In fact, all of our respondents said they plan to engage in at least one partnership or alliance agreement in 2017; one-in-five said they would enter into four or more over the year.

"In situations where we want to access a technology or some human capital, partnerships are often a great vehicle. If you try to do a traditional M&A, you will probably kill the innovation and flexibility that you valued in the first place. Partnerships can be a great way to access the benefits of small innovation companies," noted the head of M&A at a leading European reinsurer.

Again, respondents were focused on securing partnerships and alliances that will help enhance and transform their business models, followed by those that will help enhance or transform their operating models — focusing on capability, new technology infrastructure and talent. Only 12 percent reported being motivated by partnerships that respond to new innovations or industry trends (likely reflecting the fact that these are seen as enablers to transformation rather than outcomes).

Revolutionary change

Transforming a business model includes improving efficiencies; taking advantage of growth opportunities; developing further insight into consumer wants and needs; and executing a stronger strategic vision for all stakeholders.

There are, of course, inherent risks and difficulties involved in both acquisitions and partnerships — upon post-deal reflection, many acquisitions do not deliver the value they had promised. This unfortunate outcome is often the result when the additive value of a target is unclear to the organization.. However, with a strategic approach, the new capabilities acquired could act as a launch pad to help insurers refocus and reposition their business for future growth.

One example is the opportunity presented by digital. Until recently, insurers tended to lag behind other industries in terms of digital advancement for a variety of reasons, including a focus on short-term goals and general risk aversion.

However, over the past several years, leading insurers have made advancements including, creating mobile apps for more efficient distribution or claims processing and switching from manual data entry to electronic data ingestion. Insurtech start-ups are now attracting widespread attention and have increasingly become targets for acquisition and partnership. Automation, artificial intelligence, robotics, machine learning and gamification are all advancements that present opportunities for partnerships and acquisitions. Companies can often purchase the capabilities that are too difficult and pricey for them to develop themselves. Or they can look to co-create without the overheads of a traditional acquisition approach.

The head of asset strategy at a large Swiss insurer summed up their rationale for seeking digital acquisitions quite simply: it will improve their service offerings for their customers. "We are looking to gain access to technology that will allow us to reduce premiums. As we reduce the costs of our operations, we can provide the same benefits to our customers," he said.

Finding friends in the east

Our research indicates many insurers are looking east for new partnership opportunities. According to a strategy director at one large Japanese reinsurance firm, Western organizations will likely find willing partners across the region. "The entry of more foreign firms into the Asia-Pacific region will push many domestic insurance businesses to form new partnerships, in part to retain their market position, but also to rebuild the trust levels of their policyholders."

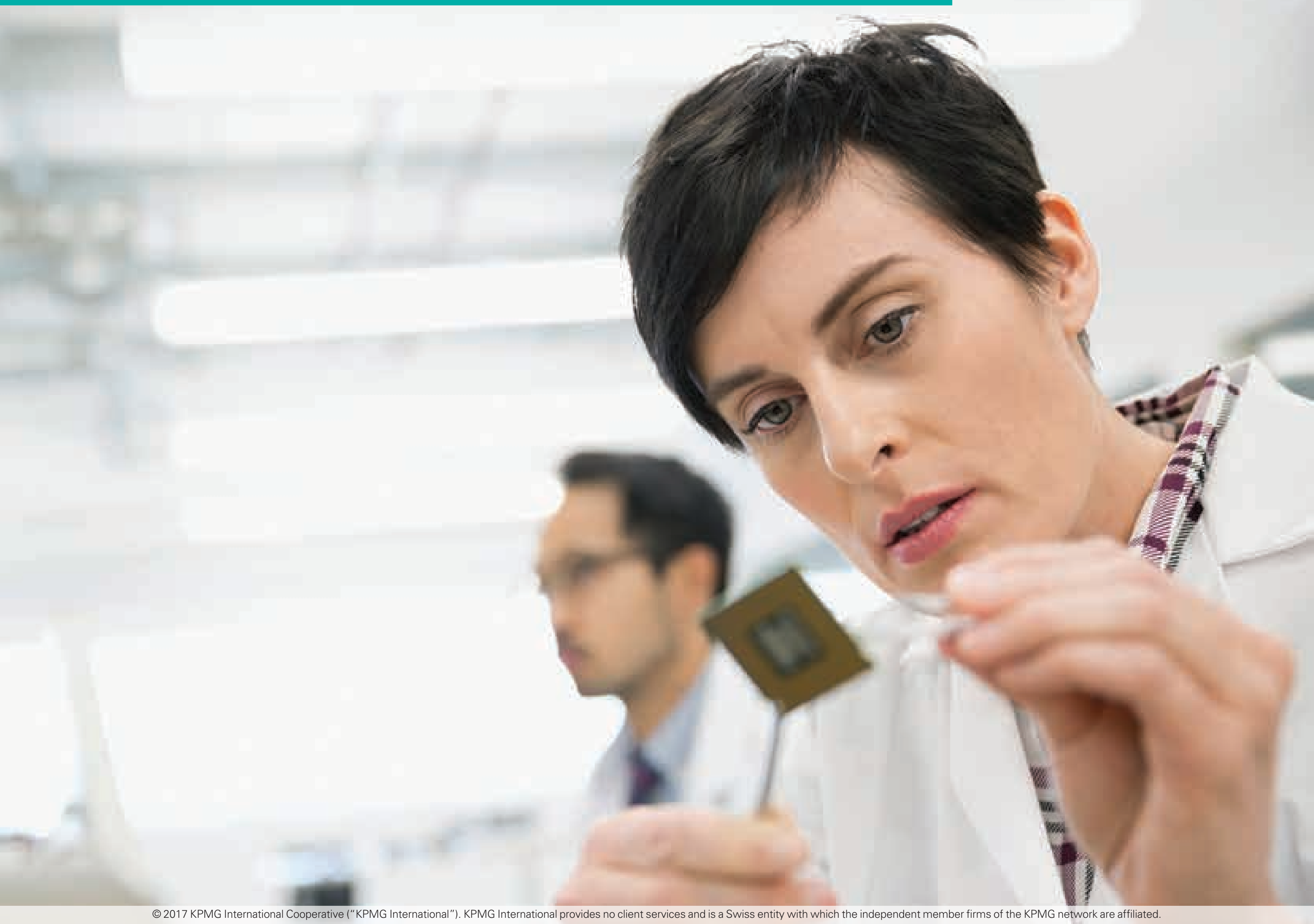
While this may be true across most emerging markets, Joan Wong at KPMG China noted that China already boasts a fairly mature partnership ecosystem between national banks and insurers. And as a result, she believes that many of the partnerships now being forged in China will be focused on acquisitions in alternative and aligned segments in the Fintech and e-commerce space.

