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CORPORATE DIVERSIFICATIONS, MERGERS, ACQUISITIONS AND JOINT VENTURES

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- Identifying appropriate types of businesses for diversification
- Identifying target companies within each business segment
- Financing an acquisition - debt, surplus cash, stock
- Tax planning related to acquisitions
- Negotiating strategy
- Life insurance companies as corporate investments

MR. CHARLES MCLEOD: Good afternoon and welcome to this panel discussion. Our three panelists are Mr. James MacNaughton, Mr. Wolcott B. (Dick) Dunham and Mr. Charles Feudtner. Mr. MacNaughton will cover some of the financial issues and the reasons why a non-insurance company might consider the purchase of an insurance company. Mr. Dunham will cover the strategic and legal issues. Finally, Mr. Fuedtner will describe the merger between Central Life and Wisconsin Life and use it to illustrate some keys to a successful merger and some pitfalls to avoid. I have asked all the panelists to pay particular attention to the issues you need to consider and the questions you need to have answered before proceeding with a diversification, acquisition or joint venture.

MR. JAMES H. MACNAUGHTON: The topic for our panel is one of continuing interest and intrigue. I've been asked to comment for a few moments on my view of why a non-insurance company would consider the purchase of a life insurance company, and how it would (or should) go about it. In theory, my remarks should include: why a company decides to diversify into life insurance; how real targets are identified; strategic and technical mechanics of pursuing an acquisition; and the financial considerations of a transaction relating to the buyer, the target, and on the surviving entity.

I think the life insurance industry's state of affairs can best be described by paraphrasing a famous line "... No one knows where the winds of war may take us, but it's certain that the life insurance business will not go on in a more orderly manner until greater definition of the financial services industry is determined ...".

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The whole subject of the life insurance business from an owner-investor's point-of-view presents a very confusing perspective scenario based on the tradition that "the past is prologue". The backdrop for this statement has developed as virtually all sectors of the insurance industry in the United States have gone through wrenching change in the past decade, especially over the last three to four years - probably as much or more so than most other major U.S. industries.

To put today's environment in perspective, let's first examine a few historical anomalies, namely the facts. There are approximately 1900 U.S. life insurance companies that are traditionally in the business of selling a fixed relationship for a consumer to invest his money at interest with what he probably believes is no credit risk. This task is done primarily through high cost individual contact by the service provider. The industry's historical "basic" product, when broken down, is quite homogeneous with alternative investments.

Finally, it takes the providing institution a long time to recover its initial "funds gathering" costs, with little "call protection". This phenomenon has led to the financial services challenge for anyone interested in operating a U.S. life insurance company today.

As a backdrop for our discussion it is sensible to review a little history of industrial America's investments in the life insurance industry. Acquisitions into your business have historically been made for three basic purposes. First, as an investment in what was believed to be an attractive operating business, without any real intent to manage the business for bigger and better things in the future. Secondly, life insurance companies were for many industrials strategic business moves, representing investments with the operating characteristics of: (1) predictable, stable, growing earnings; (2) dependable, free cash flow to support other business segments; and (3) an opportunity to participate in a hot business, the growing financial services industry. This third characteristic has led to the final purpose for life insurance acquisitions - namely as a strategic business diversification by other financial services companies.

Generally, higher prices were paid by industrial companies relative to insurance industry competitors for their "strategic acquisitions". In addition to greater acquisition premiums, managements of many acquired life insurance companies were compelled to sell to industrials based on promises of independent future operations. Representations of independence of internal cash flow were also made to comfort continuing management that capital would be available to support any reasonable business activities in the future.

Interest on the part of industrial America peaked in the mid to late seventies as many acquirors saw an opportunity to purchase, at a reasonable price, a stake in a profitable and promising industry characterized by relatively stable earnings, long-term growth opportunities, and most importantly a steady stream of free cash flow. Investment in a business which provided stable earnings and predictable cash flow on its own could balance the effects of cyclical

affiliates. Examples of this acquisition philosophy were described in discussions from the annual reports of two such acquirors.

- "The company for some time has considered the life insurance industry attractive. Like the rest of our business, it is consumer oriented, generates considerable cash flow and produces a relatively high return on investment. Its history of steady growth and its favorable demographic outlook also recommended it as a desirable field in which to broaden the company's operations." (American Brands 1978 annual report regarding their acquisition of Franklin Life.)

- "... In the area of acquisition, we are on the threshold of establishing a unique specialty financial services sector, which we view as an opportunity for accelerated growth ... unlike many others who have moved into financial services recently, we are not attempting to bring a full range of services under one umbrella; rather we intend to assemble a group of specialized companies with significant market positions in the fastest growing segments of their industry." (American Can 1981 annual report regarding their acquisition of associated Madison Companies.)

