

GN23: Life Insurance Company Takeovers

Classification

Recommended Practice

Legislation or Authority

The Panel on Takeovers and Mergers. *The City Code on Takeovers and Mergers and The Rules Governing Substantial Acquisitions of Shares*, 5th ed., 1996. (“The Takeover Code”).

Life Assurance Joint Committee of the Institute of Actuaries and the Faculty of Actuaries. *Life insurance company takeovers: a report by a Working Party of the Joint Committee*. 1993.

Application

Actuaries involved in takeovers involving life insurance companies, whether they are employed or are acting as consultants.

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Status

Approved under Due Process. Adopted by the Board for Actuarial Standards on 19 May 2006.

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from which time it ceased to operate (and cannot, with effect from that time, be relied upon) as guidance issued by the Profession. Members needing to comply with professional standards on matters covered by this Guidance Note should in future consult the standards published by the Board for Actuarial Standards.

1 Introduction

- 1.1 Although a number of actuaries, particularly consultants, have a wide experience of life insurance takeovers, for many actuaries employed in a life insurance company the experience may well be new. Actuaries may provide advice on a range of actuarial and (if a manager or director) other subjects to their clients, much of which may be private to those clients. This Guidance Note is primarily concerned with guidance about the valuation of a company and, in particular, with information which will or may be transmitted to shareholders.

- 1.2 Takeovers involve complex negotiations. There may well be tight time scales and a need to take decisions when mentally tired or without the chance to consult colleagues. These pressures are even greater should the takeover be contested, particularly if hostile.
- 1.3 When the takeover involves an offer for a public company the Takeover Code applies. The Takeover Code also applies to offers for private companies in certain circumstances. Actuaries involved with such takeovers should ensure that they are familiar with the relevant parts of the Takeover Code (and any Notices issued by the Takeover Panel, such as the Notice on Merger Benefits and Earnings Enhancement Statements issued on 3 April 1997). The Code is formulated in terms of general principles and members are strongly urged to discuss its interpretations in a particular case perhaps initially with the relevant merchant bank or legal adviser and, if appropriate, with the Panel on Takeovers and Mergers (“the Takeover Panel”) executive.
- 1.4 The purpose of this Guidance Note is to assist all actuaries who are involved in a life insurance takeover, to understand where there may be professional problems and to advise them on best professional practice. In particular, references are made to the Memorandum on Professional Conduct (“the Memorandum”) and to GN1: Actuaries and Long-Term Insurance Business, as well as to the Takeover Code.
- 1.5 The attention of Appointed Actuaries is drawn to a potential professional issue which can arise when a company is involved in a takeover. Subject to the requirements of the Takeover Code, the target company may wish to produce certain information on current performance (such as a profit forecast) for its shareholders. Similarly, the bidder may wish to produce information regarding the expected merger benefits. The need for the target company or bidder to achieve that performance or those benefits may constrain the directors from taking the advice of the Appointed Actuary at the end of the financial year and possibly in subsequent years.
- 1.6 Actuaries who become involved in a life insurance takeover are advised to refer at an early stage to Life insurance company takeovers: a report by a Working Party of the Joint Committee dated 15 October 1993 for further information on this subject. This is available from the libraries at the Faculty and Institute. It should be noted that the report refers to the 4th Edition of the Takeover Code.
- 1.7 Actuaries involved in the takeover bid for a mutual company should observe Sections 4, 5 and 6 below, as well as having regard to general concerns relating to conflicts of interest and independence arising from professional practice.

2 Conflicts

- 2.1 The Takeover Code makes it clear that the Board of Directors of a company and its advisers have a duty to act in the best interests of the company's shareholders. In this context, an Appointed Actuary who is also a director must consider carefully whether the two roles conflict bearing in mind duties to policyholders as set out in GN1.
- 2.2 The Takeover Code requires financial advisers to be mindful of conflicts of interest. This may mean the appointment of an independent actuary (who may be the usual external adviser to the company) to provide a formal, independent valuation of the company. The meaning of independence is covered in more detail in Section 3 below.
- 2.3 Should there be a possibility of conflict in terms of the Code, the actuary should seek advice as in 1.3. If there seems to be conflict in the light of professional guidance the actuary should seek advice from the Professional Body.

3 Independence

- 3.1 As mentioned in the Memorandum, for an actuary in a particular situation to describe the advice offered as independent, the actuary must be free, and be seen to be free, of any influence which might affect the advice or limit the actuary's scope.
- 3.2 In the Takeover Code 'independent' means, *inter alia*, independent of the other party. As many companies retain consulting actuaries, it is possible that such a firm could be advising both the bidder and the target. Even though it is normal practice for such a firm to withdraw as adviser to the bidder, the bidder may object on the basis that information about it might become available to and assist the target. In limiting its work in this way, the firm may feel that the target might become unnecessarily vulnerable and it might have to decide to step aside and not be lead actuarial adviser.
- 3.3 The Takeover Code also covers the position of multi-service organisations. In the case of actuaries, this could apply where a firm acts as consultants to the pension scheme of a party involved and is asked to act for the other party with regard to the takeover. Whether the Takeover Code is applicable or not, the firm in question must consider whether its actuaries abide by 3.1 above.

4 Experience

- 4.1 As mentioned in 1.1, the experience of a takeover may well be new to many of the actuaries involved. In such a situation it is essential that members who do not have the relevant knowledge and experience to undertake such work should seek the co-operation and guidance of an actuary who does. The Memorandum covers this need. Firms which wish to give advice to companies in takeover situations should ensure that there is at least one

person with a good working knowledge of the Takeover Code, particularly of those parts relevant to valuation.