Rather than jumping at opportunistic deals — insurers are starting to think more strategically about the rationale behind the deals they make." The bottom line is that insurance executives and shareholders expect investments to deliver more than just size and scale. They also need to deliver on the longer-term strategy for the organization. And that is where the big challenges will lie," cautioned Ram Menon.

> "We are looking to gain access to technology that will allow us to reduce premiums."
>
> Head of asset strategy
> Large Swiss-based insurer

Fueling the transformation engine: Corporate venture capital

As insurers seek to catalyze transformative value from their M&A investments, many have established (or are considering establishing) their own in-house corporate venture capital investment capabilities.



Any venture capitalist will tell you that insurance is one of the sectors to watch for innovative startups in 2017. Not surprising, the number of insurance tech deals signed in 2016 was up by 42 percent.[2]

Not to be left out — and with a deep desire to take advantage of emerging technology and innovation trends — many insurance organizations have established (or are considering establishing) their own in-house corporate venture capital investment capabilities.

In fact, our data suggests that the corporate venture capital model is evolving quickly. A quarter of our respondents said they already have an established corporate venture capital arm. A further 37 percent said they are currently considering establishing these capabilities. That being said, the investable capital allocated to these initiatives varied. Roughly a quarter said they had allocated between US$250 million and US$500 million. An equal number said they had allocated over US$1 billion.

"Companies right across the industry are starting to see the value inherent in the venture capital investment model, not just those with the biggest pockets or farthest reach," added Ram Menon. "However, this also suggests that the market may rapidly become crowded and valuations for VC-type investments may quickly start to rise, thereby diminishing the value of these strategies."

Going outside the box

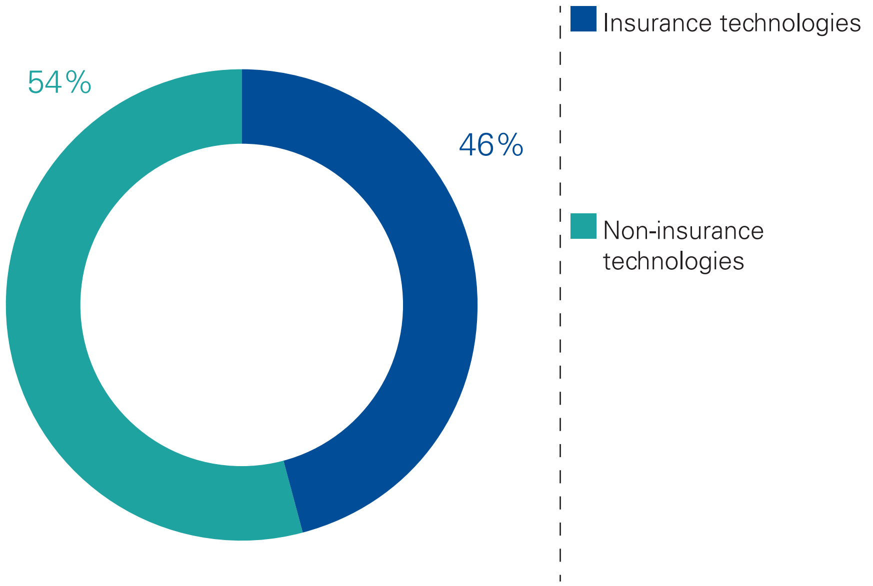
The investment decisions being made by these corporate venture capital funds suggests that a period of swift and exciting innovation is upon us. "I think we are at the early stage of the fourth industrial revolution — the digitalization era," said Joan Wong with KPMG China. "In my personal view, the sector globally will see more innovation in the next 5 years than it has seen in the last 50."