The 1970's historical trend of life insurance acquisitions by industrials may be contrasted with the trend in the 1980's. There has been a distinct reduction in industrial company interest in diversifying into the life insurance business during the last three years. Although the specific reasons may be slightly different for each company who may have had an interest in this business during the seventies, the basic reasons are quite similar. In recent years the industry has been plagued by low current earnings growth, substantial federal income tax uncertainties, unpredictable outcome of financial industries deregulation, and the lack of a definition of what the life insurance business is really all about today. Additionally, there has been a continuing contraction of the insurance industry itself, leading towards concentration of market power. This concentration of insurance management capital and innovation capabilities has scared many promising industrial acquirors. Generally speaking, most acquisition interest on the part of industrial companies today comes only as a strategic business move, rather than as an interesting investment opportunity. A successful player in the life insurance business must dedicate itself to not only preserving the business which it acquires, but also making available sufficient capital to support the business expansion necessary to compete in a tougher more contracted life insurance industry tomorrow.

Today's interest in the life insurance business is based on what I believe are three basic premises. The first, a belief in life insurance as a business which is a distinct product source. Others may view life insurance as a cheaper source of funds for a financial services company as compared to a depository institution or other funds gathering mechanism. Finally, a number of recent transactions may be most appropriately defined as attractive "one time" asset purchases.

It's fair to say that the financial services business today is in vogue. Life insurance, however, is not at the top of the list as a vehicle for most companies to make their entrance to this very competitive environment. As mentioned before, any player in this industry must be firmly dedicated to compete both in terms of capital availability as well as management time and talent. Therefore, it is sensible that a building block approach to any financial service business be taken. Many people believe that life insurance is not the most effective foundation for further investments but rather a more effective building block on top of an established base.

The diversity of acquisition transactions completed in the 1970's is interesting considering the original stated purposes for many of the life insurance company purchases and most distinctly considering each company's resulting place in the acquiror's organization today. In many cases, two financial problems resulted from the historic chronic trend to pay very full prices for companies: the inability to service acquisition debt from the purchased company's dividendable income; and the purchase accounting effects on reported earnings of public acquirors. Although the theory is presented a little bit differently in board rooms today, the number of "strategic business acquisitions" during that period resulted from somewhat of a real domino effect. As may be described by many acquisitive companies in the late seventies, one of the worst things about their investments is that 1984 is not long enough from the time of acquisition to justify to the public, their board of directors or potential buyers, the sale of the insurer today.

The reason for one such divestiture is summarized from a recent press release:

"... (Ashland Oil (Company) said it wants to sell (Integon Corp.), its insurance holding company which has been hurt by the industry's slump. ... (Ashland) said it wants to sell (Integon) to narrow its focus on its energy, chemical and related business ..." (acquired 4/81).

The environment for life insurance company acquisitions has changed dramatically in the 1980's. In the late seventies buyers were segmented not only by what was perceived to be their general constituency group's interest, but also by the group which was believed to be willing to pay the highest price - hopefully decided through ignorance or fevered bliss. The tables, however, have been turned entirely today. As in other segments of the financial services industry, contraction is the key to the life insurance business. We find only a marginal amount of interest today by industrial America in financial services businesses. The important aspect of that, however, is the difference between an investment and a strategic business move. Truly passive investments are made for competitive rates of return with similar risk capital market instruments. Strategic business moves, however, are made particularly in the financial services business by beginning with or supplementing a base business which can compete against the other players in what is generally believed to be the hottest industry in town. Therefore it's fair to say that anyone interested in investing in the insurance business must also be prepared to build upon that business.

At this point I would like to briefly describe how we believe a non-insurance company might go about buying a life insurance company. Step one is to define the businesses and products important to a company's basic acquisition objectives. It must be determined whether the acquisition of a life insurance company is meant to represent the foundation or a building block company. The acquiring company must determine whether it is looking for product offerings supplementary to other businesses it is engaged in, or as an alternative method of gathering funds. Geographic concentration versus a nations-in-scope competitor approach must be decided. An active versus passive approach to the acquisition market must be established. And finally, the mechanics of consummating an acquisition must be well outlined so that the process is understood prior to entering it.

In addition to general things, the financial considerations of acquiring and financing a life insurance company acquisition must be well understood. As is apparent, a life insurance company is already a fairly highly levered business. Consequently it is not one which is conducive to a leveraged buyout. It is also important to make sure that sufficient capital is generated for future business growth. Projected free cash flow must be determined so that it is well understood how the dividendability of a life insurance company will effect its parent and affiliates. Finally, the acquiror must understand the internal operations of the insurance company. Financing affiliate transactions or making affiliate investments with the general account funds of life insurance company is very inappropriate today.

