

Where Did all the M&A Go?

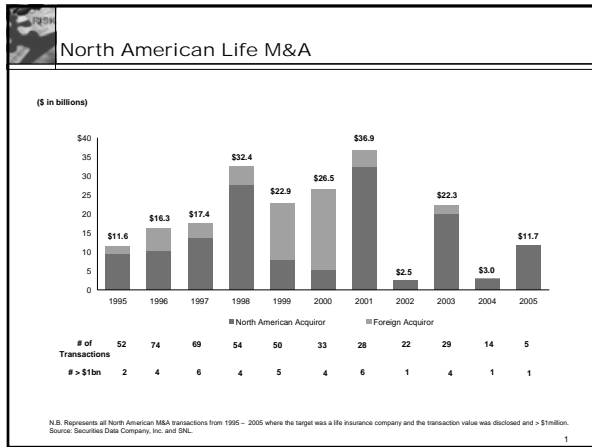
SOA 2005 (Life) Spring Meeting

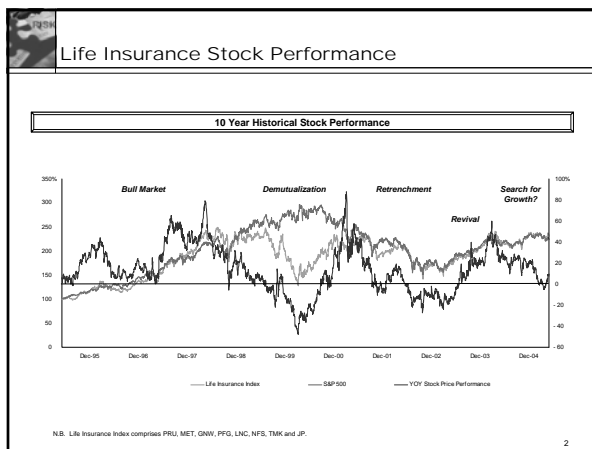
Stephen Fromm
Managing Director, Head of Insurance M&A

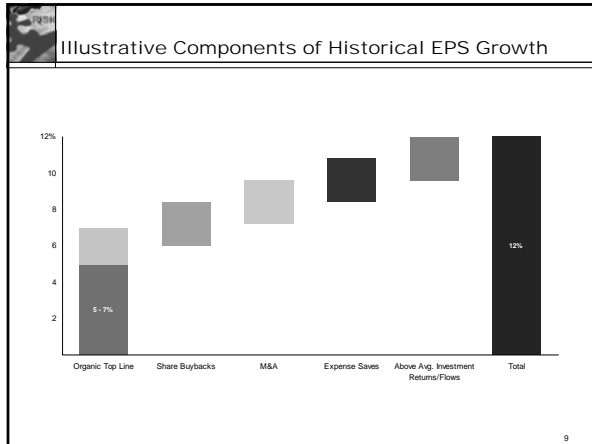
Laird Zacheis
Principal and Consulting Actuary

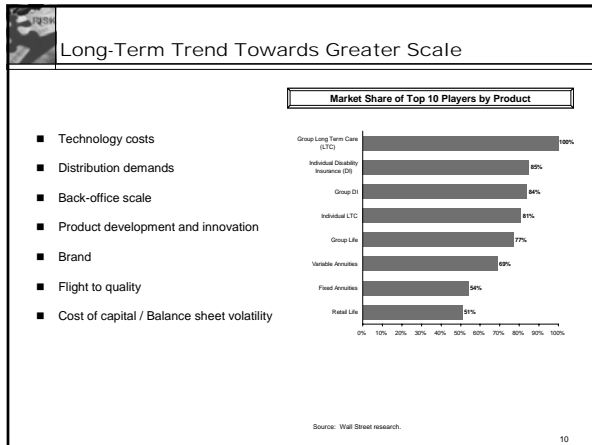
John O. Nigh, F.S.A., M.A.A.A.
Managing Principal, Mergers, Acquisitions and Restructuring Practice Leader