4.2 A takeover may involve issues related to policyholders' reasonable expectations which are of an unusual nature. In these circumstances, or where the Appointed Actuary has limited relevant experience, it may be beneficial to appoint an external actuarial adviser to advise the Appointed Actuary directly (as opposed to the shareholders or directors).

5 Relations with Other Parties

5.1 A takeover, particularly a contested takeover, is liable to cause differences of opinion between the parties and some of these may be made public. As covered in the Memorandum, actuaries should recognise that there is room for such differences and must avoid any action which would unfairly injure the professional reputation of any other actuary.

6 Disclosure

6.1 In accordance with the Memorandum, actuaries must ensure that they can be identified as the source of the advice and, where a third party is involved, that the advice is not presented in a way which is misleading. In the course of a takeover, actuaries may provide advice to their client on a range of subjects and using alternative assumptions on a confidential basis but not intended for wider disclosure. They must ensure that any advice which they provide, and which is intended to be communicated to shareholders, is appropriate for that purpose.

6.2 The Memorandum covers the need for actuaries to include in any report information, appropriate to the circumstances, as to its scope and terms of reference, the assumptions made and the methods and data which were used. The underlying principle regarding disclosure under the Takeover Code is to enable shareholders to see the extent to which the value could be sensitive to different assumptions when making a decision concerning the offer. Hence, in the use of an actuarial valuation, the need to comment as covered in 6.8.9 below. It is not the intention to provide sufficient information to enable another expert to calculate a different value on different assumptions.

6.3 The responsibility for all documents issued to shareholders rests with the appropriate Board of Directors. However, under the Takeover Code, the merchant bank adviser takes responsibility for ensuring that the rules are observed. Legal advisers are usually asked to verify that the sources of information contained in the document can be identified. The purpose of the verification procedure is to ensure so far as possible that documentation is accurate, complete and not misleading and that statements made by the Board of Directors are reasonable. The Board of Directors is entitled to rely on the

advice of experts and to hold them responsible for it. Consulting actuaries may therefore wish to retain their own legal advisers.

- 6.4 Although an actuarial valuation is not a profit forecast in the terms of the Takeover Code, the detailed notes on disclosure of assumptions in profit forecasts apply to such a valuation. Actuaries should take careful note of these requirements if they are advising a company which is producing a formal actuarial valuation.
- 6.5 In considering assumptions, the actuary should take particular note of the Takeover Code Rule 28.2. - The Assumptions. Although the Directors of the company are responsible for the assumptions, they have a right as explained in 6.3 to rely on professional advice. Equally the actuary must be satisfied that the assumptions in a valuation to be transmitted to shareholders are reasonable.
- 6.6 It is a requirement that the shareholder be given enough information to form a view on 'vulnerabilities' to which the valuation is subject. The actuary should consider sensitivity - whether there are certain assumptions which, if varied, lead to significantly different results. As explained in 6.5, the assumptions used should be reasonable as judged by the actuary. In the event the outcome may be different.
- 6.7 In dealing with an agreed merger of life insurance companies, it may be necessary to produce actuarial valuations of each of the companies involved in the merger. Where this is the case and such valuations are to be transmitted to shareholders, the actuaries involved should, where practicable, take care to ensure that the assumptions used in the valuations are consistent. If there are any material differences in the assumptions used, these should be drawn to the shareholders' attention.
- 6.8 It is possible that an actuary will be required to give a formal opinion and that an actuarial opinion letter might be printed in a document issued to shareholders. This opinion letter is likely to contain a summary of a fuller report produced for the Board of Directors. The contents will be influenced by the circumstances of the case. The following are, however, some of the matters which the actuary should, where appropriate, cover in it where its main or sole purpose concerns the value of the company:
 - 6.8.1 The name of the party instructing the actuary.
 - 6.8.2 The terms of reference.
 - 6.8.3 A statement of the data used.
 - 6.8.4 A statement that the valuation has been made assuming a continuation of current management and in a manner consistent with the operating record of that management (or otherwise if this is not the basis of valuation).

- 6.8.5 A statement of the principal bases and assumptions. These should include the assumptions underlying both the value of the in-force business and the value of future business. Where relevant, the statement should set out the treatment of any fixed contractual increases on regular premium business, state whether DSS rebate and other recurrent single premium business is treated as new business or included as business in force, and set out the allowance made for future premiums on group pension contracts. Where base profit figures or multipliers are used in calculating the value of future business, the detailed assumptions and base volume of new business should be included.
- 6.8.6 A statement that the actuary believes the assumptions are reasonable.
- 6.8.7 A statement as to how tax and the need for and amount of solvency capital have been allowed for in the valuation.
- 6.8.8 A statement of the resulting value showing, as appropriate, the separate constituent parts, normally shareholders' funds and the value of the in-force business (taken together these two are usually referred to as the Embedded Value) and the value of future business (when all three are taken together they are normally referred to as the full Appraisal Value). Care should be taken in discussing these elements, as alternative descriptions of them are sometimes used and shareholders' funds may include deferred acquisition cost assets and free reserves held within the statutory long term business fund where classification for this purpose may be ambiguous.
- 6.8.9 A statement concerning key assumptions, variation in which would result in significant changes in the value.
- 6.8.10 A statement concerning the position where actuarial advice not related to valuation, or guidance or opinions which were not strictly actuarial, was being given.

7 Conclusion

- 7.1 Actuaries are reminded that, if they have any doubts about their position, competence or experience, they should seek advice from their professional body.