

2004 Life Convention
7-9 November

Acquisition and Management of blocks of closed business

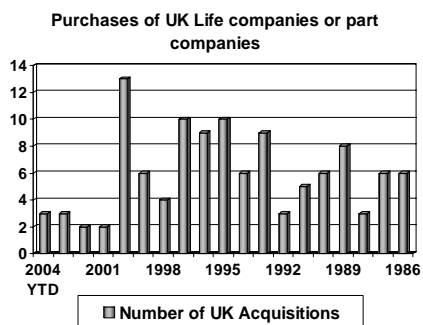
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Agenda

- , Introduction
- , Preparing a company for sale
- , Maximising value
- , Pricing, taxation and compliance issues
- , Issues for the Appointed Actuary (HOAF/WPA)
- , Transition and beyond

Introduction - some M & A history

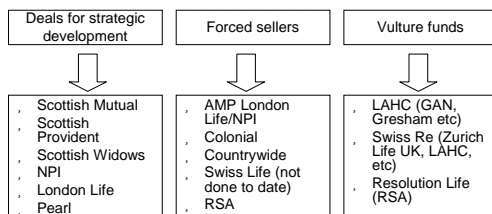


Introduction - some M & A history

- In the mid to late 1990's Bancassurers were buying to gain distribution and cross selling opportunities
- Many acquisitions were at premium prices
- With the equity market fall the number of purchases slowed to a trickle
- Sellers were not willing to sell at the prices being offered
 - Unrealistic expectations
 - Management embarrassment at selling for less than EV
 - Buyers worried about mortgage endowment mis-selling and more recently the cost of guarantees and options
- In 2003-4 sellers are still reluctant to sell at reduced prices, but
 - Buyers few and dominant in the process
 - Many EV's have now been marked down due to with profit issues and the bottoming of the equity market

Introduction - some M & A history

....and the reasons



Introduction - some M & A history

The next stage of the market?	<ul style="list-style-type: none"> · The closure of many funds · Sellers are wanting to clean up their balance sheets · Reversion to true roots of insurance, mortality and longevity · Further consolidation to gain economies of scale
	<ul style="list-style-type: none"> · Expense considerations including <ul style="list-style-type: none"> · Cost of regulation · Diseconomies of scale on closure of funds · Increased competition in selling policies
	<ul style="list-style-type: none"> · Failed sales strategies <ul style="list-style-type: none"> · Loss of distribution, death of savings policies · Many companies tried to expand their way out of cost overruns · But there is a limited consumer appetite for insurance products
Drivers for sales	<ul style="list-style-type: none"> · Access to capital · Risk reduction for financial services groups · Disposals of non-core activity · Retrenchment of overseas parents, UK seen as a bad environment

Preparing a company for sale (1)

Resolve the issues

FSA

- All correspondence needs to be closed
- Obtain expert opinion (or legal) where the company does not agree with the FSA
- Make sure the audit trail is clear

Mis-selling

- If an investigation is complete make sure all documentation is present and you have confirmation from FSA or auditor
- If an investigation is incomplete prepare for big value adjustment or indemnities
- Do not try to hide anything internally or to the buyer
- This is potentially the biggest deal breaker

Preparing a company for sale (2)

Accounting wish list

- Make sure accounting area is watertight
- Make sure all documentation is up to date
- Resolve any chart of account problems
- When providing information for a data room make sure the basis of preparation is very clear: e.g. MSSB, realistic, internal management

- All correspondence needs to be closed
- Obtain expert opinion (or legal) where the company does not agree with the FSA
- Make sure the audit trail is clear

- All reconciliations up to date and complete
- Make sure reconciliations between FSA returns, reports and account and internal management accounts are solid and complete
- Provide clear evidence for valuation of material other assets and liabilities

Preparing a company for sale (3)

Tax

- What are the latest set of closed returns
- What issues are outstanding
- If there are big issues be prepared for indemnities
- To make sure prior year computations have been done and audited
- Make sure EV incorporates the latest tax balances
- Examine all tax planning opportunities
- Obtain external reports / opinions on any uncertainties

Legal

- Check status of all policy documents
- Check all inward and outward litigation is in progress or resolved
- Make sure all reassurance treaties are signed and valid/current
- Check legal agreements for change in ownership issues
- Make sure any compliance with past schemes is obvious and documented

Preparing a company for sale (4)

Actuarial

- EV audited / updated
- Reserving basis / EV basis both fully documented
- Audit trail to experience investigations
- Model validation

Compliance

- Complaint logs
- Complaint handling
- All compliance audits clear or answered
- Policy literature
- Marketing material
- Post sale information

Staff

- What's morale like, staff turnover rate
- Are key staff on bonus schemes to retain until post deal
- Communication is critical for those involved in sale process
- Are senior staff up to the task of sale

Preparing a company for sale (5)

Complete disclosure

Preparation

- Ensure all correspondence is answered and complete
- Make sure all reports/financial results are up-to-date and in final form
- Do not 'hide' draft documents
- A problem highlighted will affect the value but not as much as a problem uncovered during the sale process