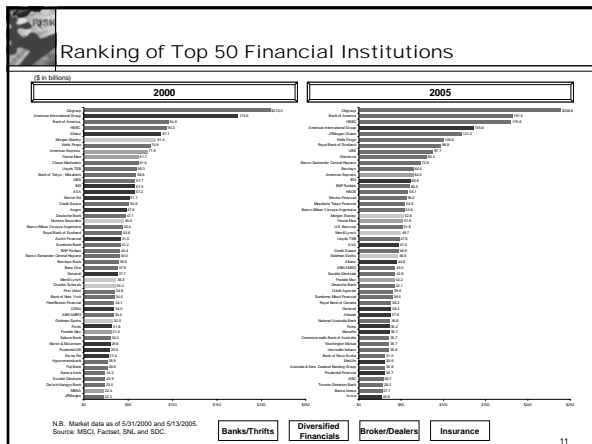
May 24, 2005



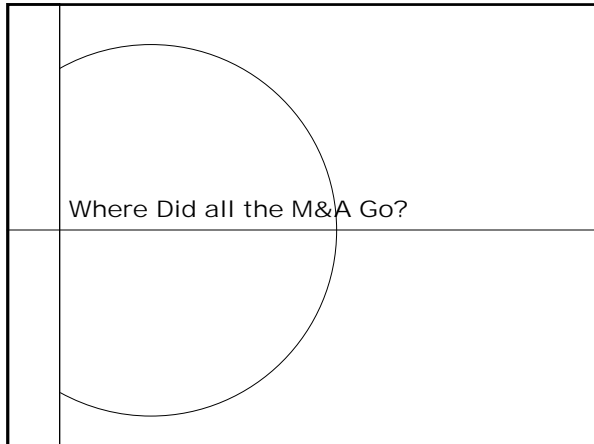








SOA 2005 May Spring Meeting - 61PD, Where Did All the Mergers and Acquisitions go?



**Life Insurer M&A
2003-2004 Characteristics**

- Search for external growth
- Search for scale: Consolidation savings
- Diversified distribution and product portfolio
- Renewed focus on capital
- Opportunities outside U.S.
- Return of private equity
- Significant activity by reinsurers
- Two Markets:
 - a) Growing, viable companies
 - b) Run-off blocks

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**Characteristics of
Life Insurance Targets**

<p>"Strong" Sellers</p> <ul style="list-style-type: none"> ■ Proprietary High Growth Products or Distribution ■ Expandable Products or Distribution ■ Efficient Administration ■ Recognized Brand/Franchise ■ Strong Management 		<p>"Weak" Sellers</p> <ul style="list-style-type: none"> ■ Limited Product and Distribution ■ Inefficient Administration ■ Limited Brand ■ High Cost of Capital/Rating Pressure ■ Risky Product Design ■ Risky Investment Strategy ■ Weak Management
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Source: Banc of America Securities L.L.C.

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Recent Transaction Pricing

- Discount Rates have not Trended Down with Interest Rates
- GAAP Results are Less of a Constraint Due to Reduced Trading Multiples
- Renewed importance of actuarial appraisal (DCF analysis) as focus shifts to underlying value

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What is an Actuarial Appraisal?

- Discounted Cash Flow analysis, where:

Distributable Cashflow = After-tax Earnings minus Increase in Required Capital

= Premium + Investment Income

- Benefits - Expenses - Commissions

- Increase in Statutory Reserves

- Taxes

- Increase in Required Capital

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Components of an Actuarial Appraisal

Component of Value

Company Value

Adjusted Book Value

Statutory Net Worth

Embedded Value

Value of Inforce Business

Actuarial Appraisal Value

Total Company Value

Other Items

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Valuation Issues

Price v. Appraisal Value: 2001-2004 Life Transactions in Excess of \$250 million			
Transaction	Discount Rate	Price as a % of	
		ABV + Value of Inforce	Total Appraisal Value
1	9% - 13%	107%	82%
2	9% - 13%	109	90
3	8% - 12%	124	92
4	10% - 14%	108	99
5	8% - 12%	147	108
6	9% - 13%	84	84
7	10% - 14%	104	86

Note: Ratio based on discount rate in midpoint of range.