All evidence suggests that insurance VC funds want to be at the forefront of that change. Indeed, more than half of our respondents with established VC funds said they are focused on non-insurance technologies rather than traditional sector investments. This type of spending can be slit into two categories:

1. startups that could potentially improve the insurer's business but are not strictly related to insurance
2. startups that have nothing to do with the insurer's business model but could provide strong investment returns.

> "**62 percent** of insurers are either active or plan to set up a corporate venture capability."

Insurers focus most of their VC investment activities in the following areas.



Source: KPMG International, 2017

[2] https://www.cbinsights.com/blog/2016-insurance-tech-funding/

> The key is to make sure that your VC investment strategy is aligned intimately to the strategic goals and direction of your company as a whole.
>
> Ram Menon
> Global Lead Partner, Insurance Deal Advisory

Clearly, the shift towards prevention solutions is already underway. Examples from the past 18 months include AIG's investment in Human Condition Safety, a developer of wearable devices and software to improve worker safety[3], and MassMutual Ventures' participation in a US$12.9 million financing round for device threat detection startup Pwnie Express[4].

"We have made considerable investments in the Fintech, cybersecurity, data analytics and digital health technology space through our venture capital wing," said the director of investment at a Fortune 100 US-based life insurer. "These targets were picked by strategy and corporate development team members who have significant experience in the M&A business." Another large US-based insurer said they were focusing on 'home, the on-demand economy, and next-generation vehicles.'

Incubating innovation

Insurers have been combining a variety of approaches and models from investment vehicles and incubation models to mass engagement approaches to acquire or gain access to innovation capabilities. For example, Aviva's 'digital garage' in London and Singapore where software developers, creative designers, and even games producers collaborate on innovative insurance tools and ideas for the UK-based insurer. In our interview with Chris Wei, Global Chairman of Aviva Digital and Executive Chairman of Aviva Asia on page 20, he spoke candidly about their evolving approach to M&A in order to meet the long-term vision for the business.

As we noted in our publication, *A new world of opportunity: The insurance innovation imperative*,[5] more than a third (36 percent) of insurers around the world already operate some form of innovation hub or lab. Forty-three percent have formed partnerships with academics and other third parties to help drive their innovation agenda. Some are using these hubs or labs as a way to create — and eventually replace — their current operating models. "Recognizing the challenge of costly legacy systems, and the complexity of replacing them, several players have made conscious decisions to develop new companies that overtime will cannibalize the existing

Investing in new products and new channels

One of the hallmarks of the Insurtech space has been a diversity of segments with potential applications for the insurance business.

The insurer Zurich, for instance, formed a partnership in August 2016 with Cocoon, a producer of smart-home security devices. Under the deal, customers can receive both discounted service from Cocoon and cheaper premiums from Zurich.

On the customer-focused side of the equation, insurers are seeking new platforms and marketplaces that can allow them to reach customers more conveniently. One example is the Wrisk startup insurance app, which has already formed a partnership with Munich Re to begin offering auto, travel and home coverage directly on a smartphone.

[3] http://www.businesswire.com/news/home/20160106005861/en/AIG-Strategic-Investment-Human-Condition-Safety-Workplace

[4] https://www.pwnieexpress.com/news/pwnie-express-announces-12-9-million-in-series-b-funding