In conclusion, I'd like to make a few remarks on the current state of the financial services environment. We are still in the throes of the construction of an "industry". Each segment of that industry will be affected by a number of important considerations among which include: deregulation of commercial banks; demutualization of the mutual life insurance business; the speed and degree to which the unregulated concentration of the multitude of competitors comes about; and finally whether the true financial supermarket becomes the dominant force in the financial services business. Each one of the considerations will affect the life insurance business and ultimately the acquisition market for life insurance companies in different ways. The confluence of these considerations however, may make the ultimate striving for a "level playing field" in the financial services business always paralleling reality without ever crossing.

MR. WOLCOTT DUNHAM: Diversification has become an imperative for life insurance companies. Market forces, including high and volatile interest rates and the emergence of new competition from other providers of financial services, have brought a blurring of the lines separating the sectors of the financial services industry and brought many insurers to the conclusion that they must compete more effectively to thrive. This requires not only the development of new insurance products, but also diversification into other businesses.

Actuaries and lawyers can play an important part in what should be the consideration of an insurer's response to change. That starting point

is strategic planning. An insurer should not diversify just because a few competitors are doing so. There should be a careful but rapid process of assessing where we are today; where is our business, where is it coming from, what trends do we see in recent years, and what environment -- competitive, economic and regulatory -- do we now face and what environment do we expect in five, ten, and fifteen years?

Most importantly, what are the long-term goals and values for the company and where do we want the company to be in five, ten and fifteen years?

Obviously, there will be uncertainty. The future cannot be predicted. Some diversification may be needed, mainly as a hedge against uncertainties in predicting the future. But it should be part of a considered strategic plan.

Actuaries play an important role in the process, in ways I will not presume to describe before this audience, but I have seen the importance of the role on many occasions.

The lawyer's role includes putting legal factors into a perspective that is meaningful for a chief executive officer in deciding what avenues to pursue. It is also the lawyer's role to minimize surprises and to participate in the decision making process.

Some diversification can take place within the life insurer. This obviously includes new insurance products, unless tax or regulatory considerations dictate use of a subsidiary or separate company. This includes products like funding agreements, authorized in New York two years ago. But many diversification moves will require forming or purchasing a new subsidiary, forming a subsidiary because the new business is best conducted in a separate corporation, acquiring a new subsidiary because the acquisition brings expertise, needed personnel, distribution channels, or other important assets that could not be generated as effectively and quickly from within.

Stock companies face few insurance law barriers to diversification. They are usually already organized in a holding company structure, with the principal stock life insurer owned by a parent holding company. An acquisition can easily be accomplished by the holding company. The acquired company becomes a sister of the life insurer. State insurance holding company acts set standards for intercompany transactions between the life insurer and its affiliates. They must be at arm's length and on fair terms. New York is one of the few states requiring prior approval of certain transactions between a life insurer and its sister subsidiaries.

Mutual life companies face greater barriers to acquisition of affiliates and subsidiaries. Of course they have no upstream holding company, and any acquisition must be made by the mutual parent directly or through a downstream holding company. State law limits the permitted activities of downstream subsidiaries and limits the amount of the mutual parent's investment in its subsidiaries. For example, a Massachusetts company must hold at least 51% of the capital

stock of its subsidiaries except with the Commissioner's approval. Permitted activities of subsidiaries include providing services to investment companies, real estate, data processing, or with the prior approval of the Commissioner, a business "complementary or supplementary to the business of a life company."[1] A Massuchesetts company cannot invest more than 10% of its capital and surplus in the capital stock of any one corporation, unless that corporation is a life company or the Commissioner has approved a larger investment after concluding that the parent's surplus is adequate.[2]

Legislation enacted last year in New York enlarges the permitted activities of an insurer's subsidiaries and the permitted amount of their investment in such subsidiaries. This replaces 1969 legislation that had allowed subsidiaries engaged in businesses reasonably ancillary to an insurance business. Subsequent changes in the market-place had made this formulation too restrictive. The 1983 legislation was based largely on recommendations of the 1982 Executive Advisory Commission on Insurance Industry Regulatory Reform, which had recommended that insurers be permitted to have subsidiaries engaged inany lawful business, and it endorsed the principle of equal regulation. As a result of the subsequent legislative process, the 1983 law, while authorizing such subsidiaries, added the "bank carve-out" that prohibits insurers from owning specified types of banking corporations, and created the Temporary State Commission on Banking, Insurance and Financial Services, the DeWind Commission, to study the financial services industry and make recommendations for legislative and regulatory change. Earlier this year, the DeWind Commission endorsed allowing insurers to acquire banks and, in a more controversial area, allowed banking institutions to underwrite and market insurance. Governor Cuomo has endorsed this recommendation and a bill is now before the Legislature. It will face strong opposition from insurance agents. My guess is that it will not be enacted this year.

