The Actuarial Profession
making financial sense of the future

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Effective Execution of Projects and Transactions

Introduction - 1

- This session is intended to function as a seminar for the exchange of ideas and experiences about the effective execution of projects and transactions by insurers
- Drawing on our own experiences of working with insurers, we present what in our view are the four main reasons for difficulties, giving anonymised examples
- We consider how these difficulties may develop in light of the issues facing the insurance industry over the next few years

Introduction - 2

- We analyse ten pitfalls that commonly trip up projects and transactions
- We warmly welcome contributions from the audience at all stages
- The objective of the session is to identify approaches to projects and transactions which will help to reduce the occurrence of avoidable difficulties

Four main reasons for difficulties - 1

- **Reason 1**:
  - Failure to formulate objectives properly at the outset
- **Reason 2**:
  - Failure to identify possible obstacles and to plan effectively how to overcome them

Four main reasons for difficulties - 2

- **Reason 3**:
  - Silo and/or herd behaviour resulting in ineffective response to problems when they arise
- **Reason 4**:
  - Failure to make the most of an advantageous negotiating position

Reason 1

Failure to formulate objectives properly at the outset

- Causes:
  - Insurer single-minded about one objective
  - Undue dominance of one individual or group
  - Failure to identify core elements
  - Failure to distinguish "must have" from "nice to have"

Reason 1

Failure to formulate objectives properly at the outset

- Effects:
  - Project or transaction has unintended results
  - Another individual or group blocks the project or transaction, possibly with damage to relationships
  - Project fails unnecessarily because it does not satisfy a criterion that was not necessary
  - Counterparties deterred, or price higher than necessary

Reason 1

Failure to formulate objectives properly at the outset

- Example A:
  - Insurer needs to have more higher quality capital so decides to amend the terms of its lower tier two capital to make it into upper tier two capital. It obtains the necessary legal opinion for regulatory purposes. However, it overlooks the fact that it will no longer receive a tax deduction on interest payments.

Resolution: Check impact extensively.

Reason 1

Failure to formulate objectives properly at the outset

- Example B:
  - Insurer is preparing to enter into an outsourcing transaction. It prepares an extensive list of its requirements but some items on the list overlap with one another or could have been managed internally with relatively minimal effort. As a result the price of the outsourcing is higher than it should be.

Resolution: Don't rush the planning stage. It's much harder to change the plans once negotiations have started.

Reason 1

Failure to formulate objectives properly at the outset

- Example C:
  - Insurer asks reinsurers to tender to provide reinsurance in respect of a portfolio of business which includes some with-profits business. One of the reinsurers it approaches is not able to accept with-profits business, so rules itself out. It might have offered a better price on the non-profit business.

Resolution: Make clear that objectives are flexible unless they are definitely not.

Reason 1

Failure to formulate objectives properly at the outset

- Key resolutions:
  - Test proposals carefully before proceeding – don't rush
  - Get sign-off from all affected groups
  - Always distinguish essentials from nice to haves
  - Identify core requirements and be flexible on other points
  - Agree on what a good outcome would look like
  - Be careful when packaging proposals

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Causes:
  - Insufficient time – planning phase is rushed because of deadline
  - Project sponsor does not know what it doesn't know, and doesn't know who to ask
  - Project sponsor relies on own experience, without taking account of recent developments

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Effects:
    - Significant additional time and resources required
    - Project completion deadline may be missed
    - Problems are solved consecutively rather than in parallel
    - Another stakeholder raises new issues at a late stage

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Example A:
  - Insurer proposes to redeem some preference shares. Checks all of the regulatory requirements and gives notices to FSA. But does not know that there is a five to seven week statutory process under company law for redemption of shares out of capital.

Resolution: Don't assume regulatory requirements are the only restrictions. Ask: "what if we weren't regulated ?"

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Example B:
    - Insurer checks that a capital raising transaction will be consistent with law and regulatory requirements but does not consider how it will be recorded in itse regulatory returns, which in turn impacts the tax treatment.

Resolution: Always check accounting and tax.

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Example C:
  - Insurer is ready to agree the terms of an acquisition but then, at a late stage, the regulator raises questions about the amount of capital needed to support the acquired business.

Resolution: Early, regular and clear communication with the regulator is essential. Raise all key issues early.

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Example D:
    - On a Part VII transfer, reinsureds give notice at a late stage that they propose to object to the scheme.

Resolution: Work out who your potential enemies are and prepare exhaustively for what they might do.