[5] The Insurance Innovation Imperative, KPMG International 2015

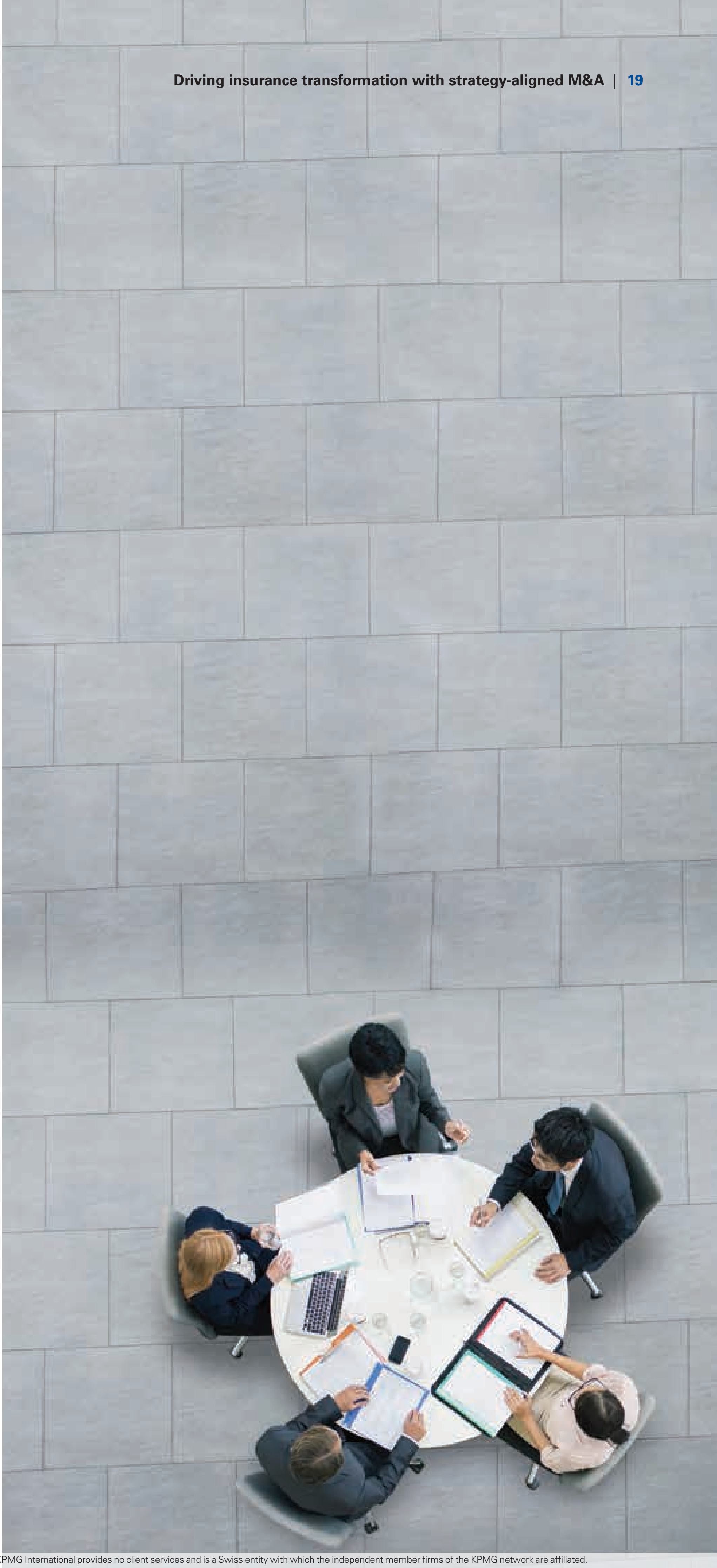
business. This frees them from creating further legacy structures and gives them the ability to scale the business more effectively," said Matthew Smith.

Maintaining alignment in hot markets

Regardless of whether a VC-type vehicle is used as an investment model for innovation, insurers will still need to ensure their investments are aligned to corporate strategy. In fact, our experience suggests that the lure of innovation can often blind dealmakers to their long-term objectives, particularly in hot sectors or competitive situations.

Buyers should therefore remain conscious of how a particular investment fits into their broader corporate strategy.

"Whatever the investment strategy of the organization, corporate venture capital is playing a vital role in the insurance landscape. The key, as always, is to make sure that the VC investment strategy is aligned intimately to the strategic goals and direction of the company as a whole," added Ram Menon.



Interview: Aviva plc invests for the future

As M&A trends shift and insurers seek out new capabilities and customer-facing technologies, Aviva plc has been rapidly evolving its M&A strategy to take advantage of the new opportunities emerging in the marketplace. To learn more about Aviva's strategy and objectives, **Gary Reader, KPMG's Global Head of Insurance**, sat down with **Chris Wei, Global Chairman of Aviva Digital and Executive Chairman of Aviva Asia**. Here are some highlights from the conversation.

Chris Wei
Global Chairman,
Aviva Digital
Executive Chairman
Aviva Asia

Gary Reader
Global Head of Insurance
KPMG International

Gary Reader: Aviva has been very clear about its intentions to transform into a digital and customer-focused organization. How is that emphasis influencing your M&A activities?

Chris Wei: Our stance is changing dramatically. For one, the traditional bank/insurance relationship has been fundamentally de-emphasized. What we are looking for today are relationships that go beyond simply leveraging bank networks to also help drive our vision around digital execution for financial services. I don't think the traditional big M&A distribution deals are going to drive our success in the future, but rather smart investments and partnerships that deliver brilliant customer experiences.

Gary Reader: Will partnerships be a bigger focus for Aviva moving forward?

Chris Wei: I think when partners share aligned interests, it can be hugely successful. Our partnership with Amazon in the UK, for example, allowed us to be the first UK insurer on the Alexa platform and helped us improve service delivery to our customers. At the same time, Amazon's cloud and infrastructure services have been very important to our growth in the UK, so there is a clear alignment of interests.

Gary Reader: Nobody has an unlimited investment budget. How do you prioritize and select your areas of focus for M&A and partnership activity?

Chris Wei: We have a few macro topics that we focus on — data and analytics and artificial intelligence, for example. More broadly, we are focused on creating a brilliant and frictionless customer experience. If the target is aligned to one of our priority areas of focus, can help us improve the customer experience and has a business model that is relevant for our business, it may be worth exploring. But we also recognize that we need to bring something to the table as well. The really good companies are not struggling to find financing; what they want is access to data, to customers and to deep industry experience.