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Market Value v. Reported Embedded Value

	Market Value/ Reported Embedded Value				Market Value/ Estimated Appraisal Value			
	Nov. 2001	Oct. 2002	Dec. 2003	Feb. 2005	Nov. 2001	Oct. 2002	Dec. 2003	Feb. 2005
	CGNU	1.51	1.28	1.22	1.39	0.80	0.96	0.94
L&G	1.45	1.34	1.23	1.24	0.91	1.04	1.00	0.92
Pru U.K.	1.97	1.52	1.70	1.45	0.89	0.90	1.02	1.01
Aegon	1.98	1.19	1.17	0.91	0.72	0.82	1.05	0.87
AXA	1.73	1.57	1.58	1.30	0.86	0.88	1.15	0.88
ING	1.68	1.40	1.42	1.50	1.04	0.92	1.26	1.04

Source: Morgan Stanley analysts' reports.

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Valuation Issues and Challenges - Variable Products

- Variable Annuity and Variable Life have been areas of significant growth in the U.S. industry
- Profitability of Variable Annuities depends heavily on growth rate of underlying assets since revenue is driven by assets under management
- Death and income guarantees in Variable Annuities have been popular but increase volatility. Policyholder behavior may be highly anti-selective for certain types of benefits.
- Use of stochastic analysis to determine costs for asymmetric benefits and, potentially, revenue
- Variable Life is less dependent due to insurance charges
- Proposed NAIC Capital Requirements can be severe for unhedged guarantees.

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Valuation Issues and Challenges - Interest Environment

- The general historic decline in interest environment has permitted companies to manage spreads to optimal levels
- The economic environment may place pressure on interest spreads
- Guaranteed Rates for inforce business vary by period of issue with life rates slightly higher than annuity rates
- New money rates have declined to a level where certain carriers will realize reduced (but positive) spreads over time under continuation of environment
- Certain lines of business have been (or may be) highly affected by interest environment:
 - a) Long Term Care: Reinvestment risk has caused some carriers to have to raise rates on new business and/or inforce
 - b) Fixed Annuities: Disintermediation could cause problems if rates rise sharply
- Potential use of stochastic analysis to measure asset-liability mismatch and cost of options

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Valuation Issues and Challenges - Expense Savings

- Value of cost savings varies by buyer
- Greatest potential for cost savings:
 - Systems
 - Corporate support
 - Distribution
- Target Cost Savings are often 20+% of the acquired company cost structure
 - AIG / American General: \$400 million expected
 - Hancock/Manulife: \$250 million expected
 - Metlife/Travelers: \$150 million expected
- Excessive cost savings can damage intrinsic value of organization
- Several effective consolidators have utilized outsourcing

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Other Valuation Issues and Challenges

- Bond defaults in 2002-2003 were 200-300% of historic average, but have since stabilized
- Mortality once again is an issue:
 - a) 2001 VBT v. 1975-80 S&U mortality slopes
 - b) Future mortality improvement
- Reserve issues
 - a) XXX and AXXX reserves
 - b) Variable products
- Long Term Care experience: evolving market
 - a) Termination rates
 - b) Mortality curves
- Tax consequences

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GAAP Accounting Issues

- FAS 141/142: Allocation to intangibles and goodwill recoverability
- Impact of low interest rate environment
- SOP 03-1 and earnings volatility

