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LIFE INSURANCE COMPANY TAKEOVERS

A REPORT BY A WORKING PARTY OF THE LIFE ASSURANCE JOINT COMMITTEE OF THE INSTITUTE OF ACTUARIES AND THE FACULTY OF ACTUARIES, 15 OCTOBER 1993

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ABSTRACT

The working party was required to establish what actuarial information is needed by the financial world for the proper evaluation of a bid for a quoted insurance company, and, in the light of these findings, to consider what may be required in the way of guidance to actuaries. The report considers the issues which occur when life insurance companies are subject to takeovers and to other changes of ownership. The Takeover Code has many implications in such situations and these are discussed fully, particularly any conflicts of interest and the independence or otherwise of the actuaries involved. The interests of policyholders are considered and advice is proffered to actuaries. A Guidance Note is being issued.

KEYWORDS

Life Office; Takeover; Advisers; Regulators; Guidance Note

1. Introduction

1.1 *Background*

On 2 October 1989 Australian Mutual Provident (AMP) launched a takeover bid for the Pearl Group (Pearl), a bid which was fiercely contested. On 22 November 1990, I. L. Salmon and A. E. M. Fine presented a paper to the Institute of Actuaries ('Reflections on a Takeover of a United Kingdom Insurer: A Case Study', *J.I.A.* **118**, 59), identifying issues which had arisen in that case, primarily of an actuarial nature, and which, in their opinion, would benefit from discussion within the profession. A summary of the key issues in that paper is in Appendix V. Following the meeting at which that discussion took place a working party was formed under the aegis of the Life Assurance Joint Committee of the Institute of Actuaries and the Faculty of Actuaries to take matters forward. The terms of reference of the Working Party are in Appendix I.

1.2 Consultation

1.2.1 At a meeting held at the Institute of Actuaries on 31 March 1993 an interim report prepared by the working party was discussed by both actuaries and non-actuaries. In the light of that discussion and some subsequent contributions the working party has produced this report. An earlier consultative document was sent to a small group; namely The Panel on Takeovers and Mergers (Takeover Panel), the DTI, individuals within merchant banks, stockbrokers, legal firms, as well as particular actuaries with experience which was expected to be, and indeed was, extremely helpful. We are grateful to all those who assisted us. We do, of course, take full responsibility for the content of the report which has been welcomed by the Takeover Panel.

1.2.2 When we started work we decided to concentrate initially on the takeover of a Stock Exchange-listed life insurer. This was for three reasons. The first was that the profession was looking to us to explore the need for professional guidance in this area. The second was that we needed to be sure that the Takeover Panel was satisfied with the role of the actuarial profession in such cases. Lastly, if professional guidance was needed, or if work was required by the Takeover Panel, then there was an obvious need to have this in place before the next takeover actually occured. We have classified the broad groups of possible takeovers in Appendix II.

1.2.3 We have prepared an Addendum which contains our comments on other cases which involve the change of ownership of life insurance businesses. While we did not identify any fundamentally new points on which guidance to the actuarial profession would be helpful, it seemed appropriate to publish our observations to complete the picture.

2. Summary of Overall Conclusions

2.1 Actuarial Information needed for Proper Evaulation of a Bid for a Quoted Life Insurance Company

2.1.1 We conclude that, in current circumstances, when the statutory accounts of a life insurance company do not provide an adequate basis for determining the value of such a company, a valuation based on actuarial techniques such as an appraisal value is appropriate.

2.1.2 There should be disclosure of the principal bases and assumptions that underlie the valuation.

2.1.3 Sufficient information should be provided to enable the sensitivity of the valuation to key assumptions to be addressed. We agree with the Takeover Panel's view that it is not intended to provide sufficient information to enable a third party to recalculate the valuation using different assumptions.

The issues in Section 2.1 are discussed in Section 3 and in Annex A.

2.2 Policyholders

Since policyholders are not a party to a takeover transaction, we conclude that it is not necessary for actuarial information to be provided specifically for policyholders. This is discussed in more detail in Section 4.

2.3 *Guidance*

Although no new principles are involved, it seems to us desirable to pull together existing guidance and to explain its relevance in takeover situations. We recommend that the guidance should be published in the Members' Handbooks of the Institute of Actuaries and the Faculty of Actuaries. A draft Guidance Note appears as Annex A, (and the final version is now being issued).

3. Takeover Code and Implications

3.1 *Background*

To understand the role of the Takeover Panel, we studied those extracts from their Code which were most relevant to our study. The most significant seemed to us to be:

(a) General Principles 4, 5 and 6, concerning the importance of sufficient accurate and timely advice.
(b) Rule 3.1 Note 2, which explains what should be done where there is uncertainty in a significant element.
(c) Rule 3.1 Note 3, Rule 3.3, and Sections 1 and 2 of Appendix 3 of the Code which refer to conflicts of interest and directors' responsibilities. In the context of the actuaries' responsibilities, these are discussed in Section 3.6 of this report.
(d) Rule 19, dealing generally with standards of care and personal responsibility of directors.
(e) Rule 28.1, explaining the standard of care needed with respect to profit forecasts.
(f) Various references in Rules 28.2, 28.3 and possibly 28.6, 28.7 and 28.9 to assumptions and estimates.
(g) Rule 29, concerning the valuation of assets.

These rules are reproduced in Appendix IV. Readers should not assume that other rules are unimportant. In addition to meeting professional criteria a member must have regard to Takeover Code requirements. Notes on the legal requirement to verify facts provided under the Code are in Appendix VIII.

3.2 *General Observations*

3.2.1 It will come as no surprise that our studies have shown us how flexible the Code is. It has been developed over a long period to provide rules sufficiently general to cover an almost infinite range of different situations, and yet sufficiently specific to enable practitioners and the Panel to perform their respective functions. From time to time new ideas are developed for bidder and target and, if necessary, the Code is varied or extended.

3.2.2 It is very unusual for valuation of assets (Paragraph 29 of the Code) to relate to the whole of a company rather than to elements within it, e.g. property or contracts. In that context, it was necessary to decide whether an appraisal value was of the nature of a profit forecast, in which case projections beyond one year would not have been permitted, or simply a valuation. The conclusion reached and its implications are discussed in § 3.3.3, and did not suggest need for amendment of the Code.

3.3 *Accounting and Valuation*

3.3.1 It is common ground that the accounts of a life insurance company, prepared under Schedule 9A of the Companies Act 1985, have severe limitations. An E.C. Directive on insurance company accounts has recently been finalised, though discussions on its implementation are continuing through DTI consultative documents. Proposals from an ABI working party for a new accruals approach to accounting for shareholders' profits have been made, and a period of experimentation has begun. Accounting for life insurance companies is developing and is in a state of fluidity.

3.3.2 Actuaries have developed different ways to assess the economic value of a life insurance company which may be used as a base for a transaction price. Even with any new accounting requirements which may occur, there is no reason to assume that accounts, valuations or reports prepared for one purpose will automatically be suitable for another. Indeed, it may be wiser to anticipate that they will not.

3.3.3 It seems quite clear to us that the Panel does, as in our opinion it should, regard its acceptance of the use of appraisal values in the AMP/Pearl case as setting a precedent. No two cases are alike, and we believe that it would be appropriate for the Panel to adopt some flexibility in interpreting the AMP/Pearl precedent.

3.3.4 How a target decides to manage a defence against a bid is a matter for the Board of Directors and its advisers. If it is decided to publish a value for the company, an actuarial opinion letter will be needed and the terms of reference should be considered very carefully by the company and the actuary. For a full appraisal value the inclusion of figures for the amount of shareholders' assets and the value of in-force business may present relatively few problems, but the value to be placed on future business may be more subjective.

3.3.5 Alternatively, the company may prefer to present information about future business and let the market decide what is the appropriate value to be placed on this element without quoting a single figure itself.

3.3.6 If, however, accounting methods develop to an extent that published accounts can be used to provide an informed opinion on the value of a company, we would expect the Panel to require the use of that published data as it does for companies generally.

3.4 *Practical Implications of Involvement in a Takeover*

Involvement in a takeover will be unfamiliar to many actuaries. A contribution to the paper has been received from lawyers looking at the varying roles of actuaries in a takeover bid. This is contained in Annex B. Appendix III contains information about other interested parties. Appendix VII explains the role of the stockbroker in a takeover.

3.5 *The Takeover Panel*

3.5.1 We understand that the Panel, supported by its permanent staff, does not normally require expert advice in specialised fields to enable it to carry out its work. If the Panel needed special assistance from the profession it would no doubt seek it.

3.5.2 We believe the Panel has a close relationship with the Asset Valuation Committee of the Royal Institution of Chartered Surveyors to assist it in relation to property valuations. While it does not seem appropriate to replicate this arrangement, it may be helpful if the profession maintains a list of consulting firms with particular expertise in the valuation of insurance companies. This could be of assistance, not only to the Panel, but to others who become involved in a takeover or similar transaction.

3.6 *Conflicts and Independence*

3.6.1 It is as well to be aware that these terms—'conflicts' and 'independence'—can mean different things to different people. Without attempting to offer precise definitions, it may be helpful to indicate some differences between meanings in the Code and in general actuarial usage.

3.6.2 Under the Code 'conflicts of interest' must be avoided. Conflicts in this sense are matters of fact. Thus, any actuary who is a director must consider the interests of shareholders. Indeed, the duty to act in the best interest of shareholders is absolute. In our opinion this may place a director who is the Appointed Actuary in a position of conflict, but should not present difficulties for any other actuary on the Board. Since the Appointed Actuary has a duty aimed at protecting the interests of policyholders, there clearly may be conflict with the duty as a director in the sense of serving two masters. We do not, however, suggest that there should be a specific ruling. In some of the cases considered in our Addendum conflicts may well not exist. We do, however, recommend any Appointed Actuary in this position to consider the issue, to discuss it within the company and, if appropriate, seek professional guidance. If resolution is not reasonably straightforward it may be that, for the reasons set out in §4.1.2, the Appointed Actuary would feel in conflict in a wider sense, and conclude that it is wiser to take no part in the discussions as a director or to stand down from the Board temporarily. This latter course would ensure that there would be no possible criticism of the actuary on grounds of conflict.

3.6.3 Similarly, 'independence' has a more specific meaning under the Code. An actuary who is a director could not give an 'independent' valuation under the terms of the Code, but a firm which regularly advises the company probably could. Thus 'independent' does not mean truly independent of all parties (as is practised in Section 49 of the Insurance Companies' Act 1982). There could be other links between the firm and the company (e.g. a consultant being the Appointed Actuary), which would require discussion with the Panel executive.

3.6.4 Many companies retain consulting actuaries to be available should the need arise in a takeover. One can envisage a situation where the same consulting actuaries are currently advising two companies, one of whom then launches a bid for the other. We understand that the normal practice in such cases is for the firm to withdraw as adviser to the bidder, but to continue as adviser to the target. Where possible this seems to us to be desirable, but there is a real possibility that the bidder may object on the basis that the information known about it by the consulting firm could become available to and assist the target. This may make it necessary for the firm to limit the extent of its work for the target. If, by so limiting its work, the firm feels that the target may become unnecessarily vulnerable, it might have to decide to step aside and not be the lead actuarial adviser.

3.6.5 In different circumstances, different complications may arise. The Panel is always available to give advice. We formed the impression generally that the advisory role is a very important aspect of the work of the Panel executive. If a member is in any doubt, we recommend that he should contact the Panel executive in advance.

4. Policyholders

4.1 *General Observations*

4.1.1 A number of those we consulted were surprised at the extent of our concern about policyholders in our earlier consultative paper. After all, so the argument goes, a takeover is a matter for shareholders, and policyholders are not party to the transaction.

4.1.2 There are two reasons why we felt it necessary to consider the position of policyholders at some length. The first is that, as a profession, actuaries may be seen by the public as protecting their interests as policyholders—not particularly in a legal sense, but more in an almost moral sense. The second is that attention has been drawn to the contrast between takeovers and transfers of insurance business under Section 49 of the Insurance Companies' Act (ICA) 1982, where the position of policyholders is central. It was suggested that in both cases there was potential for the interests of policyholders to be affected.

4.2 *Interests of Policyholders*

4.2.1 While we did not regard it as necessary to study the obligations and powers of the DTI in depth, there are two areas that appear relevant: matters relating directly to ownership or control—broadly the 'fit and proper' areas—and matters relating to distributions to policyholders and shareholders. Only the second of these is directly relevant to actuaries.