Reason 2

Failure to identify possible obstacles and to plan effectively how to overcome them

- Key resolutions:
  - Don't rush the planning stage
  - At the outset, identify all key stakeholders and their minimum requirements
  - Brainstorm to identify likely objections and think of ways to minimise their likelihood of success
  - Early, regular and clear communication with tax and accounting departments and with regulators

Reason 3

Silo and/or herd behaviour resulting in ineffective response to problems when they arise

- Causes:
  - Dominant person or group discourages:
    - identification of problems
    - effective challenge to assumptions
    - proposal of divergent solutions
  - Project sponsor treats project personally and behaves emotionally

Reason 3

Silo and/or herd behaviour resulting in ineffective response to problems when they arise

Effects:

- Over-reaction to problems that emerge (emotional self-defence)
- Under-reaction to problems that emerge (wilful blindness)
- Failure to share information with others resulting in failure to benefit from input from others

Reason 3

Silo and/or herd behaviour resulting in ineffective response to problems when they arise

- Example A:
    - Lead negotiator for the insurer exerts very dominant approach to discussions (even threatening to sack one of his team who raised a possible alternative approach).

Resolution: Be open to all ideas.

Reason 3

Silo and/or herd behaviour resulting in ineffective response to problems when they arise

- Example B:
    - Project team wants to limit costs so decides not to consult auditors. Auditors' view then has to be accommodated at a late stage in the project.

Resolution: Early, regular and clear communication with all relevant groups is essential.

Reason 3

Silo and/or herd behaviour resulting in ineffective response to problems when they arise

- Key resolutions:
    - Encourage ideas from all members of the team and all affected groups
    - Identify any incompatible requirements of different stakeholders at an early stage
    - Early, regular and clear communication with all affected groups

Reason 4

Failure to make the most of an advantageous negotiating position

- Causes:
  - Failure to identify your objectives at an early stage
  - Failure to identify obstacles means that insurer does not transfer risk in early negotiations
  - Silo behaviour results in key issues being overlooked
  - Insurer over-complicates rather than concentrating on key principles
  - The wrong skill sets

Reason 4

Failure to make the most of an advantageous negotiating position

Effects:

- Loss of value, delays, lost deal tension
- Insurer pays for points to be included that might have been included in basic package if raised earlier
- Insurer finds that certain scenarios are not covered by its detailed drafting so these need to be specifically negotiated, whereas principles-based drafting would have covered them

Reason 4

Failure to make the most of an advantageous negotiating position

- Example A:
  - Insurer is completing an outsourcing transaction. It misses certain key services out of the original tender, and only remembers to include them after selection of bidder. Pricing pressure is therefore lost.

Resolution: Be exhaustive in the original tender request.

Reason 4

Failure to make the most of an advantageous negotiating position

- Example B:
    - Insurer moves directly to contractual documents. It subsequently finds that its drafting does not cover a particular point, and lack of a term sheet prevents it from proving that the point was intended to be covered.

Resolution: Use a term sheet to set out key principles of the transaction.

Reason 4

Failure to make the most of an advantageous negotiating position

- Example C:
    - Counterparty raises points sporadically. Insurer does not take the opportunity to trade points for changes that it wishes to make.

Resolution: Ask counterparty to confirm that it has no further points, then consider what insurer wants in return.

Reason 4

Failure to make the most of an advantageous negotiating position

- Key resolutions:
  - Be exhaustive in preparing the original tender request
  - Use a term sheet to set out key principles of the transaction
  - Trade points in "packages“
  - Know the negotiating points before you start

Future issues to look out for

- Solvency II changes (honestly!)
- IFRS accounting changes
- So many metrics!
- A new and different set of likely counterparties
- Synergies ?
- CP11/05 and the future regulation of with-profits
- A new set of emerging roles

Examples of key pitfalls - 1

- Failure to consider accounting or tax treatment early enough
- Failure to understand what the other side wants, and what it needs (they're different, and should drive different negotiating positions)
- Failure to consider in advance the objections or concerns the regulator will have, and what can be done in mitigation
- Failure to allow enough time for regulatory approvals and tax clearances
- Forgetting that deals are about people as well as numbers

Examples of key pitfalls - 2

- Failure to consider Group level impact
- Knowing when you have to walk away, and ….
- Failure to consider forthcoming changes to law and regulation
- Failure to focus on fundamental terms of the transaction (because of over-focus on the ancillary details)
- Trying too hard to please

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

Further discussion

All contributions to discussion will be very welcome