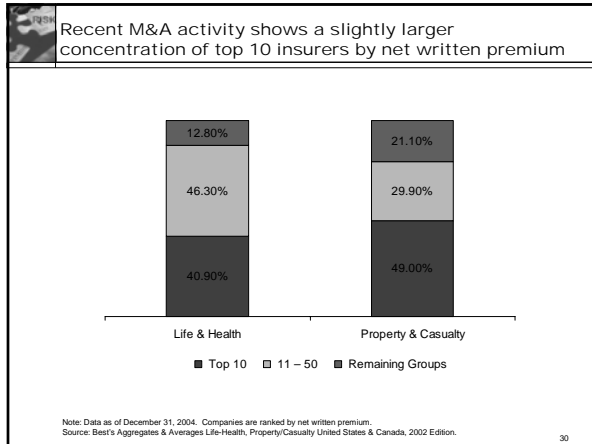
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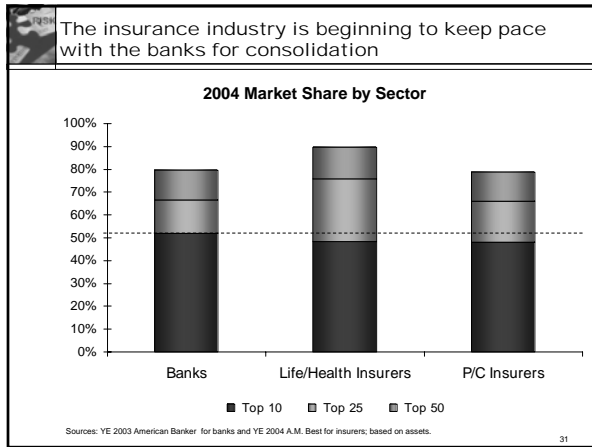
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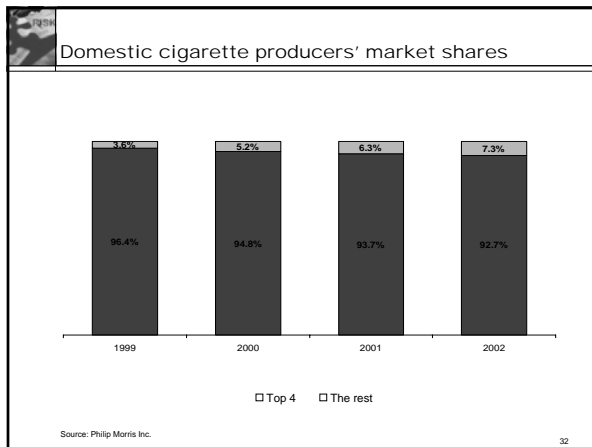
Market overview

- Concentration
- Revenue growth
- Penetration
- Non-spectacular ROEs

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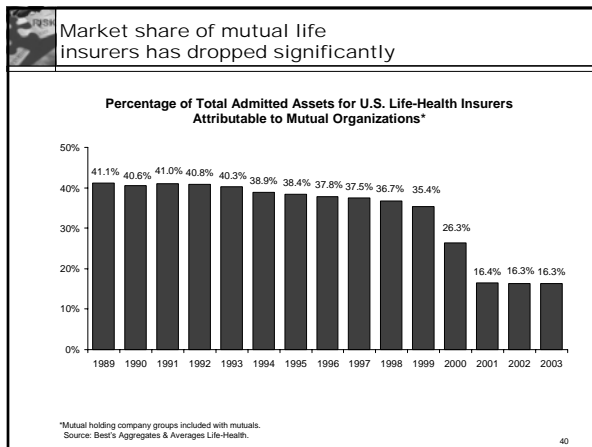
Summary

U.S. insurance market has characteristics that make sustained organic growth difficult

- High market penetration
- Low growth in industry premiums
- Relatively non-spectacular ROEs

M&A is the logical outcome...

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Disincentives to property & casualty M&A

- Legacy systems
- Legacy personnel
- Legacy thought processes
and, of course...
- Legacy LIABILITIES

These create incentives for "renewal rights only" deals and "virgin" startups, particularly in reinsurance...