4.2.2 However, it is not uncommon for consultants to be approached about a possible transaction at an early, preliminary stage. If this occurs, it is highly desirable that the consultant advises the client to enter into confidential discussions with the DTI (and possibly other regulators) as soon as practicable. Apart from being able to offer practical advice from its previous experiences on matters related to its functions, the DTI has to follow procedures laid down in statute, and it appears to us that the earlier they can be set in motion the more likely they can be completed in the time scale of a takeover.

4.2.3 In this regard it should be noted that the DTI has the statutory duty to consider the fitness and propriety of all the controllers (corporate and individual) and the directors and senior officers of insurance companies.

4.3 *Distribution to Policyholders and Shareholders*

Sections 29 and 30 of the ICA 1982 provide the statutory framework concerning transfers from the long-term business fund of an insurance company to the profit and loss account and the rules concerning distributions to policyholders. This framework applies equally to the existing management of a company and the new management put in by existing owners or by new owners (in the case of a takeover). In other words, the same protection applies in each case and, given the powers available to the Secretary of State for Trade and Industry, our view is that the position of policyholders is generally well protected. A greater concern would be if a bidder was unaware of the extent of that protection and offered a false price for a company based on unrealistic shareholder expectations. Provided, however, there has been close involvement of appropriate expert advice, which seems almost certain, the risk may be felt to be negligible.

4.4 *Conclusions on Policyholders' Issues*

The management of a life insurance company can act against or enhance the interests of policyholders within the constraints implicit in insurance company law—it does not require a change of ownership. Indeed, as far as we can see, there are no differences between changes that can be made in either case. This confirms, in a sense, that policyholders are not parties to the transaction of a takeover. A transfer under Section 49 substitutes a different entity as the insurer and may make other changes to policyholders' interests, and therefore the added protection of the court acting with independent advice is needed.

5. Advice to Actuaries

5.1 *General Observations*

5.1.1 In the course of our work we gave particular attention to roles performed by actuaries with the aim of assessing whether our existing professional code of conduct and Guidance Notes needed alteration or amplification to cover the particular circumstances of takeovers, especially when contested.

5.1.2 We believe that it is important for actuaries to be familiar with the relevant requirements of the Takeover Code where a quoted company is involved (without being experts). We would strongly recommend that any firm which acts in this field ensures that at least one person has a good working knowledge of that Code. Although a merchant bank may be in place already, this will not always be so, and in such a case the firm will need to be alert to the requirements of the Code and the risk that they might inadvertently be breached. It follows that the firm would be well advised to suggest to the company the involvement of a merchant bank at an early stage.

5.1.3 In today's world it is likely that any large company will have a team studying strategic issues, including the possibility of being a target or a bidder. In the case of a life insurance company, such a team will almost certainly include an actuary who should, therefore, be sure that he or she is aware of all the issues raised in this report. Some of the cases listed in the Addendum may involve quite small businesses, but it is clear that an actuary who is prepared for a possible transaction will be much more valuable than one to whom all the issues and pressures are new.

5.2 *Experience*

It is important that actuaries providing independent advice in a takeover situation have the relevant knowledge and experience to undertake such work. The Memorandum on Professional Conduct and Practice requires that actuaries should only act if they are satisfied that they are competent to do so, or are acting in co-operation with, or with the guidance of, an actuary with appropriate knowledge and experience.

5.3 *Disclosure*

5.3.1 It is important to be clear that, whichever side the actuary is advising, there will be pressures either to disclose publicly as little as possible or for very full disclosure (ostensibly to ensure full awareness of the issues at a possible cost of giving the other side ammunition).

5.3.2 We doubt whether it would be appropriate to try to be too specific in suggesting what, of an actuarial nature, should be disclosed, since every case is likely to be special in some respects. General Principles 4, 5 and 6 of the Takeover Code are all important. As implied in § 3.3.4, our understanding of the way these principles would apply to the particular circumstances of disclosure of an appraisal value is that it would require separate disclosure of its constituent parts, namely the shareholder's assets, the value of in-force business and the value placed on future business. In addition, the detailed assumptions underlying the valuation of the in-force business and the base profit figure and multiple used in calculating the value of future business should be stated. These requirements would need to be modified if a single value for future business was not being given. We understand the rationale to be that sufficient information should be disclosed for shareholders to see 'the vulnerabilities' to which the appraisal value would be open. It is not intended to provide sufficient information to enable a third party to re-calculate the appraisal value using different assumptions. The assumptions required and their degree of importance are described in Appendix VI.

5.3.3 Nevertheless, we thought it would be helpful to suggest what the actuary is likely to need to disclose to shareholders. Our suggestion is set out in §6.7 of Annex A, (and the final version is now being issued—see §2.3). In considering this matter, it is important to recognise that a suggested contents list included in any Guidance Note may become a benchmark against which future opinion letters will be compared. We see no objection to this, provided that the list is generally appropriate and does not become a standard to which actuaries will be required to adhere. There must be scope for varying the content and a duty to do so if the circumstances warrant it. Indeed, the content must match the terms of reference and that alone may enforce change (§3.3.4). Adhering to it should not be seen as an automatic and complete defence against criticism. Similarly departure from it, while it may require explanation, should not automatically attract criticism.

5.4 *Terminology*

5.4.1 There is a considerable lack of agreement on much of the terminology on this whole subject. Phrases like 'existing structure value', 'value of new business', 'value of the sales force' are likely to mean less to the outsider than would 'goodwill'. It is not surprising that such multiplicity of complex phrases makes the understanding of the concepts hard, and hence leads to scepticism about the value of the profession's contribution.

5.4.2 This is not a point peculiar to one topic, and we see no particular reason to attempt to classify the terminology in this one area. Rather we recommend that each of the main relevant standing joint committees should regularly (say once a year) identify new developments for which agreed terminology is needed or likely to be needed. Working parties could be set up to formulate proposals either on a temporary or permanent basis.

5.5 *Legal Liability*

The two lawyers whom we consulted included in their written response a note on legal liability with particular reference to the possible liability of actuaries. With their agreement we have included it as Annex B.

5.6 *Conclusions on Advice to Actuaries*

Our conclusion is that, while no formal changes are necessary to our existing professional code of conduct and Guidance Notes, it would be helpful to pull together in an advisory Guidance Note those elements of particular relevance in takeovers. A draft of such a Guidance Note appears as Annex A. We believe that this Note, after full review by appropriate committees, should be readily available to actuaries, both those who work in this field and more particularly those for whom the subject is unfamiliar. It is also important that it is kept under regular review, as both actuarial and accounting ideas develop. This points to the guidance being published in the Handbooks and, in the absence of an alternative system which would achieve the same effect, this is our recommendation—(see § 2.3).

ADDENDUM TO REPORT

A.1. Introduction

A.1.1 In § 1.2.2 it was stated that we had decided to concentrate initially on the takeover of a Stock Exchange listed life insurer, and we gave our reasons for so doing.

A.1.2 This Addendum gives the outcome of consideration by the working party of the circumstances relating to the remaining cases classified in Appendix II. We have attempted to identify any factors relevant to actuaries additional to those discussed in our report and have considered whether any additions to the suggested Guidance Note shown at Annex A might be appropriate.

A.1.3. For the purposes of this Addendum we have not felt it necessary to seek assistance from organisations or individuals outside the working party.

A.2. Summary

A.2.1 It is clear that the different cases referred to here have their own special features, but we suspect that the differences between transactions that could be classified under the same heading can be as great as the differences between cases. It follows that an actuary involved in any transaction needs to think carefully about the relevance of guidance and not to follow it blindly. Further, for cases where it is relevant, we cannot stress too strongly the benefit of discussion with the Takeover Panel executive and with other appropriate authorities and Regulators.

A.2.2 Our conclusion is that we have not identified any features that require us to modify or extend our suggested Guidance Note.

A.2.3 In addition we do not believe that GN1—'Actuaries and Long Term Insurance Business'—needs to be modified. We understand that a report by a working party on GN15—'Transfer of Long Term Business of an Authorised Insurance Company: Role of the Independent Actuary'—is due to be published shortly. We believe it to be unlikely that there will be any points relevant to our work which have not been considered by this working party.

A.3. Consideration of Cases where the Target Company is Proprietary

A.3.1 Case A1—the takeover of a Stock Exchange listed life insurer—was the subject of our main report.

A.3.2 Case A2 concerns the acquisition in whole or in part of the share capital of a non-listed company or subsidiary. These cases were not considered in detail, and the following sub paragraphs mainly cover that of a non-listed subsidiary. We believe, however, that the conclusion reached in § A.3.2.7 covers both cases.

A.3.2.1 The acquirer could be based in the U.K. or overseas, could be another life insurer (proprietary or mutual), but may not be. This kind of transaction might be at the instance of the selling party, in which case, using the terminology of Annex B, it is not likely to be 'hostile'. It would nevertheless be 'contested' if more than one potential purchaser was involved. Even if the initiative is from a possible purchaser, we think it unlikely that the matter can go very far without some meeting of minds, and hence is again unlikely to be 'hostile'.

A.3.2.2 The Takeover Code may apply if the deal is part of a more complex series of transactions or if the subsidiary was not 100% owned. In such cases our previous guidance would be relevant.

A.3.2.3 Either the company making the acquisition or (in the case of a subsidiary) the company making the disposal (or both companies) may be publicly quoted in the U.K. If so, the regulations governing the 'admission of securities to listing' operated by the London Stock Exchange and set out in what is known as 'the *Yellow Book*' determine the procedures in such circumstances. In particular, Section 6 of the *Yellow Book* describes how acquisitions and disposals are classified, what the requirements are for announcements and circulars and whether shareholders' approval is required. In broad terms, the acquisition or disposal is classified by comparing the size of the acquisition or disposal with the size of the listed company proposing to make it. The nature of the information that is required to be disclosed and whether shareholders' approval is required are governed by the classification. There might well be actuarial input to the information disclosed to shareholders.

A.3.2.4 If the Takeover Panel is not involved, the formal time scales applicable to such a case will not apply. Time pressures will be determined by the requirements of buyer and seller and that occasioned in seeking the necessary DTI approvals.

A.3.2.5 Further, there is likely to be a shared intention to complete a transaction and a willingness on the part of the seller to provide information. It may make available actuarial reports, in which case the actuary must ensure that, if such a report was prepared for a different purpose, then that fact is made clear to the purchaser. In particular, if the report contained assumptions which were reasonable for the original purpose, but may not be for the proposed transaction, the actuary should ensure this fact is not obscured.

A.3.2.6 In practice, the selling company may arrange for a firm of actuaries to prepare a detailed report setting out an actuarial valuation, often at more than one discount rate. Such a report may need to include comment on information on which the actuary has relied and in respect of which, therefore, warranties or indemnities may need to be sought. In addition to liability data, this may include such matters as quality of assets.

A.3.2.7 Therefore, while there may be some different features in this type of transaction compared to Case A1, we do not see any need for additional guidance.

A.3.3 Cases A3 and A4 concern the issue of new shares by an existing listed life insurer or a new listing.

A.3.3.1 As far as we are aware there are no formal requirements for disclosure of actuarial reports or summaries thereof. If there are, we have no reason to believe that our guidance would be inapplicable.

A.3.3.2 An actuary may well be asked to advise the company and, in particular, to provide an opinion as to value. In that case the format suggested in §6.7 of Annex A may be helpful.

A.3.4 Case A5 concerns the disposal in whole or in part of a subsidiary by a listed life insurer; the subsidiary could itself become Stock Exchange listed. This case could have many of the features of Case A2, discussed in Section A.3.2. We have not identified any new features or additional concerns for actuaries.

A.3.5 Case A6 concerns the takeover of a listed (or acquisition of a non-listed) non-insurance company where there is a subsidiary life insurer.

A.3.5.1 In general, points relevant to Case A1 may apply to a takeover of a listed company and to Case A2. However, the life subsidiary may represent only a small part of a large transaction. If so, it may not be a party to initial negotiations. Any actuary employed by, or advising, the life company should ensure, in particular, that the requirements of the DTI concerning change of control are noted as soon as possible.

A.3.5.2 If the life subsidiary is material to the transaction as a whole, and the parent is a listed company, it may be wise at an early stage to discuss with the Panel executive whether, and if so how, to incorporate a valuation of the life subsidiary into a sale price for the shares of the parent. We believe that the conclusion would depend so much on the facts of a particular case that a generalised comment could be unhelpful or misleading.