Gary Reader: How has this shift towards partnerships and non-financial benefits influenced the traditional due diligence process for Aviva?

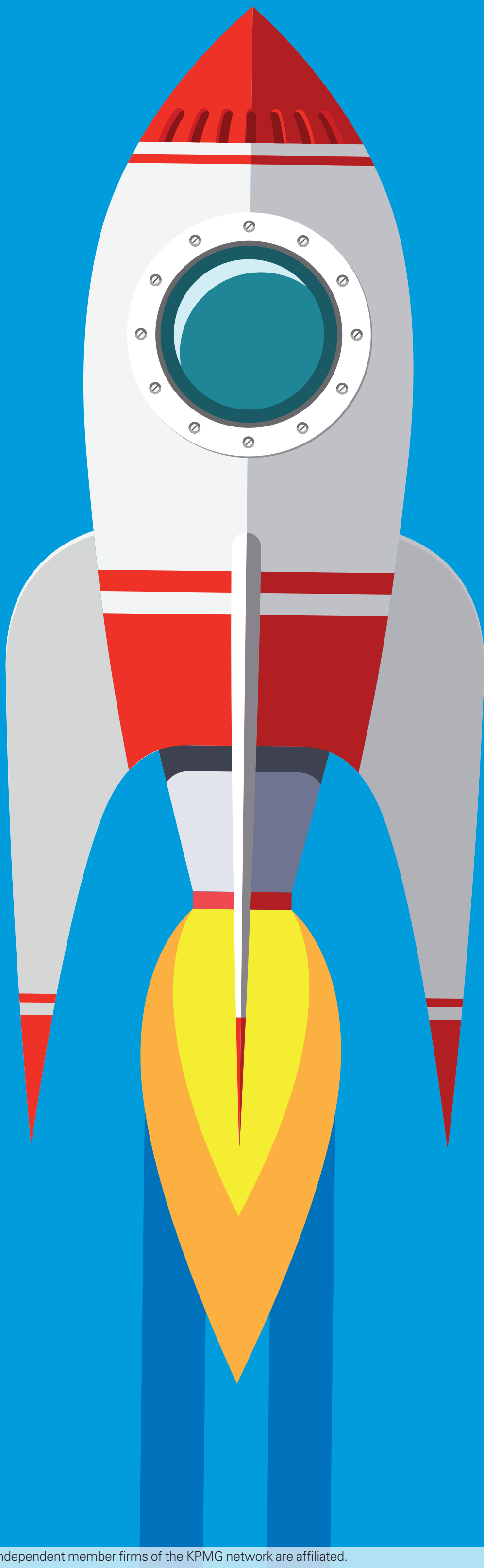
Chris Wei: It's certainly tough. If you value some of these opportunities, particularly the startups, from a pro forma perspective, you are likely going to be very, very wrong. It's almost a waste of time. You can't get too hung up on financials. We often look at other key metrics that influence the way they engage customers or users. What is their customer proposition and are customers buying into it? Ultimately, it often comes down to experience and instinct. If you think it's too expensive, you need to walk away.

Gary Reader: Aviva Ventures has also been very active in the investment space, particularly for technology startups. Is the value proposition different with the venture arm?

Chris Wei: The ventures unit is really set up to focus on startups and the like, but it reports into our group M&A director so it is very much aligned to our overall strategy. But it's a different mindset versus traditional M&A. Ventures often invests into really early stage companies, sometimes more as a way to access a technology or piece of intellectual property than anything else. And, we recognize that some of the investments simply aren't going to succeed. But where we do, the value is tremendous.

Gary Reader: In your opinion, how important has the creation of alignment between Aviva's M&A objectives and the corporations' overall strategy been?

Chris Wei: I think it's extremely important. Our very public strategy is 'digital first' and that translates throughout — into how we drive change and transformation; into how we align our investments and ventures; and into how we structure our new partnerships. The good news is that our board and group executive team are 100 percent behind the strategy and recognize the urgency. I think we're very aligned as an organization and the value of that alignment is being demonstrated in our results.



Creating alignment with strategic objectives:

Are we there yet?

While insurance executives and shareholders expect their M&A transactions to help deliver transformative value, our survey suggests that most organizations will need to create much closer alignment between their corporate strategy development and their M&A activities if they hope to deliver on these expectations.

Insurance leaders clearly recognize the need for their transactions to support their broader business agenda. "We recognize that our business performance and cost-saving strategies would improve significantly if our deals were more strategically aligned. Our strategy teams certainly understand the value that these kinds of deals can create over the years," noted one US-based life insurance executive.

Interestingly, just 43 percent said they have a dedicated corporate development and M&A team within their organization. And most worry that their efforts may not be strategically driven.

Strategy-aligned M&A

"Leading insurers need to take a more holistic approach to understand the drivers of M&A, even before evaluating potential acquisition and partnership opportunities. They need to look beyond the traditional financial due diligence aspects of evaluating the deal to consider the true strategic-fit and the potential risks associated with maximizing the value from any deal. This requires a deeper level of strategy development and design-thinking than before so that the alignment and value of potential targets is clear," noted Matthew Smith, KPMG in the UK.