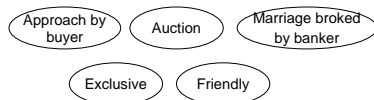
Documents

- FSA returns, Report and accounts, internal management accounts
- ICA and FCR
- EV / EEV / MCEV reports
- Investment strategy, investment committee minutes
- Arrow
- PPFM
- Audit management letters
- etc

Preparing a company for sale (6)

Project management

Decide on sale process type



Appointment of advisers



Preparing a company for sale (7)

Project management

- Project team ability key to smooth running of the sale
 - Do not skimp on this area
 - If necessary get experienced external assistance
- Make sure time horizons are realistic
 - The easiest time to commence a tender process is stating after all reporting is complete
 - An Autumn sale will require good half year financials or completion accounts
- Data room ownership/control of data is essential for the smoothing running
- Decide in advance what you are willing to photocopy and give to buyer and make copies
- Remember to redact all items that you are sensitive to

Maximising value (1)

The value depends on the issues

- Progress with FSA letters
- Progress with tax issues, compliance, misselling investigations

Enhancing the EV

- Proven expense cuts will add more value than proposals
- Do not make sudden changes to assumptions the history will need to be revealed always use best estimate
- Make sure all actuarial and accounting investigations are up to date
- Have all policy reviews been completed
- What is the history of UK policy fee increases
- What is history of other policy charge changes
- Are models comprehensive and inclusive
- Try to avoid all end piece adjustments

Maximising value (2)

Choose your exclusive buyer carefully

- May not choose highest bidder
- Cash/paper/indemnities/escrow/shared risks
- If a buyer is difficult to deal with in a first stage then may be impossible in final due diligence
- Look for the ability the buyer to make decisions and concede points/issues
- Speed of completion
- Ability to do transaction/completion/legal team experience

- What is the buyer's history
 - History of completing deals
 - Do they have a reputation to lose/brand strength
 - FSA problems in past
 - Financing the deal/do they already have the cash or will further financing be needed
 - The deal will be subject to FSA approval, is the buyer suitable from the FSA's perspective

Pricing, Tax, Compliance (1)

Hot topics

Mis-selling	<ul style="list-style-type: none"> • Mortgage endowments / time baring / 'promises' • Precipice bonds • Pension transfer / FSAVC
Sales	<ul style="list-style-type: none"> • DSS rebate business / S2P • Vesting pension annuity business • Stakeholder pensions • Childs trust fund • Group business
Regulatory	<ul style="list-style-type: none"> • With profits governance <ul style="list-style-type: none"> • Realistic reporting • PPFM • ICA, ICG, Solvency II

Pricing, Tax, Compliance (2)

Hot topics

Financial reporting	<ul style="list-style-type: none"> • IAS or US GAAP (or MOS) • EV vs EEV vss Economic value vs Fair value • Fred 34
Tax	<ul style="list-style-type: none"> • AC1 ('the crown option') pricing implications • Anti avoidance rules, new schemes • Derivative backed structures • IAS tax impact/transitional arrangements

Price considerations

<ul style="list-style-type: none"> • Fixed price • Roll forward • EV at completion date <ul style="list-style-type: none"> • Audit issues • Scope for disagreement
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Issues for "Appointed Actuary" and board (1)

- FSMA requirements
- Faculty and Institute guidance
 - GN1 requirements
 - GN37, GN39 onwards
- With profits actuary / reviewing actuary / peer review
- New directors' certificate
 - Throughout the year complied with SYSC, PRIN, IPRU(INS) and PRU
 - With-profits fund managed in line with PPFM
 - The directors have taken and paid due regard to advice from the actuarial function holder and with-profits actuary
 - The rules require the company to complete the valuation "in accordance with" / "with due regard to" generally accepted actuarial best practice
- Corporate governance
- Risk management – arrow visits

Issues for “Appointed Actuary” and board (2)

Model handover process

- Regulatory requirements
- FCR's, ICA, ICG
- Capital levels / outlook
- Investment strategy
- PPFM's

- Policy library
- PRE
- Policy reviews
- Options / guarantees
- Assumptions (documentation and history)

- Reinsurance
- Inherited estate issues
- Compliance issues
- Unit pricing

Transition and beyond (1)

- Is the seller only selling a block of business?
- Project management – key to success
- Planning and prioritisation
- TPA models / build relationship / is is the first time

- Depending on type of sale chosen oversight needed for
 - Experience control
 - Modelling systems
 - Data flows
 - General ledger
 - Staff motivation, performance standards etc
 - Asset management
 - Transfer of assets (matching or junk)
 - Ensure key staff do not resign
 - Retention of business etc
 - TUPE issues very complex

Transition and beyond (2)

- Is there a transitional service agreement or is there a straight purchase?
 - Agreement needs to be clear and well written
 - Transitional service agreement needs close oversight by buyer
 - Penalties for non-compliance
 - Is it worth the paper it is written on

- Learn about the issues you did not “identify” with detailed investigation
 - Unit pricing
 - Data extraction
 - Data reconciliation
 - Data quality, general data ‘holes’/errors’
 - Accounting reconciliations
 - Policy reviews
 - Policy conditions
 - Policyholder communications
 - Quality of administration staff and management
 - Ability of workforce to accept change