A.3.5.3 Similarly it might be necessary to depart to some extent from guidance concerning disclosure of assumptions, etc., depending on the significance of the life subsidiary to the whole transaction.

A.3.6 Case A7 concerns the mutualisation of a proprietary life insurer.

A.3.6.1 There are no recent examples of mutualisation in the U.K., and the information we have been able to obtain from actuaries involved several decades ago leads us to believe that circumstances are now very different. In particular, the main motivation at that time seems to have been a desire by the management of a proprietary company to prevent a possible takeover by an unwanted predator. For a listed company with a wide shareholding ownership, mutualisation for any such reason is unlikely to be considered.

A.3.6.2 If mutualisation were, in a particular case of a privately owned company, to be considered, the most likely mechanism would seem to be to set up a mutual under the Companies Act and to effect a Section 49 transfer. In our view, the alternative of seeking an amendment to an Act of Parliament (many of the existing mutuals are constituted by such an Act) is likely to be discouraged, given the pressures on Parliamentary time.

A.3.6.3 Although we see Case A7 as unlikely, we have identified some problem areas which we record for completeness. We see significant conflicts for the directors whose main duty is to the shareholders and who, therefore, may need to extract maximum value from the policyholders who will then become the owners of the business. In particular the shareholders, with their interest in the business as a whole (including future business), may have a different view of its value from the policyholders (whose financial interest in future business may be limited). We believe it would be essential for the directors of the company to organise and fund a policyholders' committee with access to its own independent actuarial advice to ensure that a fair price was negotiated and that the expectations of policyholders were maintained or improved.

A.4. Consideration of Cases where the Target Company is a Mutual

A.4.1 Three distinct cases were identified under this heading. Cases B1 and B2 both involve demutualisation: in B1 the shares becoming listed on the Stock Exchange; and in B2 the company becoming a wholly or partly owned subsidiary of another organisation which might or might not be a life insurer and could be U.K. or overseas based. Case B3 concerns a merger of mutuals.

A.4.2 We understand that there is a theoretical argument that certain transactions within the B cases could be arranged under the Companies Act. However, in the absence of precedent, it seems that the guidance of the Court would be needed to establish the procedure to adopt. It is probable that they would insist that the procedures of Section 49 of the Insurance Companies Act be followed, but, otherwise, their guidance would no doubt include matters relevant to the actuarial profession.

A.4.3 It follows that, in practice, cases are likely to be subject to Section 49 procedures. Thus there will be a High Court Hearing, and an Independent Actuary's Report will be available to the Court. GN15 provides the relevant guidance. A working party has been reviewing this and a report is expected shortly. This working party is aware of our work, and we understand that all relevant points will have been taken into consideration.

A.5. Special Cases

A.5.1 Case C1 concerns the purchase of a direct sales force, though not the insurance business, of one company by another. This case does not involve the business of an insurance company as a whole and is therefore not strictly our remit. There are, however, some aspects which have interested us and these are recorded below.

A.5.1.1 Central to the transaction is the definition of what is being transferred. In simple terms it is a sales force, i.e. a business with managers and sales staff. However, there may be uncertainty about the willingness of existing staff to stay under new control or about their suitability to the new owner. There are likely to be questions concerning reimbursement of financing loans for indemnity commissions which may be due for repayment if policies are discontinued.

A.5.1.2 It seems likely to us that the consideration for the transfer of a sales force is best met by stage payments so that price can reflect the value as it emerges over time. If not, the value of future business will need to reflect some of the risks associated with the future performance of the sales force. In either event actuarial advice is almost certainly needed, but we have not identified any new points.

A.5.1.3 In the case of stage payments there will be a need to set up and carry out a monitoring system against criteria. More generally, we would expect after any financial transaction covered by our report, whether it takes place or not, that a monitoring process be established. This may be particularly important if a bid fails.

A.5.1.4 A further matter which we debated concerns the actual payment or receipt of money for the transfer of a direct sales force. In the case of a mutual company the only source or beneficiary is the life fund, but in the case of a proprietary office it could be the shareholders' fund or it could be split. We did not attempt to reach a conclusion of general application.

A.5.2 Case C2 concerns the purchase or sale of a proprietary life insurer where the new or existing owner is the long-term business fund of another life insurer.

A.5.2.1 Many of the points relevant to this case are covered either in our report on Case A1 or in Section A.3.2 on Case A2. In particular, the policyholders in the company being transferred are protected by the DTI requirements in the same way as for any change of control. Having been notified about the change in control, the DTI can also consider the interests of the policyholders of the long-term business fund purchasing or selling the life company.

A.5.2.2 A new feature is that the life insurance company is (or will become) an investment of a long-term business fund, although the purpose of holding such an investment could be (or could have been) to extend the life business of the purchasing (or selling) company. The suitability, both in size and nature, of such an investment is a matter for the directors. However, the Appointed Actuary would have responsibility under GN1 Section 4.2(c) to consider the investments and Section 6.10 to advise the company on the appropriateness of the investments. *In extremis*, under Section 3.2 he would have a duty to inform the DTI that its ability to meet its required minimum solvency margin could be at risk. In the case of a sale, the Appointed Actuary might be concerned that the price was not unrealistically low, resulting in the reasonable expectations of the policyholders of the long-term fund being adversely affected.

A.5.2.3 In these circumstances, it does not seem that further comment by us is needed. It is not apparent to us that any modification of the guidance to Appointed Actuaries contained in GN1 is needed to cover this particular example of concentration of investment.

ANNEX A

DRAFT GUIDANCE NOTE

GNXX: LIFE INSURANCE TAKEOVERS

Classification (see APC)
This Guidance Note is classified in relation to the code of professional conduct as *advisory*.

Scope
United Kingdom.

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

Legislation or Authority
This Guidance Note is written to assist members. In some cases The City Code on Takeovers and Mergers—the Takeover Code—will apply.

Date of Issue
. . . . . .

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 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 and may require members to work under greater pressure than usual. 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. Members should ensure that they are familiar with the relevant parts of the Takeover Code. 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 executive.

1.4 The purpose of this Note is to assist all members 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 and Practice and to GN1: 'Actuaries and Long Term Business', as well as to the Takeover Code.

1.5 Members may wish to refer to 'Life Insurance Takeovers—A Report by a Working Party of the Institute of Actuaries and the Faculty of Actuaries' dated 15 October 1993 for further information on this subject.

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 addition the professional guidance requires an Appointed Actuary who is also a director to consider particularly carefully whether these two roles conflict.

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.

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 Guidance Committee.

3. Independence

3.1 As mentioned in Paragraph 13 of the Memorandum on Professional Conduct and Practice (the Memorandum), for a member in a particular situation to describe the advice he offers as independent, he must be free, and be seen to be free, of any influence which might affect his advice or limit his 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 somehow become available to and assist the target. By limiting its work in this way the firm may feel that the target may 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 members this could apply where a firm acts as consultant 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 they 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 cooperation and guidance of an actuary who does. Paragraph 15 of 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 When a takeover arises the Appointed Actuary should consider quickly whether he has the relevant knowledge and experience. If an external actuarial adviser is appointed the respective roles should be clarified as soon as possible.

4.3 As a matter of urgency an Appointed Actuary may need to follow the guidance in § 2.3 above and may also need to seek advice from the Government Actuary's Department (on behalf of the Department of Trade and Industry).

5. Relations with Other Parties

5.1 A takeover, particularly a contested takeover, is likely to cause differences of opinion between the parties and some of these may be made public. As covered in Paragraph 17 of the Memorandum, members should realise that there is room for such differences but must avoid any action which would unfairly injure the professional reputation of any other member.

6. Disclosure

6.1 It is important that members abide by Paragraph 11 of the Memorandum. A member must ensure that he 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, a member may provide advice to his client on a range of subjects and using alternative assumptions on a confidential basis but not intended for wider disclosure. In any advice which he provides which is intended to be communicated to shareholders he must ensure that it is appropriate for that purpose.

6.2 Paragraph 14 of the Memorandum covers the need for members 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. In particular in a report containing an actuarial valuation, all or part of which is to be transmitted to shareholders, the member should provide the information contained under §§6.7.5 and 6.7.8 below and in the suggested opinion letter in Paragraph 6.7. The underlying principle is to enable shareholders to see the extent to which the value could be sensitive to different assumptions and hence to make a decision concerning the offer, and thus the need to comment as covered in §6.7.9 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 opinion is usually sought to ensure 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 are reasonable. The Board 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. Members 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. 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. The actuary should not present a valuation for this purpose which contains assumptions which he or she is not satisfied are reasonable.

6.6 The actuary should consider sensitivity. That is he should consider 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 and it is a requirement that the shareholder be given enough information to form a view on 'vulnerabilities' to which the valuation is subject.

6.7 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. 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:

6.7.1 The name of the party instructing the actuary.

6.7.2 The terms of reference.

6.7.3 A statement of the data used.

6.7.4 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).

6.7.5 A statement of the principal bases and assumptions. These should include the detailed assumptions underlying both the value of the in-force business and the value of future business. Where base profit figures or multipliers are used in calculating the value of future business the detailed assumptions should be included. It is not the intention to provide sufficient information for a third party to recalculate the valuation.

6.7.6 A statement that the actuary believes the assumptions are reasonable.

6.7.7 A statement as to whether the value has been calculated in respect of a net investor or a gross investor.

6.7.8 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).

6.7.9 A statement concerning key assumptions, variation in which would result in significant changes in the value.

6.7.10 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

Members are reminded that, if they have any doubts about their position, competence or experience, they should seek advice from the Honorary Secretaries.

ANNEX B

MEMORANDUM BY FRESHFIELDS AND HERBERT SMITH

PART A: The Varying Roles of Actuaries in a Takeover Bid

1. Introduction

The roles of all advisers—banks, stockbrokers, solicitors and actuaries—differ markedly depending upon whether a bid is 'friendly' or 'hostile'. This is so in spite of the fact that the structure of each is identical. A takeover bid consists simply of an offer by Bidder ('Bidder') to the shareholders of Target ('Target') to acquire all, very occasionally some, of their shares in Target. The City Code requires that the Board of Directors of Target should seek independent financial advice on the merits of the offer and make this available to the Target shareholders. The offer may be of cash, or Bidder securities or a mixture of both.

The differences in the advisers' roles in hostile as opposed to friendly bids derive from the differences in the nature and extent of the dealings between the respective Boards and advisers. In a hostile offer there may have been nothing in the nature of a negotiation at all, or negotiations may have broken down. By contrast, in a 'friendly' bid, the process of negotiation may not be much different from that of a 'private company' acquisition. There may have been months of information exchange, 'due diligence' and price and structural discussions, all culminating in the same contractual structure as for a hostile offer, but this time with a recommendation from the Board of Target (and its financial advisers) that shareholders accept the offer.

There are, naturally, offers which fall somewhere between these two extremes. Not all 'recommended' offers are 'friendly', as for example where the Board of Target may prize its independence but where the price offered by Bidder is so generous that shareholders can only be advised to accept it. There is also a difference between a 'contested' offer and a 'hostile' one. It is not infrequent for an offeror that the Target Board would otherwise reject to outbid a friendly offeror. The Target Board seldom has any alternative in these circumstances but to let the two offerors fight it out.

In a hostile offer, therefore, Bidder and all its advisers will be working with less information about Target than it would like but will still have to persuade Target's shareholders to reject the advice of Target's Board. Bidder will inevitably criticise the past performance of Target and/or publicly doubt its ability to generate sufficient shareholder value in the future to justify a decision not to accept the offer (which will nearly always be at a significant premium to the previous quoted price). Target's Board, on the other hand, has to convince the shareholders that it possesses qualities or strategies which the market had not previously recognised. Emotions run high, and all advisers come under pressures which are absent in the context of a friendly takeover offer.

2. *Role of Appointed Actuary*

Where Target is a life insurer both Bidder and Target will require a firm of consulting actuaries to advise on the offer. For a number of reasons, it is unlikely to be appropriate for an employed Appointed Actuary alone to provide such advice. Target's Appointed Actuary will however, still play a significant role in the context of a takeover offer. Even if he or she is not a director of Target, with all the legal and regulatory responsibilities that this entails, the consulting actuaries will rely on the Appointed Actuary for much of the input to their work.

Where Bidder is itself a life insurer, its Appointed Actuary may have an even more extensive role, especially in connection with the pricing and financing of the offer, and its impact upon the reasonable expectations of Bidder's with profit policyholders.

