Insurance sector still seeing M&A activity

BY **Joyce Goh**

Sridharan: Local M&A activity will continue both in conventional insurance and takaful

PATRICK GOH/THE EDGE

Wong: Interest rates and talent are key concerns for local insurers

If there were an award for the sector that has seen the most number of mergers and acquisitions (M&A), it would go to insurance.

Kurnia Asia Bhd is the latest to join the list of insurers that are M&A targets. Over a week ago, the general insurer announced that it was seeking Bank Negara Malaysia approval to enter into talks with parties for the possible disposal of its insurance business.

Kurnia will not be the last as industry observers feel the trend of consolidation in the sector since 2009 will continue as Malaysian insurers remain attractive primarily due to the low penetration rate here.

According to Sridharan Nair, partner of PricewaterhouseCoopers Malaysia (PwC), the relatively developed industry combined with the low penetration rate in the life insurance market and the recent easing of the foreign equity cap make local insurers more appealing than those in other Asian countries.

"If you look at the developed insurance markets such as Japan and Korea, they are relatively saturated. Fast-growing markets like China, India and Indonesia are huge in potential but associated with significant risks, and the markets in those countries are far less organised and structured," he observes.

"So, if one looks at the risk and reward trade-off, Malaysia fares well. You may not be able to make as much money here compared with China or India but you know that the parameters you have to play with are fairly well defined and the market is well regulated. During the global financial crisis, we saw a few global players pull back from some of the markets in Asia but now, their appetite is back and Malaysia is on the radar screen.

"The penetration rate of the local life sector rate is still low — around 40% compared with 30% a decade or so ago. In the developed markets, the rate can be more than 100%, meaning on average, an individual holds more than one policy. So, international players can see the potential in this country."

Angie Wong, executive director of PwC's assurance-financial services, says this increase in interest in local insurers has been particularly evident in the last year or so. "This is not just from well-known European insurance giants. We have also seen interest from around Asia-Pacific, Australia and Japan, for example. We are seeing that pickup, even in the general insurance industry, which is very fragmented, with the smaller insurers looking for strategic players to partner them or keen to exit the business altogether."

An analyst with RHB Research highlights how fragmented the general insurance industry is. "There were 39 general insurers in 1990 compared with 24 in 2010. There are still quite a number of them and some are too small to attain the scale needed to survive. As for life insurers, there were three in 1990 compared with nine in 2010."

It is because of this that the head of research at another local investment bank believes there will be more M&A activity in general insurance. "We can expect more of the smaller players to become targets. After the risk-based capital framework came into play, a number of them have been finding it difficult to sustain the capital requirements," he remarks.

Interested acquirers started sniffing around after Bank Negara liberalised the insurance sector in 2009, raising the cap on foreign shareholding to 70% from 49%. However, it took about a year for actual M&A activity to kick in.

Last year, composite insurer Hong Leong Assurance set a new record when it was sold for 6.5 times book. However, the bulk of the M&A activity involved general insurers.

Jerneh Insurance Bhd was sold to US insurer ACE Ltd at 2.24 times book last year while this year, Berjaya Corp Bhd's disposal of a 40% stake in Berjaya Sompo Insurance Bhd to its Japanese stakeholder set a new benchmark for the pricing of general insurers — 3.3 times book. In March this year, Pacific-Mas Bhd sold its insurance business to Fairfax Asia Ltd at 1.57 times book while in June, MAA Holdings Bhd announced a proposal to dispose of its insurance business to Zurich Insurance Co Ltd at 1.35 times book.

So, which are the listed insurers that are left?

Those listed on Bursa Malaysia include Manulife Holdings Bhd, Allianz General Insurance Co (M) Bhd, Pacific & Orient Bhd and LPI Capital Bhd. There are also local reinsurer MNRB Holdings Bhd and takaful player Syarikat Takaful Malaysia Bhd.

A number of other insurers belong to larger listed groups: Berjaya Capital still owns 30% of Berjaya Sompo Insurance, Uni.Asia is in DRB-Hicom's stable, Multi-Purpose Insurans Bhd comes under Multi-Purpose Holdings Bhd while Main Market-listed Malayan United Industries Bhd has a 52.21% stake in MUI Continental Insurance Bhd. In addition, there are insurers under banking groups such as AXA Affin Group, AmG Insurance Bhd and CIMB Aviva Bhd.

Lingering concerns

While the local insurance sector remains attractive to some, industry practitioners have their concerns.

"The key concern of local insurers is interest rates. They say the rates have been too low for far too long. It's a challenge for them because they have obligations to their policyholders and have to match their investments with the returns," says Wong, sharing the results of an insurance industry survey undertaken by PwC.

"Talent is second on the list of concerns for local players. As it is a very small industry, its talent pool is small as well. Succession planning is an issue with the people with experience reaching retirement age."

According to Swiss RE in its Global Insurance Review 2010 and Outlook 2011/2012, "Insurers, pension funds and private savers are paying for the cheap financing of governments and for households and corporations to borrow. The result for non-life insurers is a modest 6% to 8% ROE [return on equity] over the next couple years instead of the average 12% in the period of 2003 to 2007.

"Insurers thus face a serious dilemma. Investment yields will be low if they continue — as they have recently and traditionally — to invest substantially in risk-free assets. They could deviate from the conservative path, earning higher returns on riskier assets. However, rating agencies and investors might regard this as highly risky, especially with the ongoing market turmoil. Thus, the best strategy to boost profitability is to strive for higher underwriting standards, which means a rise in rates and a tightening of terms and conditions."

Still, the report notes, premiums in the emerging markets grew to 16.7% from 10.5% in 2007 while those in the industrialised countries stagnated.

In 2010, non-life insurance premiums in the emerging markets grew 7.4% (2009: +2.9%) to US$243 billion compared with a long-term interest rate of 8.9%. Two factors — the recovery of external trade and sustained public-sector investment in infrastructure projects — have been the drivers of premium growth in Asia, the Middle East and Latin America.

Life insurance premiums in the emerging markets are estimated to have grown 16.7% to US$361 billion in 2010 compared with an average of 13.5% over the past decade. The strong growth reported in Asia (+21.7%) was due to robust economic fundamentals and a swift rebound in investment-linked products.

Moving forward, Sridharan believes bancassurance will continue to be a key distribution channel for insurers. "Insurers will, however, have to address the backroom challenges in terms of systems and processes and make themselves more consumer-centric in their day-to-day operations, like how the banks in Malaysia have evolved. Over time, they will invest more in cutting-edge IT platforms and customer relationship management systems to meet customer needs," he predicts.

"Local M&A activity will continue in the near future, both in the conventional insurance sector and gradually in the takaful sector. Perhaps five years from now, as Malaysia becomes more developed and the market becomes saturated, local insurers will begin to look at investing in insurance players overseas, starting with the region." E

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