Consider, for example, the fact that 37 percent of all respondents said that their approach to M&A is largely reactive and not necessarily aligned to overall corporate strategy. Or the fact that just 47 percent of those with dedicated M&A teams thought that their objectives were highly aligned with strategy when identifying deal opportunities.

Deal evaluation objectives seem equally reactive, even though respondents ranked 'alignment to corporate strategy' as the most important factor for successful deal evaluation overall. Only half were able to claim that their deal evaluation objectives are highly aligned, particularly when it comes to identifying risks associated with integrating or separating the target's operating model. Those with dedicated M&A teams reported only marginal advantages here.

At the same time, insurers are recognizing that the required capability mix for successful and strategy-aligned M&A is also changing. "As insurance M&A teams focus more on the strategic fit of a target, key considerations related to HR, tax and regulatory start to come into focus," noted David Bunce with KPMG in Brazil. "The due diligence in these areas can certainly be outsourced, but M&A leaders will need to place real focus and importance on the results of

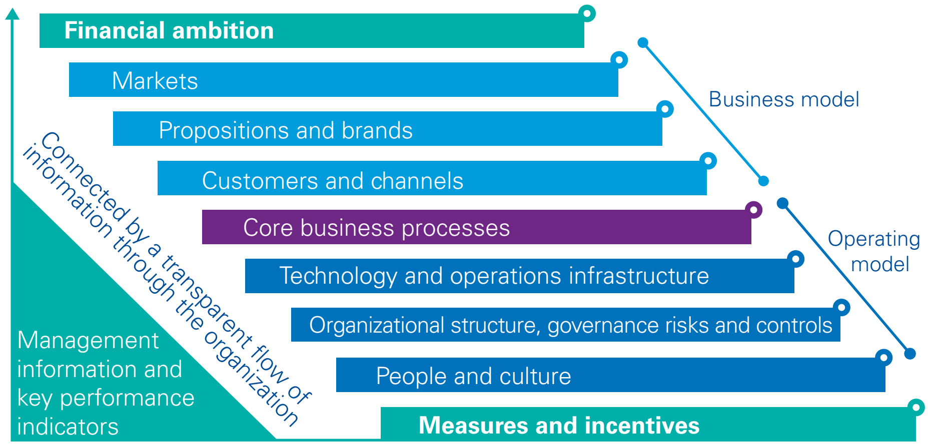
> "Just **47 percent** of insurers with M&A teams think their objectives are highly aligned to strategy when identifying deals."

The 9 Levers: Understand and create value

M&A leaders should be thinking about how these 9 Levers create value for their organizations.

1. **Financial outcomes structuring, investment and capital allocation:** What are the 3-5 year financial and strategic objectives?
2. **Markets:** Does the current portfolio of businesses support the financial and strategic objectives?
3. **Propositions and brands:** How should the portfolio of propositions and brands be managed over time to deliver financial and strategic objectives?
4. **Customers and channels:** What changes to the operating model can enable customer/ channel performance?
5. **Core business processes:** What are the priority business processes to deliver the financial outcomes, and a winning business model?
6. **Technology and operations infrastructure:** What are the priority infrastructure and technology elements that will be required to enable the strategy?
7. **Organizational structure, governance, risk and controls:** What does the organizational structure need to be to enable the strategy?
8. **People and culture:** What leadership is required to drive the transformational change and what culture and behaviors are required as enablers?
9. **Measures and incentives:** What will you measure to monitor progress on strategy, identify issues and enable action where required?

KPMG Global Strategy Group: The 9 Levers of Value methodology



Source: KPMG International, 2017

that due diligence if they hope to secure the right strategic-fit."

Evaluating strategic-fit

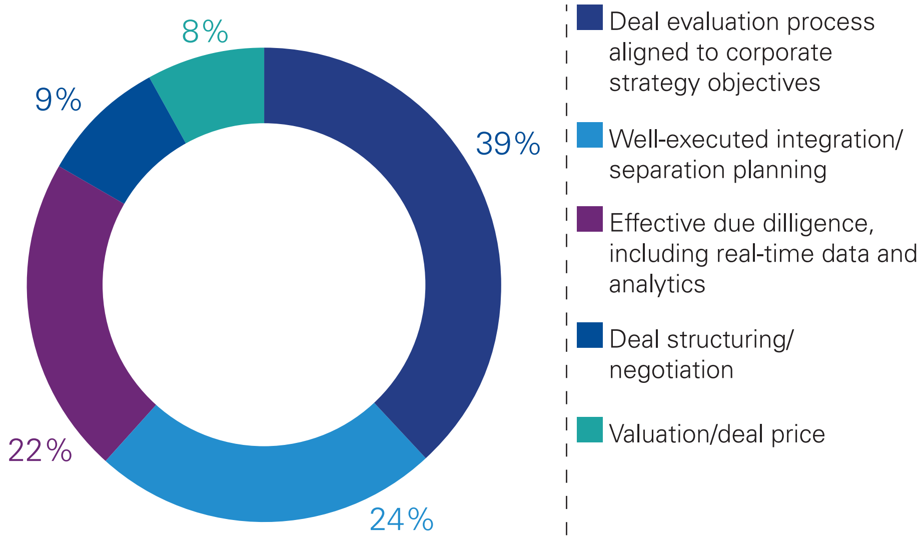
"In most cases, insurers will need to extend and expand their deal evaluation process at the outset, evaluating the strategic-fit of the target's business model, and in considering the execution, conducting a strategic risk assessment of the target's operating model, its people, processes and systems that they are hoping to acquire. Then they will need to decide whether or not to integrate into there own operating model" noted Ram Menon.