3. *Role of Consulting Actuaries*

3.1 *Hostile offers*

In a hostile offer the role of the consulting actuary to Bidder will principally comprise:

(a) advice to Bidder, based on published information, on the value of Target, and on the impact on that value of any strategic plan which Bidder might have devised. This would include what has come to be known as 'due diligence', ie an investigation and report on any particular risks or weaknesses in the position of Target, so far as is apparent from published sources;
(b) assistance in the preparation of offer documents and circulars to Target shareholders, including assistance in the verification of these documents and in critically evaluating any actuarial information published by the other camp during the course of the offer; and
(c) occasionally, if Bidder is itself a life insurer (or owns one) and is offering its own securities, the publication of an actuarial appraisal valuation of the life insurance business or of a report on any actuarial elements of a profit forecast in respect of that business.

So far as (b) is concerned it is perhaps worth pointing out that although there is nothing in the City Code or any other regulation or law to suggest that the contents or tone of a 'hostile' offer document should be any different from those of a 'friendly' offer document, the difference is in practice substantial. In the latter case the document rarely has to work very hard: shareholders will generally follow their Board's advice to accept the offer and will not need to be persuaded by strong statements in an offer document.

In a hostile offer, on the other hand, the primary means by which Bidder and Target communicate with the Target shareholders is through offer and 'defence' documentation. Each will contain strongly worded material. The information in the offer or defence documents will then form the basis for press and analyst presentations, meetings with Target's institutional shareholders and shareholder 'help-lines'. The risk of inaccurate or misleading statements occurring is significant—the time pressure is often acute and statements are based on published information alone—and the consequences of a mistake are serious. Each side will therefore go to great lengths to ensure that every such document is carefully 'verified', and the consulting actuaries will play an important part in this process.

The consulting actuaries to Target will fulfil two principal roles:

(a) as outlined above, they will be involved in preparing and verifying the defence documents, which will rebut criticism of Target in the Bidder documentation, explain to Target shareholders why their shares are intrinsically worth more than Bidder is offering and, even where Bidder is offering only cash, criticise Bidder; and
(b) it will almost invariably be the case that at some stage the defence will wish to publish a short-form actuarial appraisal valuation of Target by its consulting actuaries and/or some form of profit or dividend forecast, aspects of which may require to be reported on publicly by its consulting actuaries.

It is implicit in all this that in a hostile offer, the consulting actuaries on each side are in open and, possibly, public disagreement. The merchant banks will expect the consulting actuaries to fulfil a forensic role, identifying damaging items of information about the opposition. Occasionally the bitterness of the fight and the significance of the actuarial issues will be such that the merchant banks involved—who have the highest public profiles of any of the advisers—will appoint their own actuarial advisers.

3.2 *Friendly offers*

In a friendly offer the two firms of consulting actuaries may well be put in touch with each other, so that each may perform any actuarial 'due diligence' on their respective clients. A 'long-form' actuarial appraisal valuation of Target will probably be prepared by one or other of the firms, based perhaps on mutually agreed business plans, and its contents discussed openly between the firms and their clients.

Where there is perceived to be a risk of a competing offer there is sometimes a reluctance to disclose information. This is because information disclosed to one potential offeror must be disclosed to others (if they ask for specified items of information which had been disclosed to the favoured bidder). Otherwise the relationship between the two companies and firms may be very similar to that which arises in a private transaction.

Once the valuation exercise and price negotiations are completed, both firms will then have some involvement in the preparation of the offer document, which in a friendly offer will be a single document incorporating letters on behalf of both companies to the shareholders of Target, urging acceptance, which may contain a short form appraisal valuation by Target's consulting actuaries. It bears little resemblance in tone to its 'hostile' equivalent.

PART B: Legal Liabilities of Actuaries in a Takeover Bid

This section summarises in general terms complex provisions of statute and common law. It should be read with this fact in mind and is not a substitute for specific legal advice.

4. *Criminal Liability*

An actuary may commit one or more criminal offences in the context of a takeover bid if his advice is either reckless or fraudulent. 'Recklessness' is more than mere carelessness. For faulty advice to be reckless it must have been given either with knowledge that (for whatever reason) it had insufficient basis, or without even considering whether it was adequately based. Fraud probably requires no further explanation. Penalties depend upon the precise nature of the charge but could include both imprisonment and a fine.

5. *Civil Liability: Consulting Actuaries*

5.1 *What might the actuary be liable for?*

The actuary may incur civil liability if his advice is fraudulent or reckless (as to which see above). He may also incur liability if he is negligent. There are a variety of statutory and common law heads of liability, but these are unlikely to be relevant unless he has been fraudulent, reckless or negligent.

He will be held negligent if his work is faulty because he has failed to exercise the skill and care which is reasonably to be expected from him in carrying out his duties; and, probably, the greater the expertise and experience which he claims to possess, the higher the standards which will be expected of him.

5.2 *Who might he be liable to?*

He would incur this liability to his client (as a matter of contract, at the least) and to anybody else whose position in relation to him is such that the law requires that he should owe to that person, as well as to his client, a duty of care.

There is great uncertainty as to how broad this category of potential non-client claimants might be. In the *Caparo Industries* and subsequent cases the courts have shown great reluctance in this context to extend the categories of claimant in cases of negligence giving rise solely to economic loss, but it is difficult to draw general conclusions from the court's reasoning on a particular set of facts. However, the recent decisions in the context of takeover offers do suggest that:

(a) the consulting actuaries to Target might, if negligent, be liable not only to Target but also to Target's shareholders and, in certain circumstances, (where for example Bidder has increased its offer relying on the actuaries' valuation) to Bidder; and
(b) the consulting actuaries to Bidder might, if negligent, be liable to Bidder or to Bidder's shareholders (where shareholder approval is required for the offer to proceed) and, just possibly, to Target's shareholders;

(c) if one of the other advisers has been held liable for advice given which was affected by the consulting actuaries' negligence, the adviser may be entitled to a right of contribution.

The risk increases with the consulting actuaries' profile in the transaction. There is little doubt that Target's consulting actuary will be potentially liable to Target's shareholders and, possibly, to Bidder in relation to any formal opinion which he gives and which is published in a defence document. Bidder's consulting actuary, on the other hand, may not be identifiable from the offer documentation; if a statement in that document is wrong and was negligently verified by him a claimant may be in some difficulty showing the necessary degree of reliance on the actuary's work. However, Bidder and its financial advisers (other likely defendants) may still have claims for contribution.

It is therefore important to appreciate in the context of a takeover that, although advice and opinions included in a takeover document may be formally addressed to the client and, possibly, the client's financial advisers, they are included in order to influence the recipients of that document in making a decision whether, for example, to sell or not to sell shares in Target. The law may require that the consulting actuary accordingly accept a responsibility to a much wider class of potential claimant than the formal addressees of his advice.

5.3 *For what amount is the actuary liable?*

The amount for which the actuary may be liable can only be described in broad conceptual terms. There are differences between the measure of damages where the client is the claimant and that which applies to non-client claims. In essence, however, the court will identify the loss suffered by the claimant which is a foreseeable consequence of the actuary's negligence, quantify it as a money amount and (subject to the application of certain limiting factors which may apply in certain circumstances) that is what will be paid, possibly with some amount in respect of interest. The aim is to compensate the claimant and not to penalise the defendant.

5.4 *Who decides whether the actuary is liable and how?*

Any claim for damages will be made (in England) in the High Court, but claims may well have been preceded by enquiries by the Stock Exchange, Takeover Panel or, in very serious cases, DTI Inspectors. Views expressed by any of these may well be significant in subsequent court proceedings.

The question whether a duty of care was owed to the claimant in question is a matter of law, for the judge to determine. The question whether the actuary failed to meet the standard of care imposed upon him is a matter of fact, on which the court will rely principally on expert evidence from fellow members of the actuarial profession. Once it is established, for example, that the advice was wrong, that the conclusions were mistaken, the actuary will have in effect to establish that it is unlikely that his fellow professionals would have done any better in the circumstances.

5.5 *Is there anything which the actuary can do (apart from insurance) to limit his exposure?*

He can, within limits, protect himself from claims by his client with a specific agreement, limiting or excluding his liability in specified circumstances or generally. It is not uncommon in the context of takeover offers for merchant banks (for example) to obtain engagement letters from their clients which contain indemnities (designed to provide some protection against third party claims) and exclusion clauses.

However, it is almost invariably the case that liability for 'negligence or wilful default' will be excluded from any such indemnity and exclusion clause. In effect the indemnity may therefore only protect against the costs of successfully defending a claim for negligence. Furthermore, the agreement with the client will not necessarily affect liability to any third party to whom the courts decide the actuary owes a duty of care.

It is however open to the actuary (although this would be most unusual, and likely to be strongly resisted by the client), in relation to any document in whose preparation he has played a part, to insist on the inclusion of an express disclaimer or exclusion clause on his behalf.

6. *Civil Liability: Appointed (and other employed) Actuaries*

So far as Appointed (and employed) Actuaries are concerned, it is doubtful whether as a matter of law their position changes (in terms of to whom they may incur liability and for what) in the context of a takeover, although the risks of liability will increase owing to the increased demands that will be made of them.

7. *Foreign Jurisdictions*

Finally, there will be occasions where U.K. professional advisers will have to beware of incurring liability in other jurisdictions, especially the United States, where the costs and exposure involved are very much greater.

22nd October 1992

Philip Richards
Freshfields

Marian Pell
Herbert Smith

APPENDIX I

THE TERMS OF REFERENCE AND WORK PROGRAMME OF THE WORKING PARTY

I.1. The Terms of Reference

The terms of reference were:

(1) To establish what actuarial information the financial world needs for the proper evaluation of a bid for a quoted insurance company.
(2) In the light of these findings, to consider what guidance to members may be required.

It was decided to concentrate initially on the takeover of a Stock Exchange listed life insurer for the reasons set out in § 1.2.2, and the early discussions were largely limited to the issues emerging from the AMP/Pearl case.

I.2 The Work Programme

I.2.1 One of the first tasks was to classify all the possible types of takeover which might arise, and then to decide on an order of priorities (see Appendix II). The range of different cases is wide and covers everything from the takeover of a Stock Exchange listed life insurer through to demutualisations and mergers between mutuals. The common theme is that all the cases will or may require actuarial input as regards the value of the business in question.

I.2.2 We prepared a list of what we have called interested parties and users of actuarial advice, together with a note on who does what and when (see Appendix III). We attempted to prioritise the list and the note by indicating the degree of likelihood of actuarial advice being used. Thus we see the directors of bidder and target company, the merchant banks and, amongst 'commentators', credit rating companies as probable users. Possible users include 'pressure groups'—policyholders, shareholders or current or former employees—the Takeover Panel and stockbrokers in their research and information capacity.

I.2.3 In discussion with some of those listed in § 1.2.1 it became clear that the reason for our consideration of the interests of policyholders was unclear, and therefore their inclusion in our list as possible users seemed strange. We revert to this in Section 4 . It was also suggested that the DTI's interest was rather different from the other parties in the list, as was that of the Government Actuary's Department, to whom it would look for any actuarial advice it might need in performing its special role.

I.2.4 To understand the role of the Takeover Panel we studied certain extracts from the Code which seemed most relevant to our study.

I.2.5 This study was aided by a note that we have regarded as confidential from an actuary who advised the Panel on certain matters in the AMP/Pearl case.

I.2.6 We noted that the Code (Rule 28.3(c) for example) makes specific reference to income from land and buildings. A paper based on discussions with property share analysts explored any similarities between valuations of property companies and life companies. It was an interesting comparison, but did not yield particularly valuable insights.

I.2.7 Other work included:

I.2.7.1 An analysis of the points emerging from the Salmon & Fine paper and the discussion on it which, to a large extent, provided the agenda for our considerations of substance (see Appendix V).

I.2.7.2 A note on the actuarial assumptions required to produce embedded and appraisal values, together with comments on the degree of importance of particular assumptions for different classes of business (see Appendix VI).

I.2.7.3 Notes on the role of stockbrokers as commentators (see Appendix VII).

I.2.7.4 A note on the verification process as it might apply to actuaries involved in a takeover (see Appendix VIII).

APPENDIX II

LIFE INSURANCE TAKEOVERS WORKING PARTY CLASSIFICATION OF CASES

Notes:

1. In all cases the target company is assumed to be U.K.-based.
2. The term 'life insurer' as used below includes composite companies or groups of companies.

