# HIPPOS, SAILS AND LEMONADE: THE EVOLUTION OF M&A IN INSURANCE

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Historically, the insurance world's value chain hierarchy was Carriers develop products and captive or independent advisors, distribute it. With Insurtechs, online options and rate aggregators, the lines have blurred. Initially, the debate was: Is Insurtech an insurer with technology approaches or a technology company supporting insurers? The definition settled on tech companies selling to insurers; however, the debate now adds the latest trend: technology companies owning and distributing insurance.

The paradigm shift began with brokerages, challenged with distributing their digital solutions on a wide scale, facing gaps in scalable technology and single-entry, multi-carrier interfaces. Brokerages merged and outgrew their suppliers. Now they dictate products, commissions, and even white-labeling solutions to assume ownership of the marketing of insurance products. With Aon-Willis Towers Watson merging,[1] new mega-brokerages will have unprecedented opportunities[2] to scale their businesses as they market themselves as a one-stop-shop not only for brokers but for policyholders and true digital capabilities. They demand solutions from product and service providers for the solutions needed to scale.

## ECONOMIES OF SCALE IN TRADITIONAL ACQUISITIONS

Typically, 'Insurer A' buys 'Insurer B' and inherits their book of business and technology. These acquisitions targeted distribution opportunities, extending into non-standard or specialty product lines, or entering new geographic markets. Acquisitions help leap-frog rating, licensing and regulatory hurdles.

Historically, these M&As faced challenges in achieving economies of scale due to a lack of scalable technology or assets to improve efficiency as many independent carriers within the market were still using legacy systems. These M&As consolidate assets, but siloed legacy systems only do not create synergies. Additionally, companies should heed caution to a potentially disjointed organization, and in most cases, inevitable, culture clashes occur.

1. https://investors.willistowerswatson.com/news-releases/news-release-details/aon-combine-willis-towers-watson-accelerate-innovation-behalf
2. https://www.capco.com/Intelligence/Capco-Intelligence/Unforeseen-Impacts-And-Opportunities-Of-The-Era-Of-Mega-Brokerages

# MODERN ACQUISITIONS

As insurers modernize their core systems, they will be able to extract books of business from one system into another quickly. One-to-one book transfers can be [relatively] seamless transitions because the modern core systems support data mapping tools and migration. These M&As allow more significant market synergies as carriers only buy the portions of books that meet their growth goals, whether new lines or existing. Brokerages and advisors have perfected this type of transfer across their networks.

Again though, these M&As support portfolio growth and not necessarily scale across back-office processes.

# BEYOND TRADITIONAL AND MODERN ACQUISITIONS

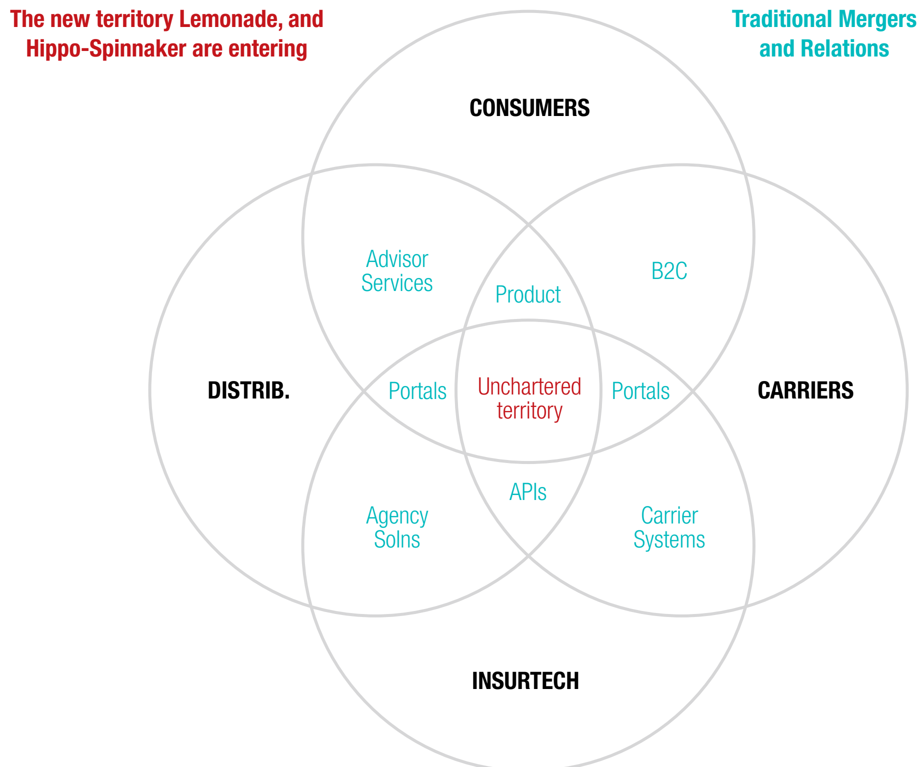
Insurance companies began purchasing and investing in Insurtechs to expand their product offerings, distribution opportunities and scale their technology offerings as alternatives to M&A. Tokio Marine and Intact jointly invested in pay-by-the-mile auto insurance company Metromile,[3] looking for solutions to simplify the insurance experience. Similarly, Prudential Insurance's acquisition of Assurance IQ's data science and machine learning improve application times will add new revenues not sensitive to equity markets, interest rates and credit.[4]