For many insurers, the challenges with strategy-aligned deal evaluation may be more about lack of internal skills and capabilities than desire. Indeed, when asked to rate the capabilities of their corporate development and M&A teams, only 61 percent rated their ability to evaluate the strategic-fit of a target's business model as 'high'. Furthermore, 50 percent believe they are less aligned when it comes to evaluating potential risks associated with integrating/separating the target's operating model.

"While it can feel incredibly complex, when we work with insurers we look to bring clarity and simplicity," said Matthew Smith, KPMG in the UK. Using the 9 Levers of Value framework, we support insurers with their deal evaluation by aligning their strategy to execution throughout the M&A process. The proprietary 9 Levers framework allows management teams to drive alignment between their financial, business and operating models. The outcome is a better understanding of the relationship between each component of the business.

"By focusing on the Levers of Value to define your strategy, it becomes easier to evaluate a potential target's strategic-fit. This means insurers are able to achieve a clear view of how value from the acquisition is created for their business," added Matthew Smith. "You simply can't make strategic decisions unless you know where you want to play to win and therefore where the value can be captured."

Respondents felt the most important factors for deal execution success were:



Source: KPMG International, 2017

> Insurers will need to look beyond the financial due diligence aspects of evaluating a deal to consider the true strategic-fit and the potential risks.
>
> Matthew Smith
> Global Strategy Group,
> Insurance Sector Lead
> KPMG in the UK

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Conclusion

Demand for transformation — and deals — is on the rise

Considered by many to be ripe for disruption, the global insurance industry clearly expects a rise in deal activity. Many are now reevaluating their portfolio of businesses and rationalizing their global footprint to strategically determine 'where they will play' and 'how they will win' in the future. Not surprisingly, around two-thirds of the respondents identified business model transformation and enhancement as a key motivator for corporate M&A activity across the industry, either to gain access to new markets or to penetrate deeper into their current markets.

Partnerships emerge as the preferred vehicle for operating model transformation

The majority of respondents said they intend to enter into at least one to three strategic partnerships and alliances, primarily for accessing new operating capabilities and new technology infrastructure. Asia-Pacific is expected to see the most partnerships and alliances forged with China and India ranking as the top two destinations in the region. The majority of the respondents also said they intend to forge strategic partnerships and alliances with larger firms (those with values ranging from US$250 million to US$1 billion).

Corporate venture capital to drive innovation

To stay abreast of emerging trends in technological innovation, several insurance companies have already established or are considering establishing in-house corporate venture capital (CVC) investment capabilities, largely as a way to invest in innovative technology capabilities. In fact, of those with established CVC models, the majority stated that their investment activities are focused on non-insurance technologies. While more than a quarter of insurers with CVC models boast more than US$1 billion in allocations, 90 percent say the median value of their CVC investments ranged between US$10 million and US$50 million.

Strategy-alignment is a critical success factor

To successfully transform their business models, insurers expect to closely align their corporate development and M&A activities with their corporate strategy and innovation initiatives. Our research indicates that the key to M&A success in this dynamic environment is for insurers to achieve alignment with their overall corporate strategy, supported by a keen understanding of their financial, business and operating model. Insurers recognize that this alignment is critical to evaluating the 'strategic-fit' of their M&A, partnerships and alliances, and venture capital investment opportunities. They know that greater alignment between functions will bring better clarity on which markets, geographies, products and channels they wish to 'play in' or 'exit out of'. And they understand that alignment will be key to assessing the relevant operating processes, technology infrastructure, talent and culture they will need to acquire in order to win and transform their operating model. However, most also agree the shift towards strategy-aligned M&A requires a different mindset and organizational capabilities.

Insurers are not there yet

There is clearly more work to be done. Most organizations surveyed admit that their corporate development and M&A teams' objectives were not necessarily fully aligned to their overall corporate strategy. Far too many respondents admitted that their M&A priorities continue to be reactive to market opportunities, as opposed to targeting deals that are strategically aligned to overall corporate strategy. Most admitted that their capabilities to execute cross-border acquisitions and divestitures was moderate to low. And they confessed poor alignment when evaluating potential risks associated with integrating/separating the target's operating model.

Start developing your enterprise-wide M&A playbook

One of the first steps insurers may want to consider is the development of an enterprise-wide M&A 'playbook' to enhance and deepen their evaluation of the strategic-fit of a potential acquisition target, throughout the due diligence, deal evaluation, and post-deal integration/separation processes. Creating a robust, strategy-aligned enterprise-wide M&A playbook could help improve deal outcomes over the long-term, versus simply pursing any or all deal opportunities that present themselves.

