Cold feet

Britain's financial regulator shares investors' worries about the Pru's giant Asian deal.

THE bankers were in Prudential's headquarters at Laurence Pountney Hill in the City of London on May 4th, poised to price a $21 billion (£14 billion) rights issue, set to be launched the next morning. Printing presses were ready to spew out the 1,000-page prospectus. Then came the bombshell: the man from the Financial Services Authority (FSA) was not happy with the man from the Pru; the rights issue was halted.

With that, a $35.5 billion deal to transform Prudential PLC, Britain's best-known life insurer, into a dominant force in Asia was put on hold. Prudential (unrelated to the American insurer of the same name) wants to buy AIA, the Asian operations of American International Group (AIG), an insurance giant bailed out by the American government in 2008. AIA is in ten large Asian countries and the biggest life insurer in two of them; Prudential dominates in four. Together AIA and the Pru would become the leading life insurer in seven Asian countries, and the biggest foreign provider in China and India. Apart from the rights issue, Prudential is planning to raise another $10 billion in bonds, and to place $5.5 billion of its own shares with AIG.

The deal was delayed, it seems, because the FSA got cold feet. It would remain the Prudential's lead regulator, under international rules now in the works, even though at least 60% of the insurer's new business income would be in Asia. With blood from the global financial crisis still flowing, it makes sense that the main regulator of a far-flung conglomerate, by most measures too big to fail, would want to be sure that capital is available in London in case of need. This last-minute hitch rather thwarted the earlier regulatory due-diligence done on behalf of Prudential by lawyers Slaughter & May.

Capital rules for insurers are in a state of flux. A new European Union directive known as Solvency II, which will have global ramifications, is being thrashed through various EU bodies and is about 95% complete. But studies on its likely impact are still being done. A big concern about the Prudential deal, under Solvency II, is whether the British holding company would have ready access to capital held outside the EU. The new Prudential plans to list its shares in Hong Kong and Singapore as well as in London and New York.

The FSA's objections may require the Pru to find yet more capital. This week's thwarted attempt was already the biggest British rights issue ever, apart from those involving government money. And critics of the acquisition, including some of the Pru's big shareholders, think the firm is overpaying. AIG was preparing to float AIA for up to $25 billion when Prudential stepped in with an offer $10 billion higher.

Tidjane Thiam, Prudential's chief executive, and Mark Tucker, his predecessor, have pushed it resolutely towards Asian expansion. The potential for growth in Asia, compared with prospects in more mature markets in Europe and America, is mouth-watering on paper: life-insurance premiums gathered in India and China account for only 4% and 2.2% of GDP respectively. In Hong Kong, where life insurance took hold earlier, the ratio is 9.9% of GDP and climbing; in Britain it is 10.6%.

Yet there are those who worry, following reports that the Pru is ready to sell its British business to chase its Asian dream, that this 162-year-old insurance company is burning boats it should hang on to. On the numbers alone it may seem compelling to go flat-out for growth. But shareholders in financial institutions have seen rather too much of that strategy lately to be entirely comfortable with it.

In a report published on April 30th the OECD, a rich-country club, analyses the impact of the financial crisis on insurance. It warns supervisors to take more account of macroprudential spillover as many insurers react similarly to economic events. It may be that some such consideration prompted the FSA to slam on the brakes.

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