Group A—Cases where the Target Company is Proprietary

A1: *Takeover of a Stock Exchange listed life insurer:*
- —could be hostile or friendly,
- —predator could be U.K.-based or overseas,
- —predator could be a non-insurance organisation, or could be another life insurer (either proprietary or mutual),
- —target could be fully-listed or 'USM listed'.

A2: *Acquisition of share capital of a non-listed subsidiary or a non-listed company:*
- —could acquire part of capital or 100% for full control,
- —acquiror could be U.K.-based or overseas,
- —acquiror could be another life insurer (either proprietary or mutual).

A3: *Issue of new shares by an existing listed life insurer:*
- —rights issue,
- —private placing.

A4: *New listing on Stock Exchange for a previously unlisted life insurer:*
- —full listing,
- —'USM listing'.

A5: *Disposal of a subsidiary by a listed life insurer:*
- —could be full disposal or partial disposal,
- —subsidiary could itself become Stock Exchange listed.

A6: *Takeover or acquisition of a non-insurance company where there is a subsidiary life insurer:*
- —if a takeover of a Stock Exchange listed company, points given under case A1 apply,
- —if an acquisition of a non-listed company, points given under case A2 apply.

A7: *Mutualisation of a proprietary life insurer:*
—life insurer could be Stock Exchange listed or a wholly-owned subsidiary.

Group B—Cases where the Target Company is Mutual

Note:
For this group the target mutual could alternatively be a friendly society.

B1: *Demutualisation, with shares offered to policyholders and general public, and being listed on the Stock Exchange.*

B2: *Demutualisation, with the new company becoming a wholly-owned subsidiary of another organisation:*
—new parent could be U.K.-based or overseas,
—new parent could be another life insurer.

B3: *Merger with another mutual:*
—combined organisation could continue as a mutual or could subsequently demutualise,
—one of the mutuals involved could be overseas.

Group C—Miscellaneous Special Cases

C1: *Transfer of a direct salesforce from one life insurer to another:*
—either party could be proprietary or mutual.

C2: *Acquisition/Disposal of a proprietary life insurer, where the new/existing owner is the long-term business fund of another insurer:*
—fund in question could be proprietary or mutual,
—if mutual, an acquisition then falls under cases A1/A2,
—particularly complicated if long-term business fund has with-profits business.

Examples

A1: Takeover of Pearl by AMP,
Takeover of Eagle Star by BAT,
Takeover of Equity & Law by Compagnie du Midi,
Takeover of Provident Life by Winterthur.

A2: Acquisition of Target Life by TSB,
Acquisition of Black Horse Life by Lloyd's Abbey Life,
Acquisition of Gresham Life by Windsor Life,
Acquisition of Crusader by Britannia Life,
(plus many others).

A3: London & Manchester, Prudential. $\left.\begin{matrix}\text{}\\ \text{}\end{matrix}\right\}\left\{\begin{matrix}\text{in 1980s to}\\ \text{finance acquisitions}\end{matrix}\right\}$

A4: Hambro Life,
Abbey Life (floated by ITT).

A5: Sale of Victory by L&G.

A6: Acquisition of Midland Bank (and therefore Midland Life) by Hong Kong and Shanghai Bank.

A7: Mutualisation of Clerical Medical,
Mutualisation of Scottish Life.

B1: UNUM (U.S. case),
(no U.K. case?).

B2: FS Assurance/Britannia Building Society,
Pioneer Mutual/Swiss Life,
Scottish Mutual/Abbey National.

B3: London Life/AMP,
UKPI/Friends Provident.

C1: Sale of the Target Life direct salesforce to Equity & Law.

C2: Disposal of controlling interest in NELPHI by NEL's with-profits long-term business fund.

APPENDIX III

OTHER INTERESTED PARTIES

III.1. General Observations

There are a number of interested parties who may or do use actuarial advice. Some of these require little comment here. As explained in §I.2.3, for example, the DTI can be assumed to have available all the advice it needs via the Government Actuary's Department. Similarly, life insurance companies must have Appointed Actuaries (who may be directors, employees or consultants). That does not preclude them wanting additional or independent advice, but further consideration of that issue comes later in this document. Brief comments on other users may be appropriate.

III.2. Interested Parties and Users of Actuarial Advice

(A) Policyholders*

(B) Shareholders*

(C) Directors†

(D) Appointed Actuary*

(E) Employees, Unions, Pensioners, Pension Trustees*

(F) Regulators:
- —GAD
- —DTI†
- —SIB/LAUTRO/IMRO
- —Office of Fair Trading
- —Monopolies and Mergers Commission
- —Stock Exchange
- —The Takeover Panel*
- —Other U.K. Regulators (e.g. Bank of England)
- —Overseas Regulators*
- —The Courts (relating to S49 merger)†

(G) Professional Advisers:
- —Merchant Bank†
- —Stockbroker acting for the Parties
- —Consulting Actuaries

—Solicitors
—Accountants
—Public Relations Advisers
—Property Valuers

(H) Commentators:
—Stockbrokers*
—Press
—Credit Rating Companies†

(I) Intermediaries*

(J) Financiers:
—Bankers
—Venture Capitalists

(K) Parliament*

*Possible users of actuarial advice
†Probable users of actuarial advice.

III.3. Merchant Banks

III.3.1 In a takeover the two companies involved are advised by their merchant banks, who are at the heart of the action. As such each will be thoroughly familiar with the Code. Each will usually have an existing relationship with the company and know it well. The company (certainly if a life company) will usually have its own actuarial advisers in place.

III.3.2 The necessary actuarial experience appears to us to be readily available and known to the merchant banks, who may advise the companies accordingly where no existing relationships exist.

III.4. Stockbrokers as Advisers and Commentators

III.4.1 Stockbrokers to a company involved in a takeover form part of a team, and as such have available to them actuarial advice. They cannot, of course, comment on a proposed transaction to which their client is a party.

III.4.2 The material supplied by stockbrokers who are acting as commentators to shareholders of a target company of whatever type may provide the only source of advice to shareholders, other than the documents from the boards of the two companies, which may be lengthy and complicated. The stockbroker's advice is likely to be expressed in relatively simple terms and to be highly influential at least for the private investor.

III.4.3 Given the current unsuitable nature of published accounting information for takeover purposes, it seems to us that those who provide actuarial advice to stockbrokers (and through them financial journalists) bear a particularly onerous obligation to provide expert advice and recommendations.

III.5. Credit Rating Agencies

Insurance companies receive credit ratings in respect of both their claims paying ability and their ability to service and repay debt. In the U.S.A., credit rating agencies employ their own actuaries (both life and property/casualty). In the U.K., the use of actuarial advice appears to be on an occasional and informal basis at present.

In the course of a takeover, it is common for both companies to be placed on 'credit watch', as an indication that their rating is under review.

The provision of actuarial advice to credit rating agencies during the course of a takeover appears, therefore, to be a potential issue, but not a significant one at present.

APPENDIX IV

EXTRACTS FROM TAKEOVER CODE (4th Edition July 1993)

Introduction

It is impracticable to devise rules in sufficient detail to cover all circumstances which can arise in offers. Accordingly, persons engaged in offers should be aware that the spirit as well as the precise wording of the General Principles and the ensuing Rules must be observed. Moreover, the General Principles and the spirit of the Code will apply in areas or circumstances not explicitly covered by any Rule.

While the boards of an offeror and the offeree company and their respective advisers have a duty to act in the best interests of their respective shareholders, these General Principles and the ensuing Rules will, inevitably, impinge on the freedom of action of boards and persons involved in offers; they must, therefore, accept that there are limitations in connection with offers on the manner in which the pursuit of those interests can be carried out.

Each director of an offeror and of the offeree company has a responsibility to ensure, so far as he is reasonably able, that the Code is complied with in the conduct of an offer (see Appendix 3 for Guidance Note). Financial advisers have a particular responsibility to comply with the Code and to ensure, so far as they are reasonably able, that an offeror and the offeree company, and their respective directors, are aware of their responsibilities under the Code and will comply with them. Financial advisers should ensure that the Panel is consulted whenever relevant and should co-operate fully with any enquiries made by the Panel. Financial advisers must also be mindful of conflicts of interest (see Appendix 3 for Guidance Note).

General Principles

1. All shareholders of the same class of an offeree company must be treated similarly by an offeror.
2. During the course of an offer, or when an offer is in contemplation, neither an offeror, nor the offeree company, nor any of their respective advisers may furnish information to some shareholders which is not made available to all shareholders. This principle does not apply to the furnishing of information in confidence by the offeree company to a bona fide potential offeror or vice versa.
3. An offeror should only announce an offer after the most careful and responsible consideration. Such an announcement should be made only when the offeror has every reason to believe that it can and will continue to be able to implement the offer: responsibility in this connection also rests on the financial adviser to the offeror.
4. Shareholders must be given sufficient information and advice to enable them to reach a properly informed decision and must have sufficient time to do so. No relevant information should be withheld from them.

5. Any document or advertisement addressed to shareholders containing information or advice from an offeror or the board of the offeree company or their respective advisers must, as is the case with a prospectus, be prepared with the highest standards of care and accuracy.

6. All parties to an offer must use every endeavour to prevent the creation of a false market in the securities of an offeror or the offeree company. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market.

7. At no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits.

8. Rights of control must be exercised in good faith and the oppression of a minority is wholly unacceptable.

9. Directors of an offeror and the offeree company must always, in advising their shareholders, act only in their capacity as directors and not have regard to their personal or family shareholdings or to their personal relationships with the companies. It is the shareholders' interests taken as a whole, together with those of employees and creditors, which should be considered when the directors are giving advice to shareholders. Directors of the offeree company should give careful consideration before they enter into any commitment with an offeror (or anyone else) which would restrict their freedom to advise their shareholders in the future. Such commitments may give rise to conflicts of interest or result in a breach of the directors' fiduciary duties.

10. Where control of a company is acquired by a person, or persons acting in concert, a general offer to all other shareholders is normally required; a similar obligation may arise if control is consolidated. Where an acquisition is contemplated as a result of which a person may incur such an obligation, he must, before making the acquisition, ensure that he can and will continue to be able to implement such an offer.

3.1 Board of the Offeree Company

The board of the offeree company must obtain competent independent advice on any offer and the substance of such advice must be made known to its shareholders.

NOTES ON RULE 3.1

1. *Management buy-outs and offers by controlling shareholders*

The requirement for competent independent advice is of particular importance in cases where the offer is a management buy-out or similar transaction or is being made by the existing controlling shareholder or group of shareholders. In such cases, it is particularly important that the independence of the adviser is beyond question. Furthermore, the responsibility borne by the adviser is considerable and, for this reason, the board of the offeree company or potential offeree company should appoint an independent adviser as soon as possible after it becomes aware of the possibility that an offer may be made.

2. *When there is uncertainty about financial information*
When there is a significant area of uncertainty in the most recently published accounts or interim figures of the offeree company (e.g. a qualified audit report, a material provision or contingent liability or doubt over the real value of a substantial asset, including a subsidiary company), the board and the independent adviser should highlight the factors which they consider important.

3. *When no recommendation is given*
When the board or the independent adviser is unable to form a view on the merits of an offer or to give a firm recommendation to shareholders, they should set out fully the arguments for acceptance and rejection, emphasising the important factors.

3.2 Board of an Offeror Company

The board of an offeror must obtain competent independent advice on any offer when the offer being made is a reverse takeover or when the directors are faced with a conflict of interest. The substance of such advice must be made known to its shareholders.

NOTES ON RULE 3.2

1. *General*
When the board of an offeror is required to obtain competent independent advice, it should do so before announcing an offer or any revised offer: such advice should be as to whether or not the making of the offer is in the interests of the company's shareholders. Shareholders must have sufficient time to consider advice given to them prior to any general meeting held to implement the proposed offer. Any documents or advertisements issued by the board in such cases must include a responsibility statement by the directors as set out in Rule 19.2.

2. *Reverse takeovers*
A transaction will be a reverse takeover if an offeror might as a result need to increase its existing issued voting equity share capital by more than 100%.

3. *Conflicts of interest*
A conflict of interest will exist, for instance, when there are significant cross-shareholdings between an offeror and the offeree company, when there are a number of directors common to both companies or when a person is a substantial shareholder in both companies.

3.3 Disqualified Advisers

The Panel will not regard as an appropriate person to give independent advice a person who is in the same group as the financial or other professional adviser (including a stockbroker) to an offeror or who has a significant interest in or financial connection with either an offeror or the offeree company of such a kind as to create a conflict of interest (see also Appendix 3).

