FinTech- / InsurTech-driven M&A Transactions by Insurance Companies

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Digitalization, the use of modern technologies and its implications for traditional business models has become a main focus for banks ("FinTech") as well as for insurers ("InsurTech"). Although the number of already well-established InsurTechs is still relatively modest, there are hardly any insurance companies which are not implementing or at least analyzing InsurTech initiatives. The focus of such initiatives is to acquire the relevant technologies and know-how in order to react or adapt to new developments and competitive challenges.

InsurTech-driven (and other) M&A transactions of insurance companies are subject to insurance regulation even if the InsurTech company is not regulated. Insurance regulatory notification and approval requirements applicable to insurance companies require a careful analysis and coordination of the transaction, in particular if, in addition, stock exchange or merger control notification requirements apply.

Key takeaways:

- **In order to react to new technologies and adapt to business models and new competitors, insurance companies often acquire new technology and know-how from InsurTech companies, be it by means of M&A transactions or joint ventures**
- **M&A or JV transactions by insurance companies are subject to insurance regulation, even if the InsurTech company is itself not regulated.**
- **Depending on the transaction structure, insurance companies are subject to regulatory notification or approval requirements.**

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1. Insurance technology

Insurance technology - "InsurTech" - attempts to combine modern technologies and alternative business models with insurance expertise in order to make the current insurance industry model (even more) efficient. Existing InsurTech startups are in particular active in peer-to-peer insurance, contract management/brokerage, spot insurance, e-commerce insurance, health insurance and usage driven insurance.

Categorization, however, is not key. All that matters is how insurance companies achieve the transformation of their business models in order to adapt to new technologies and competitive challenges. In the broadest sense InsurTech can also mean exploring new online sales channels.

As the "technology part" of InsurTech (as opposed to the "insurance part") is often not (yet) a core competence of established insurance companies, the relevant technology or know-how is often acquired from the outside. Such M&A and JV transactions by insurance companies are subject to a variety of laws and regulations.

2. Acquisition of an InsurTech company (share deal)

a) Share deal and FINMA review

An insurance company that acquires shares in an InsurTech company exceeding a 10, 20, 33 or 50 percent threshold of the InsurTech's voting or capital rights has to notify FINMA before the closing of the transaction (article 21 of the Insurance Supervision Act (ISA)), irrespective of whether or not the InsurTech is itself regulated.

FINMA has significant discretion to intervene against M&A transactions by insurers in case FINMA considers that the acquisition puts the interests of the insured at risk. In most cases, the InsurTech transaction will be rather small in size in comparison to the existing business of the insurance company and a (subsequent) FINMA intervention may not seem very likely. However, in the context of an M&A transaction, often any sort of uncertainty, is not acceptable.

Therefore, in practice insurers usually obtain FINMA's prior consent for share transactions (before signing the transaction agreements or as a condition precedent in case the agreements are signed before FINMA approval is obtained).

b) (Indirect) change of business plan

As a condition to receive (and keep) an insurance license, insurance companies need to file a formal business plan with FINMA. Any change of the business that results in the amendment to such business plan must be notified to or in important cases pre-approved by FINMA (article 4 and 5 ISA).

Therefore, it needs to be assessed whether an InsurTech-transaction may cause any change in the insurer's business activity and, consequently, to its formal business plan. Clearly, a relatively small investment to a (compared to the insurer) small InsurTech company is unlikely

to cause an immediate change at the level of the investing insurance company. However, as an InsurTech investment is usually made in order to adapt and change the future business activity and organization of the insurer, a change of business plan can be a (indirect) consequence of an InsurTech transaction. Without having the activity and steps (that follow the InsurTech transaction) cleared with FINMA, such transaction (or associated business development) may not be worth the costs or may even become subject to a later intervention by FINMA.

Of course, if the InsurTech company is itself already active in the insurance business and, consequently, is subject to a licence requirement, the respective notification or approval requirement may also apply at the level of the InsurTech company. Similarly, in case the transaction contemplates the InsurTech itself (also) becoming active in a regulated area, the InsurTech company needs to obtain a relevant licence

c) Group supervision

Theoretically, the acquisition of an InsurTech company by an insurance company could also cause these (now) affiliated companies to become subject to group supervision, meaning that FINMA supervises the whole group of companies on a consolidated basis. Group supervision usually applies in case a group operates on an international scale and has a complex structure. Arguably, a single InsurTech transaction, if viewed in isolation, is unlikely to trigger a group supervision. Of course, group supervision aspects are relevant if the acquiring group is already subject to FINMA group supervision, which is currently the case for Baloise, Helvetia, Mobiliar, Swiss Life, Swiss Re und Zurich).

Group supervision comes in addition to individual supervision of the insurance company itself, which can cause additional costs and efforts for affiliated companies and could cause the (controlled) InsurTech company to become to some extent subject to FINMA regulation, e.g., duties to provide FINMA with information (article 71 and 79 ISA). In particular, the supervised group needs to notify FINMA (before implementation) of:

- material intra group transactions between the insurance group and the (controlled) InsurTech company, or;

- the acquisition or sale of a "qualified shareholding/investment" by the (controlled) InsurTech or other group company (FINMA determines for each insurance group what constitutes a "qualified shareholding", see FINMA circular 2016/4 for more information).