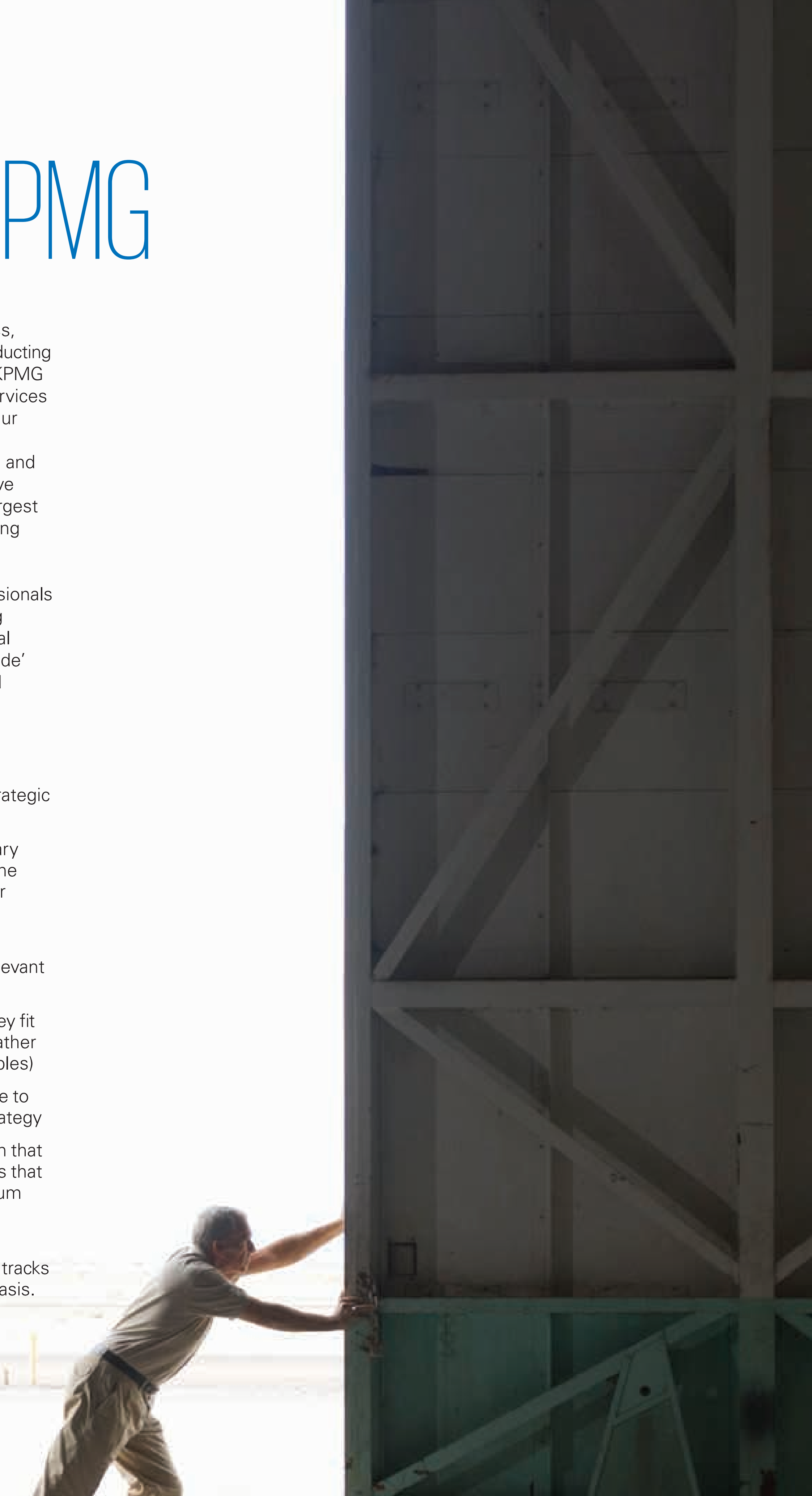
About KPMG

Whether acquiring a new business, selling an existing business or conducting a business restructuring initiative, KPMG member firms have a range of services to help insurers enhance value. Our dedicated Global Strategy Group, M&A teams, investment advisors and insurance restructuring teams have supported some of the world's largest transactions, IPOs and restructuring projects.

KPMG's global network of professionals aim to create value by challenging conventional thinking, bringing real industry insights and 'investor-grade' rigor, and providing on-the-ground support.

We help insurers:

- identify targets with unique strategic fit and value creation potential
- identify and prioritize the primary synergies of a deal, including the unique synergies that only your company can create
- conduct due diligence that is focused on the strategically relevant parts of the business
- value targets based on how they fit uniquely with your business (rather than just rely on average multiples)
- suggest deal type and structure to align with your competitive strategy
- plan for an integration approach that will foster the unique synergies that will create and achieve maximum value
- set in place a post-transaction performance assessment that tracks value creation on an ongoing basis.



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