NOTE ON RULE 3.3

Investment trusts

A person who manages or is part of the same group as the investment manager of an investment trust company will not normally be regarded as an appropriate person to give independent advice in relation to that company.

SECTION I. CONDUCT DURING THE OFFER

RULE 19. INFORMATION

19.1 Standards of Care

Each document or advertisement issued, or statement made, during the course of an offer must, as is the case with a prospectus, satisfy the highest standards of accuracy and the information given must be adequately and fairly presented. This applies whether it is issued by the company direct or by an adviser on its behalf.

NOTES ON RULE 19.1

1. *Financial advisers' responsibility for release of information*

The Panel regards financial advisers as being responsible to the Panel for guiding their clients and any relevant public relations advisers with regard to any information released during the course of an offer.

Advisers must ensure at an early stage that directors and officials of companies are warned that they must consider carefully the Code implications of what they say, particularly when giving interviews to, or taking part in discussions with, the media. It is very difficult after publication to alter an impression given or a view or remark attributed to a particular person. Control of any possible abuse lies largely with the person being interviewed. In appropriate circumstances, the Panel will require a statement of retraction. Particular areas of sensitivity on which comment must be avoided include future profits and prospects, asset values and the likelihood of the revision of an offer (see also Note 2 on Rule 20.1).

2. *Unambiguous language*

The language used in documents, releases or advertisements must clearly and concisely reflect the position being described. In particular, the word 'agreement' must be used with the greatest care. Statements must be avoided which may give the impression that persons have committed themselves to certain courses of action (e.g. accepting in respect of their own shares) when they have not in fact done so.

3. *Sources*
The source for any fact which is material to an argument must be clearly stated, including sufficient detail to enable the significance of the fact to be assessed; however, if the information has been included in a document previously sent to shareholders, an appropriate cross reference may be made.

4. *Quotations*
A quotation (e.g. from a newspaper or a stockbroker's circular) must not be used out of context and details of the origin must be included.
Since quotations will necessarily carry the implication that the comments quoted are endorsed by the board, such comments must not be quoted unless the board is prepared, where appropriate, to corroborate or substantiate them and the directors' responsibility statement is included.

5. *Diagrams, etc.*
Pictorial representations, charts, graphs and diagrams must be presented without distortion and, when relevant, must be to scale.

6. *Use of television, videos, audio tapes, etc.*
If any of these are to be used, even when they do not constitute advertisements (see Rule 19.4), the Panel must be consulted in advance.

7. *Section 47 of the Financial Services Act 1986*
Persons involved in offers should note that Section 47 of the Financial Services Act 1986 may be relevant.

19.2 Responsibility

(a) Each document issued to shareholders or advertisement published in connection with an offer must state that the directors of the offeror and/or, where appropriate, the offeree company accept responsibility for the information contained in the document or advertisement and that, to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case), the information contained in the document or advertisement is in accordance with the facts and, where appropriate, that it does not omit anything likely to affect the import of such information. This Rule does not apply to advertisements falling within paragraphs (i), (ii) or (viii) of Rule 19.4 and advertisements which only contain information already published in a circular which included the statement required by this Rule.

(b) If it is proposed that any director should be excluded from such a statement, the Panel's consent is required. Such consent is given only in exceptional circumstances and in such cases the omission and the reasons for it must be stated in the document or advertisement.

NOTES ON RULE 19.2

1. *Delegation of responsibility*

Offeror and offeree company boards must have regard to the introduction to the General Principles and to Section 1 of Appendix 3.

If detailed supervision of any document or advertisement has been delegated to a committee of the board, each of the remaining directors of the company must reasonably believe that the persons to whom supervision has been delegated are competent to carry it out and must have disclosed to the committee all relevant facts directly relating to himself (including his close relatives and related trusts) and all other relevant facts known to him and relevant opinions held by him which, to the best of his knowledge and belief, either are not known to any member of the committee or, in the absence of his specifically drawing attention thereto, are unlikely to be considered by the committee during the preparation of the document or advertisement. This does not, however, override the requirements of 'Admission of Securities to Listing' relating to the acceptance of responsiblity for listing particulars where applicable.

2. *Expressions of opinion*

The responsibility statement is regarded by the Panel as embracing expressions of opinion in the document or advertisement.

3. *Quoting information about another company*

Where a company issues a document or advertisement containing information about another company which makes it clear that such information has been compiled from published sources, the directors of the company issuing the document or advertisement need, as regards the information so compiled, only take responsibility for the correctness and fairness of its reproduction or presentation. The responsibility statement may be amended accordingly, but where it relates to listing particulars the provisions of 'Admission of Securities to Listing' may affect the position. Where statements of opinion or conclusions concerning another company or unpublished information originating from another company are included, these must normally be covered by a responsibility statement by the directors of the company issuing the document or advertisement or by the directors of the other company; the qualified form of responsibility statement provided for in this Note is not acceptable in such instances.

4. *Responsibility for part of listing particulars*

Where, for the purpose of obtaining listing for new securities, persons other than the directors accept responsibility for part of a document which comprises or includes listing particulars, the Panel should be consulted. The adapted form of responsibility statement required by 'Admission of Securities to Listing' will normally be acceptable in such cases.

5. *Exclusion of directors*

Although the Panel may be willing to consider the exclusion of a director from the responsibility statement in appropriate circumstances, where that statement relates to listing particulars the provisions of 'Admission of Securities to Listing' may affect the position.

6. *When an offeror is controlled*

If the offeror is controlled, directly or indirectly, by another person or group, the Panel will normally require that, in addition to the directors of the offeror, other persons (e.g. directors of an ultimate parent) take responsibility for documents or advertisements issued by or on behalf of the offeror. In such circumstances, the panel must be consulted.

SECTION K. PROFIT FORECASTS

RULE 28

28.1 Standards of Care

There are obvious hazards attached to the forecasting of profits; this should in no way detract from the necessity of maintaining the highest standards of accuracy and fair presentation in all communications to shareholders in an offer. A profit forecast must be compiled with scrupulous care and objectivity by the directors, whose sole responsibility it is; the financial advisers must satisfy themselves that the forecast has been prepared in this manner by the directors.

NOTE ON RULE 28.1

Existing forecasts

At the outset, an adviser should invariably check whether or not his client has a forecast on the record so that the procedures required by Rule 28.6(b) can be set in train with a minimum of delay.

28.2 The Assumptions

(a) When a profit forecast appears in any document addressed to shareholders in connection with an offer, the assumptions, including the commercial assumptions, upon which the directors have based their profit forecast, must be stated in the document.

(b) When, after an offer document has been posted, a profit forecast is given in a press announcement, any assumptions on which the forecast is based should be included in the announcement.

NOTES ON RULE 28.2

1. *Requirement to state the assumptions*

(a) It is important that by listing the assumptions on which the forecast is based useful information should be given to shareholders to help them in forming a view as to the reasonableness and reliability of the forecast. This should draw the shareholders' attention to, and where possibly quantify, those uncertain factors which could materially disturb the ultimate achievement of the forecast.

(b) There are inevitable limitations on the accuracy of some forecasts and these should be indicated to assist shareholders in their review. A description of the general nature of the business or businesses with an indication of any major hazards in forecasting in these particular businesses should normally be included.

(c) The forecast and the assumptions on which it is based are the sole responsibility of the directors. However, a duty is placed on the financial advisers to discuss the assumptions with their client and to satisfy themselves that the forecast has been made with due care and consideration. Auditors or consultant accountants must satisfy themselves that the forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made.

Although the accountants have no responsibility for the assumptions, they will as a result of their review be in a position to advise the company on what assumptions should be listed in the circular and the way in which they should be described. The financial advisers and accountants obviously have substantial influence on the information about assumptions to be given in a circular; neither should allow an assumption to be published which appears to be unrealistic, or one to be omitted which appears to be important, without commenting appropriately in its report.

2. *General rules*

(a) The following general rules apply to the selection and drafting of assumptions.

(i) The shareholder should be able to understand their implications and so be helped in forming a judgement as to the reasonableness of the forecast and the main uncertainties attaching to it.

(ii) The assumptions should, wherever possible, be specific rather than general, definite rather than vague.

(iii) All-embracing assumptions and those relating to the general accuracy of the estimates should be avoided. The following would not be acceptable:

"Sales and profits for the year will not differ materially from those budgeted for."

"There will be no increases in costs other than those anticipated and provided for."

Every forecast involves estimates of income and of costs and must obviously be dependent on these estimates. Assumptions of the type illustrated above do not help the shareholder in considering the forecast.

(iv) The assumptions should not relate to the accuracy of the accounting systems. If the systems of accounting and forecasting are such that full reliance cannot be placed on them, this should be the subject of some qualification in the forecast itself. It is not satisfactory for this type of deficiency to be covered by the assumptions. The following would not be acceptable:

> "The book record of stock and work-in-progress will be confirmed at the end of the financial year."

(v) The assumptions should relate only to matters which may have a material bearing on the forecast.

(b) Even the more specific type of assumption may still leave shareholders in doubt as to its implications, for instance:

> "No abnormal liabilities will arise under guarantees."
> "Provisions for outstanding legal claims will prove adequate."

Such phrases might be dismissed on the grounds that the first relates to the unforeseen and the second to the adequacy of the estimating system. In both these examples information would be necessary about the extent or basis of the provision already made and/or about the circumstances in which unprovided for liabilities might arise.

(c) There may be occasions, particularly when the estimate relates to a period already ended, when no assumptions are required.

28.3 Reports Required in Connection with Profit Forecasts

(a) A forecast made by an offeror offering solely cash need not be reported on. With the consent of the Panel, this exemption may be extended to an offeror offering a non-convertible debt instrument.

(b) In all other cases, the accounting policies and calculations for the forecasts must be examined and reported on by the auditors or consultant accountants. Any financial adviser mentioned in the document must also report on the forecasts.

(c) When income from land and buildings is a material element in a forecast, that part of the forecast should normally be examined and reported on by an independent valuer: this requirement does not apply where the income is virtually certain, e.g. known rents receivable under existing leases.

(d) Exceptionally, the Panel may accept that, because of the uncertainties involved, it is not possible for a forecast previously made to be reported on in accordance with the Code nor for a revised forecast to be made. In these circumstances, the Panel would insist on shareholders being given a full explanation as to why the requirements of the Code were not capable of being met.

28.4 Publication of Reports and Consent Letters

When an offer document has been posted, the reports must be included in the document containing the forecast or, when the forecast has been made in a press announcement, in a document which must be sent to shareholders with a minimum of delay after the announcement is published; the reports must be accompanied by a statement that those making them have given and not withdrawn their consent to publication.

28.5 Subsequent Documents—Continuing Validity of Forecast

When a company includes a forecast in a document, any document subsequently sent out by that company in connection with that offer must, except with the consent of the Panel, contain a statement by the directors that the forecast remains valid for the purpose of the offer and that the financial advisers and accountants who reported on the forecast have indicated that they have no objection to their reports continuing to apply.

28.6 Statements which Will be Treated as Profit Forecasts

(a) When no figure is mentioned
Even when no particular figure is mentioned or even if the word 'profit' is not used, certain forms of words may constitute a profit forecast, particularly when considered in context. Examples are "profits will be somewhat higher than last year" and "performance in the second half-year is expected to be similar to our performance and results in the first half-year" (when interim figures have already been published). Whenever a form of words puts a floor under, or a ceiling on, the likely profits of a particular period or contains the data necessary to calculate an approximate figure for future profits, it will be treated by the Panel as a profit forecast which must be reported on. In cases of doubt, professional advisers should consult the Panel in advance.

(b) Forecasts before the offer period
Except with the consent of the Panel, any profit forecast which has been made before the commencement of the offer period must be examined, repeated and reported on in the document sent to shareholders.

(c) Estimates of profit for a completed period
An estimate of profit for a period which has already expired should be treated as a profit forecast.

(d) Interim and preliminary figures
Except with the consent of the Panel, any unaudited profit figures

published during an offer period must be reported on. This provision does not, however, apply to:

(i) unaudited statements of annual or interim results which have already been published;
(ii) unaudited statements of annual results which comply with the requirements for preliminary profits statements as set out in the Stock Exchange's 'Admission of Securities to Listing';
(iii) unaudited statements of interim results which comply with the requirements for half-yearly reports as set out in the Stock Exchange's 'Admission of Securities to Listing' in cases where the offer has been publicly recommended by the board of the offeree company; or
(iv) unaudited statements of interim results by offerors which comply with the requirements for half-yearly reports as set out in the Stock Exchange's 'Admission of Securities to Listing', whether or not the offer has been publicly recommended by the board of the offeree company but provided the offer could not result in the issue of securities which would represent 10% or more of the enlarged voting share capital of the offeror.