3. Technology transfer, asset deal

a) Asset deal / Carve out transaction

Instead of acquiring an InsurTech company, the insurance company may also acquire specific assets (e.g., specific technology/IP-rights or even a whole part of its business, including employees). Such transaction can be done by way of an asset deal under the Swiss Merger Act (SMA) or outside the SMA, and may be subject to mandatory laws, which may cause joint liabilities, employee information, consultation or other disclosure duties to apply.

b) Change of business plan

From a regulatory perspective, an asset deal is per se not subject to FINMA notification or approval requirements. However, the acquisition of assets or parts of a business may cause a change in the insurer's business activity that often results in notification or approval requirement (see section 2b).

c) No non-insurance business

Alongside their insurance business, insurance companies may only engage in business that is directly connected to insurance (article 11 ISA). FINMA may approve exceptions in case the interests of the insured are not at risk. Usually, exceptions are only granted if the non-insurance business is relatively minor and its liability and solvency exposure is limited and can be easily assessed by FINMA.

However, activities of many InsurTechs are likely to comply with article 11 ISA as usually an InsurTech's business activity is directly linked to insurance activity. If there is doubt whether the acquired business (part), or the insurer's business as transformed following an asset deal, is sufficiently linked to insurance activities, the transaction should be pre-discussed with FINMA. Alternatively, the non-insurance business could be transferred into a subsidiary (which may cause other notification or approval requirements to apply, see section 2 or 4).

4. Cooperation by way of a joint venture company

a) JV incorporation and carve out

In case an insurance company wishes to establish a substantial cooperation with an InsurTech company, such cooperation may often involve the incorporation of a (jointly controlled) JV-company as well as the JV-partners' contribution of assets and liabilities, or even a whole part of their business, to the JV-company.

Such carve out transactions are challenging from a legal point of view. The transfer of parts of the business that include employees is for example subject to mandatory employment laws (art. 333 of the Swiss Code of Obligations) and the incorporation may have to comply with certain disclosure duties in view of the anticipated transaction between affiliates after incorporation (beabsichtigte Sachübernahme).

Furthermore, insurance regulatory rules apply. Essentially, the carve-out of assets and liabilities into a newly incorporated JV-company combines the requirements as set out in sections 2 and 3 above). Simplified, the participation of an insurance company in the JV-company follows the rules of a share deal (section 2) and the carve-out from an insurance company into the JV-company follows the rules of an asset deal (section 3).

b) Other insurance regulatory rules

In case the JV-company offers or concludes insurance contracts, rules relating to insurance intermediaries may apply (e.g., disclosure and registration duties). In addition, if an insurance company (or any of its affiliates) that is subject to group supervision controls the JV-company, the JV-company may to some extent also fall under FINMA regulation (see section 2c, for

example in case of material intra group transactions or qualified shareholding/investment). Furthermore, should the carve-out to the JV-company also involve the outsourcing of material insurance functions, then the rules applicable to outsourcing need to be considered (see section 5).

In an InsurTech-driven transaction one would not expect the insurance company to also transfer (parts) of its insurance portfolio (meaning the insurance contracts with the insured). If it does, the JV-company would require the necessary licenses and the transfer of the insurance portfolio would have to comply with specific insurance regulatory transfer rules (art. 62 ISA).

c) Demerger

For tax and other reasons it may be beneficial to demerge the assets and liabilities from the insurance company first. As a result, the demerged entity becomes a sister company of the insurance company (as opposed to a subsidiary). As a second step, the JV-partner can then become a shareholder in the demerged entity.

Such demerger can follow the (burdensome) rules of the statutory demerger (demerger under the SMA) or be made outside the SMA (contribution of the demerged business into a wholly owned subsidiary of the insurance company and distribution in kind of the shares in such subsidiary to the parent of the insurance company).

A demerger of parts of the business of an insurance company is subject to prior approval by FINMA (art. 3 para 2 ISA, also if non-insurance related business is demerged).

5. Contractual Cooperation

A partnership between the insurance company and the InsurTech company may also be based on contracts (as opposed to forming a separate entity). In this respect, one legal question that may arise is whether the cooperation leads to an outsourcing of material insurance functions from the insurance company to the InsurTech company. As the outsourcing of material insurance functions has to be described in the insurer's business plan, respective changes must be notified to FINMA.

In particular, FINMA requests a careful selection, instruction and control of the (outsourcing) service provider and such InsurTech company must also be in good standing and assure a proper business conduct. However, it is noteworthy, that currently, the applicable rules and standards requested by FINMA for outsourcing are in the process of being amended in order to become (more) harmonized with outsourcing rules applicable for banks. Based on a draft of such new FINMA circular as published in early 2017, generally the rules relating to outsourcing will become less strict from an insurer's perspective.

As a final remark, similar as in the case of cooperation by means of a JV-company, a contractual cooperation may also lead to a regulated insurance intermediary activity (see section 4b).

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