Most insurtechs run losses but have the funding to support them. Ultimately, they are not proven, sustainable businesses, but investors fund them for growth opportunities and technology[5]. Insurer regulators will not allow carriers to run losses, eroding their premium base, and threatening their ability to meet claim obligations.

Lemonade started as a peer-to-peer technology approach for insurance – adapting from insurtech to insurance company to prove market appetite existed for tech-driven insurance offerings. Now they are announcing an Initial Public Offering (IPO)[6] while still running tech-style losses with their re-insurers absorbing the regulatory risk. Re-insurers versus an investment base protects their underwriting losses.

Is this a single interesting experiment, or could it become a trend? Insurtech Hippo acquired Spinnaker Insurance.[7] The itch of a next-level digital experience acts as a catalyst for insurers to bypass the red tape and bureaucracy carriers usually face for these kinds of projects. Hippo can continue to leverage Spinnaker's appetite for technology for future projects. Spinnaker, on the other hand, as an insurer, cannot run losses to fund their digital development but can justify the technology spend with their investment in Hippo.

3. https://www.bloomberg.com/news/articles/2018-07-23/tokio-and-intact-bet-on-metromile-insurance-as-people-drive-less
4. https://www.reuters.com/article/us-assuranceiq-m-a-prudential-finl/prudential-buys-assurance-iq-for-2-35-billion-in-new-tech-bet-idUSKCN1VQ19J
5. https://www.cnbc.com/2018/10/01/more-money-losing-companies-than-ever-are-going-public.html
6. https://www.reinsurancene.ws/lemonade-files-for-nyse-ipo-reveals-new-reinsurance-arrangements/
7. https://finance.yahoo.com/news/hippo-acquires-spinnaker-insurance-company-130000075.html




This next-generation M&A cements not only the investment relationship but also the technology commitment between them. In these cases, you free the client-vendor relationships from bureaucracy and processes that could potentially be disrupted by other vendors.

# CONCLUSION

Investing in technologies is trendier and seen to give better returns. In an era of low returns overall, this appetite for technology demonstrates that investment is in the wrong place. Consider: Nike's supply chain from factory to the end-consumer is covered heel-to-toe by insurance – property coverage, employee liability, cargo, product liability and warranties. Insurance quintessentially underwrites our economy, yet we bind the investment in this industry with high regulatory concerns.

Insurtechs are potentially in a position to buy insurers for the same reasons they bought each other (market access, growth, expansion) and prove their value rather than looking for an insurer to buy them out. The combination of innovative technologies with established insurers provides excitement in the industry. Still, it will be interesting to see if Insurtechs and not insurers drive more future acquisitions.

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