The Panel should be consulted in advance if the company is not listed on the Stock Exchange but wishes to take advantage of the exemptions under (ii), (iii) or (iv) above.

(e) Forecasts for a limited period
A profit forecast for a limited period (e.g. the following quarter) is subject to this Rule.
(f) Dividend forecasts
A dividend forecast is not normally considered to be a profit forecast unless, for example, it is accompanied by an estimate as to dividend cover.
(g) Profit warranties
The Panel must be consulted in advance if a profit warranty is to be published in connection with an offer as it may be regarded as a profit forecast.

28.7 Taxation, Extraordinary Items and Minority Interests

When a forecast of profit before taxation appears in a document addressed to shareholders, there must be included forecasts of taxation (where the figure is expected to be significantly abnormal), extraordinary items and minority interests (where either of these amounts is expected to be material).

28.8 When a Forecast Relates to a Period which has Commenced

Whenever a profit forecast is made in relation to a period in which trading has already commenced, any previously published profit figures in respect of any expired part of that trading period, together with comparable figures for the same part of the preceding year, must be stated.

28.9 Inflation-Adjusted Forecasts

In general, all the relevant provisions of this Rule apply also to a profit forecast prepared on an inflation-adjusted basis. The basis of computation underlying such a forecast should be stated. Any such forecast should also be accompanied by a corresponding forecast prepared on an historical cost basis.

RULE 29

29.1 Valuations to be Reported on if Given in Connection with an Offer

When a valuation of assets is given in connection with an offer, it should be supported by the opinion of a named independent valuer. (For the purposes of this Rule, 'an independent valuer' means a valuer who meets the requirements of an 'external valuer' as defined in The Royal Institution of Chartered Surveyors' Statement of Asset Valuation Practice No 8 and, in addition, has no connection with other parties to the transaction.)

(a) Type of asset
This Rule applies not only to land, buildings and process plant and machinery but also to other assets, e.g. stocks, ships, T.V. rental contracts and individual parts of a business. Where such assets are involved, the Panel should be consulted in advance.

(b) The valuer
In relation to land, buildings and plant and machinery, a valuer should be a corporate member of The Royal Institution of Chartered Surveyors, The Incorporated Society of Valuers and Auctioneers or The Institute of Revenues Rating and Valuation or some other person approved by the Panel. He should have appropriate post-qualification experience in and knowledge of valuing land and buildings and/or plant and machinery of that particular type in that particular locality; if he does not have post-qualification experience in and knowledge of that particular locality, he should be assisted formally by a valuer who he is satisfied has experience in and knowledge of the valuation of that particular type of asset and in that particular locality. In the case of land, buildings and plant and machinery situated outside the United Kingdom, a valuer should have the appropriate knowledge and experience and prepare the valuation in accordance with the established principles and professional practices of the foreign country concerned. Similarly, in the case of assets other than land, buildings and plant and machinery, the valuer should have appropriate knowledge and experience.

(c) In connection with an offer
In certain cases offer documents or defence circulars will include statements of assets reproducing directors' estimates of asset values published with the company's accounts in accordance with Schedule 7 Part I of the Companies Act 1985. The Panel will not regard such estimates as "given in connection with an offer" unless asset values are a particularly significant factor in assessing the offer and the estimates are, accordingly, given considerably more prominence in the offer documents or circulars than merely being referred to in a note to a statement of assets in an appendix. In these circumstances, such estimates must be supported, subject to Rule 29.2(e), by an independent valuer in accordance with this Rule.

29.2 Basis of Valuation

(a) In relation to valuations of land, buildings and plant and machinery, attention is drawn to The Royal Institution of Chartered Surveyors' Statements of Asset Valuation Practice and Information Papers.

(b) The basis of valuation must be clearly stated and for non-specialised properties this will normally be open market value. Property which is occupied for the purposes of the business will be valued at open market value for the existing use. Where a property has been adapted or fitted out to meet the requirements of a particular business, the open market value should relate to the property after the works have been completed. Alternatively, the open market value may relate to the state of the property before the works had been commenced and the works of adaptation may be valued separately on a depreciated replacement cost basis, subject to adequate potential profitability. Specialised properties occupied by the business should be valued on a depreciated replacement cost basis, subject to adequate potential profitability. Properties held as investments or which are surplus to requirement and are held pending disposal should be valued at open market value. Only in exceptional circumstances should the basis of valuation be qualified (e.g. as between a willing seller and a willing purchaser) and in that event the valuer must explain the meaning of the words used. Similarly, assumptions should not normally be made in a valuation but, if assumptions are permitted by the Panel, they should be fully explained. In this connection attention is drawn to The Royal Institution of Chartered Surveyors' Statement of Asset Valuation Practice No 2 providing definitions of open market value and forced sale value.

(c) In the case of land currently being developed or with immediate development potential, in addition to giving the open market value in the state existing at the date of valuation, the valuation should include:

(i) the value after the development has been completed;
(ii) the value after the development has been completed and let;

(iii) the estimated total cost, including carrying charges, of completing the development and the anticipated dates of completion and of letting or occupation; and

(iv) a statement whether planning consent has been obtained and, if so, the date thereof and the nature of any conditions attaching to the consent which affect the value.

(d) Where a property which is occupied for the purposes of the business is valued at open market value for an alternative use, the costs of cessation and removal should be estimated by the directors and shown.

(e) In some exceptional cases, it will not be possible for a valuer to complete a full valuation of every property. The Panel may be prepared to regard the requirements of this Rule as met if the valuer carries out a valuation of a representative sample of properties and certifies those valuations, with the directors taking sole responsibility for an estimate, based on the sample, to cover the remaining properties. This procedure will be available only where the portfolio as a whole is within the knowledge of the valuer, who must also certify the representative nature of the sample. Where this is done, the document sent to shareholders should distinguish between properties valued professionally and those where the directors have made estimates on the basis of the sample valuation and should also compare such estimates with book values.

29.3 Potential Tax Liability

When a valuation is given in connection with an offer, there should normally be a statement regarding any potential tax liability which would arise if the assets were to be sold at the amount of the valuation, accompanied by an appropriate comment as to the likelihood of any such liability crystallizing.

29.4 Current Valuation

A valuation must state the effective date as at which the assets were valued and the professional qualifications and address of the valuer. If a valuation is not current, the valuer must state that a current valuation would not be materially different. If this statement cannot be made, the valuation must be updated.

29.5 Opinion and Consent Letters

(a) Publication of opinion

The opinion of value must be contained in the document containing the asset valuation.

(b) Consent

The document must also state that the valuer has given and not withdrawn his consent to the publication of his valuation certificate.

(c) Valuation certificate to be on display

Where a valuation of assets is given in any document addressed to shareholders, the valuation certificate must be made available for inspection, in the manner described in Rule 26, together with an associated report or schedule containing details of the aggregate valuation. Where the Panel is satisfied that such disclosure may be commercially disadvantageous to the company concerned, it will allow the report or schedule to appear in a summarised form. In certain cases, the Panel may require any of these documents to be reproduced in full in a document sent to shareholders.

29.6 Waiver in Certain Circumstances

In exceptional cases, certain companies, in particular property companies, which are the subject of an unexpected offer may find difficulty in obtaining, within the time available, the opinion of an independent valuer to support an asset valuation, as required by this Rule, before the board's circular has to be sent out. In such cases, the Panel may be prepared exceptionally to waive strict compliance with this requirement. The Panel will only do this where the interests of shareholders seem on balance to be best served by permitting informal valuations to appear coupled with such substantiation as is available. Advisers to offeree companies who wish to make use of this procedure should consult the Panel at the earliest opportunity. In this connection, attention is drawn to paragraph 12 of Chapter 1 of Section 10 of 'Admission of Securities to Listing'.

APPENDIX 3

DIRECTORS' RESPONSIBILITIES AND CONFLICTS OF INTEREST GUIDANCE NOTE

1 Directors' Responsibilities

While a board of directors may delegate the day-to-day conduct of an offer to individual directors or a committee of directors, the board as a whole must ensure that proper arrangements are in place to enable it to monitor that conduct in order that each director may fulfil his responsibilities under the Code. These arrangements should ensure that:

(a) the board is provided promptly with copies of all documents and announcements issued by or on behalf of their company which bear on the offer; the board receives promptly details of all dealings in relevant securities made by their company or its associates and details of any agreements, understandings, guarantees, expenditure (including fees) or other obligations entered into or incurred by or on behalf of their company in the context of the offer which do not relate to routine administrative matters;

(b) those directors with day-to-day responsibility for the offer are in a position to justify to the board all their actions and proposed courses of action; and

(c) the opinions of advisers are available to the board where appropriate.

The above procedures should be followed, and board meetings held, as and when necessary throughout the offer in order to ensure that all directors are kept up-to-date with events and with actions taken.

Any director who has a question concerning the propriety of any action as far as the Code is concerned should ensure that the Panel is consulted.

The Panel expects directors to co-operate with it in connection with its enquiries; this will include the provision, promptly on request, of copies of minutes of board meetings and other information in their possession, or in the possession of an offeror or the offeree company as appropriate, which may be relevant to the enquiry.

2 Financial Advisers and Conflicts of Interest

Instances where conflicts of interest may arise include those resulting from the possession of material confidential information or where the adviser is part of a multi-service financial organisation, as exemplified below.

(a) Material confidential information

A financial adviser may have the opportunity to act for an offeror or the offeree company in circumstances where the adviser is in possession of material confidential information relating to the other party, for example, because it was a previous client or because of involvement in an earlier transaction. In certain circumstances, this may necessitate the financial adviser declining to act, for example, because the information is such that a conflict of interest is likely to arise. Such a conflict may be incapable of resolution simply by isolating information within the relevant organisation or by assigning different personnel to the transaction; however, when a financial adviser has been actively advising a company which becomes an offeree company, it may be acceptable for it to continue to act.

(b) Segregation of businesses

It is incumbent upon multi-service financial organisations to familiarise themselves with the implications under the Code of conducting other businesses in addition to, for example, corporate finance or stockbroking. If one part of such an organisation is involved in an offer, for example, in giving advice to an offeror or the offeree company, a number of Rules of the Code may be relevant to other parts of that organisation, whose actions may have serious consequences under the Code. Compliance departments of such organisations have an important role in this respect and are encouraged to liaise with the Panel in cases of doubt.

The concepts of 'exempt fund managers' and 'exempt market-makers' in the Code are in recognition of the fact that fund management and market-making may be conducted on a day-to-day basis quite separately within the same organisation; but it is necessary for such organisations to satisfy the Panel that this is the case. It is essential, therefore, that such organisations arrange their affairs to ensure not only total segregation of those operations but also that those operations are conducted without regard for the interests of other parts of the same organisation or of their clients. The Code contains a number of Rules which are designed to ensure that the principles on which these concepts are based are upheld.

APPENDIX V

SUMMARY OF THE KEY ISSUES IN THE PAPER 'REFLECTIONS ON A TAKEOVER OF A UNITED KINGDOM INSURER: A CASE STUDY', BY I. L. SALMON AND A. E. M. FINE

1. *Guidance*
   (a) Need for guidance,
   (b) Type of guidance (advisory, mandatory, etc.),
   (c) Content of guidance,
   (d) Guidance on form and content of report,
   (e) Role of Institute, Faculty, DTI, Takeover Panel,
   (f) Recommendations of Embedded Value Working Party,
   (g) U.S. Appraisal Value Guidance,
   (h) How to enforce guidance on non actuaries.

2. *Terminology*
   (a) Some terms have different meanings to different advisers,
   (b) Actuaries' use of 'market value',
   (c) Appraisal value,
   (d) Transaction value,
   (e) Goodwill, existing structure value (blue sky!),
   (f) Embedded value,
   (g) Embedded value earnings,
   (h) 'Profits',
   (i) Estate.

3. *Methodology for appraisal and embedded values*
   (a) Treatment of estate,
   (b) Multipliers . . .,
   (c) General business,
   (d) Net asset value.