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The drivers of M&A in the insurance industry remain unchanged

External Drivers

- Changing demographics and customer demands
- Globalization
- Deregulation
- Rating agency/stock analyst pressure

Internal Drivers

- Access to capital, customers and markets
- Need for critical mass
- Economies of scale

Continuing M&A Activity

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Other trends/events also point to increased insurance M&A activity over the longer term

- Insurance executives continue to believe M&A is important
- Cataclysmic events occurring in the market could force mergers and acquisitions
- There is also the potential for further spin-off activity
- European insurers continue to show interest in acquiring U.S. companies
- Cost and complexity of compliance with Sarbanes-Oxley and other regulatory entities may force smaller companies to merge

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Challenges to acquisition success

Companies have had varying degrees of success with the acquisition process...

Source: 1996 Economist Intelligence Unit Survey of 150 Company Senior Executives

Source: 2003 Tillinghast Survey of 30 Insurance CFOs

...Due to a range of potential reasons

Rank	Top Ten Pitfalls	Negative Impact
1	■ Incomplete due diligence	5.89
2	■ Inability to manage target	5.59
3	■ Unable to implement change	5.54
4	■ Synergies nonexistent or overestimated	5.22
5	■ CFO not participate foreseeable events	5.14
6	■ Chief of management off/border	5.11
7	■ Acquirer paid too much	5.00
8	■ Acquired firm too unhealthy	4.88
9	■ Need to spin off or divest too much	4.65
10	■ Incompatible marketing systems	4.01

Source: Survey of Forbes 500 CEOs, assessed on a scale of 1 to 7, where 7 is high.

Problems Encountered in M&A Transactions That Did Not Fully Meet Expectations

Source: Tillinghast Life Insurance CFO Survey #4, 2003.

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These pitfalls result from failures or omissions at key stages in the acquisition process

Strategy	Due Diligence	Implementation
<ul style="list-style-type: none"> ■ Incompatible cultures ■ Nonexistent or overestimated synergies ■ Incompatible marketing systems 	<ul style="list-style-type: none"> ■ Overly high acquisition premium ■ Did not anticipate foreseeable events ■ Unhealthy acquisition target ■ Need to spin off or liquidate too much 	<ul style="list-style-type: none"> ■ Inability to manage targets ■ Inability to implement change ■ Clash of management styles

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The keys to implementation success are often people related

- Keep key talent
- Ensure good understanding and communication of objectives and synergies
- Be able to manage and implement change
- Build a new culture that incorporates "best of both"
- Align people's incentives with the successful implementation of the merger/acquisition

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A Time for Exuberance?

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Leo Collins

"Well, let's do something and do it quickly, because I'm sitting on a big pile of cash over here."

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Or Caution?

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"My gut tells me this is a time to mute our hoopla."

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M&A Drivers and Constraints

Drivers	Constraints
<ul style="list-style-type: none"> ■ Search for growth <ul style="list-style-type: none"> ■ Distribution ■ Expense saves ■ Benefits of scale <ul style="list-style-type: none"> ■ Back-office ■ Technology ■ Distribution ■ Product ■ Brand ■ Cost of technology / Legacy issues ■ Creation of long-term market leaders and survivors ■ Exit from non-core / capital re-allocation ■ CEO succession ■ Ratings / capital pressures 	<ul style="list-style-type: none"> ■ Lack of seller motivations <ul style="list-style-type: none"> ■ Improved capital positions ■ Hard markets ■ Mutual companies ■ Social issues ■ Buyer's return criteria / caution / valuations ■ Shortage of motivated buyers for large properties ■ Quality of properties for sale ■ Low interest rate environment ■ P&C: <ul style="list-style-type: none"> ■ Balance sheet exposures ■ Skepticism regarding scale benefits / tradeoffs

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