4. *Disclosure*
   (a) Methodology,
   (b) Assumptions,
   (c) Purpose of a valuation,
   (d) Level of detail required,
   (e) Commercially sensitive assumptions (e.g. lapse experience),
   (f) Sensitivities to changes in assumptions,
   (g) Shareholders:
      (1) What level of disclosure is appropriate,
      (2) 'Profit' reporting,

(h) Communication of what is of interest to clients,
(i) Onward presentation of advice—fairness of presentation.

5. *Interests of policyholders*
   (a) Ownership of free estate,
   (b) Change in shareholders' proportion,
   (c) Policyholders' reasonable expectations,
   (d) Bonus philosophy,
   (e) DTI's ability to intervene.

6. *Appointed Actuaries, consultants, actuaries as directors*
   (a) Pressures on,
   (b) Role,
   (c) Conflict between job duties and Institute membership, i.e. commercial v professional interests,
   (d) Responsibility to alert DTI in certain circumstances,
   (e) Respective responsibilities of boards and actuaries,
   (f) Legal action possibility,
   (g) Duty of care to:
      (1) Bidder,
      (2) Target,
   (h) Support available to an actuary:
      (1) Verification process,
      (2) His firm,
         (i) Partners,
         (ii) Standards,
         (iii) Reputation,
      (3) External lawyers,
(4) Institute's Memorandum of Professional Conduct and Practice.

7. *Independence*
   (a) 'Independent Consultants',
   (b) 'Independent Valuation'.

8. *Takeover Code*
   (a) Legal force,
   (b) Reasonable care and attention,
   (c) Highest standards of accuracy.

9. *Other related issues*
   (a) Mutualisation,
   (b) Demutualisation,
   (c) Flotation,
   (d) Disclosure for Annual Report and Accounts,
   (e) Relations with press, analysts and merchant bankers.

APPENDIX VI

EMBEDDED AND APPRAISAL VALUES—ASSUMPTIONS REQUIRED AND THEIR DEGREE OF IMPORTANCE

This Appendix sets out the factors about which assumptions need to be made for the purpose of calculating embedded and appraisal values. In some cases certain assumptions would only be needed in certain particular circumstances.

Comments are also given on the likely level of importance of the assumptions in relation to the values produced. Such comments must, by definition, be very general, as the circumstances of particular classes of business written by particular offices will be a major factor. Also, some assumptions may be regarded as commercially sensitive, and this will affect whether or not they are publicly disclosed. In many areas, an important factor will be how the future assumption compares to the past experience.

For with-profits business, the effect of differing assumptions will, from the shareholders' point of view, be diluted by the 90/10 split of profits.

VI.1. Embedded Values

VI.1.1 *Investment Returns*

- —gross rates of return on various asset classes:
  - —gilts and other fixed interest,
  - —equities,
  - —property,
  - —other.
- —dividend and rental yields for equities and property,
- —proportion of franked investment income to total investment income,
- —gross unit growth rates for linked busness.

These will be important for all classes of non-linked business, both non-profit and with-profits. Returns on certain existing assets (e.g. gilts) might be determined in relation to their market values, in which case an assumption is only required in respect of future investment. For linked business, unit growth rates may not be the most important of assumptions, but their disclosure is unlikely to be contentious. Investment return assumptions on non-linked assets will be important.

VI.1.2 *Inflation*

- —salary-type inflation (e.g. National Average Earnings Index),
- —price-type inflation (e.g. Retail Price Index)

This will be important in all circumstances where maintenance expenses are expressed as £*X*p.a. initially (i.e. the usual method). It will also be important if credit is taken in the embedded value for increments on policies subject to regular RPI-linked increases, and for pensions business where contributions are defined as a percentage of salary.

VI.1.3 *Mortality Rates*
—normal mortality,
—AIDS mortality,
—future mortality charges for linked business.

These will be important for annuities in payment, term insurances and other non-linked non-profit business, but not so important for with-profits and linked business, due to the variability of bonuses and mortality charges respectively.

VI.1.4 *Other Decrement Rates*
—lapses,
—surrenders,
—withdrawals,
—early retirements,
—paid-ups.

Generally this will be an important assumption for all classes of business, with some particular exceptions (such as annuities in payment). The level of importance will depend on how actuarially neutral the terms for surrender/withdrawal, etc. are.

VI.1.5.1 *Expenses*
—maintenance expenses:
    —premium-paying cases,
    —non-premium-paying cases,
    —annuities in payment,
    —treatment of any current expense overruns,
—claim expenses,
—investment expenses.
These will be important for all classes of business.

VI.1.5.2 *Commission*
—bad debt assumptions for clawbacks of indemnity initial commission.

This will not be vitally important unless the amount of indemnity commission outstanding is large and lapse/bad debt experience is expected to be poor.

Note: Renewal commission rates should be known, but in some cases assumptions may be required. The same is true for any non-indemnity initial commission on business already written.

VI.1.6 *Taxation*
—basic rate of income tax,
—rate of corporation tax (for shareholder profits),

- —rates of tax relief on expenses,
- —treatment of carried forward items:
  - —unrelieved management expenses (XSE),
  - —NCl losses,
  - —Case VI losses,
- —treatment of unrealised gains for 'CGT' purposes,
- —tax allowance in unit-prices for linked business.

Generally this will be important for most classes of business. For some classes of business, certain aspects of taxation may be less important, e.g. CGT assumptions for linked business.

VI.1.7 *Bonuses*

- —rates of reversionary and terminal bonuses for with-profits business,
- —bonus philosophy/methodology (refer to Appendix 7 of Salmon & Fine paper),
- —future policyholders'/shareholders' proportions,
- —treatment of the 'estate' and of any 'orphan estate'

By definition, these will be important for with-profits business only.

VI.1.8 *Discount Rate*

- —not purely an actuarial assumption.

This will be important for all classes of business.

VI.1.9 *Asset and Liability Valuation Bases*

- —future methods/bases for determining published liabilities (including associated solvency margin requirements),
- —future methods/bases for valuing assets.

Both of the above items will be important, particularly if any divergence from current practice (as in latest DTI returns) is assumed.

VI.2. Appraisal Values

Additional Assumptions Required

- —future acquisition expenses, acquisition commission and corresponding rates of tax relief,
- —new business multiplier:
  - —rate of new business growth,
  - —pre-issue discount rate.

Note: The approach is assumed to be based on the adjusted value of the most recent year's new business and a multiplier. The final choice of multiplier is subjective, taking into account the theoretical value and the nature/quality of the sales channels.

All of the above assumptions needed to produce the value of future new business are likely to be important.

APPENDIX VII

THE ROLE OF THE STOCKBROKER IN A TAKEOVER

VII.1. Introduction

The purpose of this Appendix is:
—to describe the role of the stockbroker in the event of a takeover,
—to identify the information required if the role is to be performed well, and
—to identify what the actuarial profession could do to help.

VII.2. The Role of the Stockbroker

The stockbroker under consideration in this paper is *not* the professional adviser to either of the parties involved (aggressor or defender), but rather the stockbroker who provides advice to clients on whether to buy or sell the shares of the defender or the aggressor (if a quoted company) and on whether to accept or reject the bid.

The stockbroker provides advice directly to clients of his/her company (whether those are institutions or private clients) and indirectly to shareholders or potential shareholders via the media (press, television, screen services).

Through the media the stockbroker may also influence indirectly the opinions of legislators, regulators, policyholders, intermediaries, financiers, etc. Compliance requirements prohibit research being sent to non-clients.

VII.3. The Information Required

The stockbroker needs to assess:

—what the probability is of the bid being successful,
—what will be the final price paid.

This requires judgements on:

—what the 'value'—of the target is,
—how much the bidder is prepared to pay in relation to the 'value', and
—whether a third party (or further parties) will enter the contest.

From our perspective the information required is, therefore, that needed to assist stockbrokers to make an accurate assessment of value.

Stockbrokers vary enormously in terms of:

—resources available,
—stockbroking experience, and
—actuarial expertise.

It should be noted that, axiomatically, there is a good probability that most (or at least many) of the stockbrokers best qualified to give independent advice will not be in a position to do so. This is because their employers may be stockbrokers to either party or else because they are part of a group which includes the merchant bank adviser to either party.

The stockbrokers which appear less well qualified to provide independent advice may be very influential in the bid outcome, either because they happen to be very close to the major shareholders or because all, or most, of the better qualified ones are sidelined. There is also the point that analysts well qualified in the life insurance sector will have little experience of judging how a contested bid might develop.

VII.4. Valuation of the Target Company

The three key elements of a valuation are likely to be:

—an appraisal value,
—a profits forecast, and
—a dividend forecast.

VII.4.1 *Appraisal Value*

Many analysts will already have their own estimated appraisal value. A few of these will have been calculated in the conventional actuarial manner (either by the stockbroker or else by consulting actuaries employed for this purpose) using DTI Returns and other published information. Others will have been done on a rough and ready basis.

An appraisal value published in the course of a takeover should include full details of the assumptions used. It is viewed to be important for it to contain a sensitivity analysis. This would enable those analysts not undertaking detailed appraisal value calculations (who, for the reasons detailed above, may be influential in a bid) to make their own assumptions on interest rates, expense inflation, lapses and new business profitability and growth. This process would give much greater credibility to the use of appraisal values in these circumstances.

VII.4.2 *Profit Forecast*

This can only be provided if the company is past, or close to, its year-end.

If the forecast is made on a statutory basis, then details should be provided on bonus rates implied and of any changes in the valuation basis.

If the forecast is made on an embedded value basis and the company has already been using embedded value reporting, then additional details of the valuation basis should be provided.

If the forecast is made on an embedded value basis, but profits have hitherto been reported on a statutory basis, then comparative figures should be provided together with the details of the valuation basis and, ideally, an analysis provided of the sources of embedded value profits. Forecasts of statutory profits should also be provided under these circumstances.

VII.4.3 *Dividend Forecast*

This is not a subject of actuarial interest (though it is to shareholders and stockbroker).

VII.5 How the Actuarial Profession could Help

There appears to be a need for stockbrokers to take actuarial advice in the event of a takeover.

The demand for actuarial advice will be dictated by two considerations:

(a) the size of the deal and the amount of business likely to be generated in the course of the takeover, and
(b) the perceived need by stockbrokers to provide a competitive service to clients in the form of informed advice.

The nature of the actuarial advice will also be dictated by the time pressures inherent in a takeover; a full-scale appraisal value calculated from scratch may not be appropriate, because much of the activity in the shares may take place before the appraisal value becomes available.

An alternative approach could include advice on an ongoing basis on any actuarial issues, particularly on any figures produced for embedded values, appraisal values and embedded value (or 'accruals') profit forecasts.

APPENDIX VIII

NOTE ON THE VERIFICATION PROCESS

VIII.1 Each director of the offeror and offeree has a responsibility under the Takeover Code to ensure that the Code is complied with. In particular, the directors of the offeror and offeree are required by the Takeover Code to take responsibility on the face of the document for information relating to their respective companies. Each director will be required to sign a responsibility statement evidencing this position.

VIII.2 Financial advisers are identified by the Code as having a particular responsibility for complying with the Code and for ensuring that their clients do likewise.

VIII.3 Verification normally occurs as a separate exercise when drafting is well advanced. It is nevertheless wise to appraise all those involved in the drafting process of the nature of the verification exercise at the outset, since this can avoid unnecessary redrafting. Those involved in the drafting may include the actuary, the solicitor, the accountant, the merchant bank or the company.

VIII.4 The mechanics of the verification exercise are primarily the responsibility of the company's solicitors, although the financial adviser will normally have separate legal advisers who will take a major role in the process. This process will involve the preparation of verification notes. These are in the form of a question (posed by the lawyers) and an answer (to be provided by the party most appropriate to answer the question—normally this would be the company, but, in the case of a life company, is also likely to involve consultants) for each and every factual statement in the document. Greater scrutiny will attach to more sensitive issues.

VIII.5 In the case of one document, the actuarial consultants go through the sections attributed to them with the company's solicitor, explaining from where all the underlying information came.

VIII.6 Ultimately each question (and answer) is initialled by the person(s) taking responsibility for it. In addition, the directors of the company will be required formally to approve and adopt the notes.

VIII.7 The purpose of verification is to ensure that the document is accurate, complete and not misleading. In particular, where statements of opinion are made, the purpose is to establish that it was reasonable for the board of the relevant company to make the statements.

VIII.8 Where verification is provided by consultants, they are effectively taking responsibility for the statements made. They may, therefore, wish to have separate legal advice.