Thus, for the present, a New York life insurer may acquire any kind of subsidiary except specified banking corporations. Incidentally, the law does not prohibit the parent insurer from engaging in quasi-banking activities directly, nor does it prohibit a subsidiary engaging in certain fiduciary activities incidental or reasonably ancillary to an insurance business.

A New York insurer may make an unlimited amount of investment in subsidiaries that hold assets treated as direct portfolio investments of the parent, subsidiaries held in separate accounts, insurance subsidiaries engaged in any kind of insurance business in which the parent may engage, and temporary holdings of subsidiaries acquired in workouts and on exercise of conversion rights.

[1] Massachusetts General Laws C. 175 § 66D.

[2] Massachusetts General Laws C. 175 § 66. Special provisions apply to investment in stock of insurance companies. Massachusetts General Laws C. 175 § 66C.

As for other subsidiaries, the parent's investment is limited to 2% of admitted assets in any one subsidiary, not more than 10% of admitted assets in all such subsidiaries, and not more than 5% in subsidiaries with their principal operations outside of New York. Subsidiary investments are included in the overall equity cap, which limits aggregate investments in equity securities, real estate and personal property to 40% of admitted assets, or 45% if certain socially desirable investments in New York are made.

Mutual life insurers are still handicapped in diversifying through acquisition of subsidiaries. First, they cannot use stock as the consideration for the acquisition, at least not stock of the parent entity. Second, the amount of permitted investment is subject to insurance law limits. This is one reason for today's current interest in demutualization, a topic I'd be glad to address during the discussion period later.

Insurance law is not the only source of constraint on diversification. For example, the federal Bank Holding Company Act would prevent an insurance company from buying a "bank". Normally, acquisition of the bank makes the parent a "bank holding company," and a bank holding company generally cannot underwrite insurance, which could cause minor problems if the bank holding company is an insurance company. However, this did not stop Prudential from acquiring a non-bank bank in Georgia. A bank is not a bank unless it both accepts demand deposits and makes commercial loans. Numerous non-bank bank acquisitions have been approved, but there are moves in Congress to close this so-called "loophole."

In other specific industries, there will be particular regulatory approvals and other constraints on acquisitions.

Now I would like to say a word about the process of doing an acquisition. Let's say that your strategic planning has reached a stage where you decide to seek an acquisition target, that you have found a likely candidate, that you've had enough discussions with its management to think that a deal can be done at an acceptable price if everything checks out.

Particularly, where one or more of the parties has publicly traded securities, it is extremely important to preserve confidentiality regarding acquisition preparations and discussions. Serious legal consequences could follow from premature leaks to persons who trade on inside information.

Depending on the circumstances, it may be appropriate to prepare an agreement in principle or letter of intent. At that point, a carefully prepared press release may be appropriate.

In any acquisition, the federal antitrust laws must be considered. The McCarran-Ferguson Act exempts the business of insurance from the federal antitrust laws to the extent such business is regulated by the states. But it does not exempt from antitrust scrutiny acquisitions in which an insurance company is a party. Market

structure and market shares in the financial services industry mean that few mergers will ultimately be blocked on antitrust grounds, but any significant merger or acquisition will require a filing with the Federal Trade Commission and the Justice Department under the Hart-Scott-Rodino Antitrust Improvements Act.

For example, if a purchaser with assets of $100 million or more is acquiring the stock or assets of a target company with total assets of $10 million or more, then both purchaser and seller must file notices with the FTC and Justice Department. The notice can be filed as soon as the parties reach an agreement in principle, and the parties must wait at least 30 days before closing. The government can extend the waiting period by asking for additional data, but it can also shorten the time period in appropriate circumstances. (Shorter waiting periods apply to tender offers.)

For parties who have never done an acquisition subject to these filing requirements, preparing the filing can cause delay, and preparation should begin well in advance.

For major acquisitions, the process proceeds from strategic planning to identification of one or more targets, often with the help of outside advisors. Again, for major acquisitions, an acquisition team may include not only company officers from various sides of the company but also outside advisors including actuarial consultants, investment bankers, accountants, and a law firm experienced in financial services, mergers, and acquisitions.

Once it becomes time to prepare a purchase agreement, attention should focus not only on the tax and legal considerations bearing on the structure of the acquisition, but also on due diligence and representations and warranties. The purchaser will want to review the target's business, affairs and assets with great care. This process, sometimes called exercising due diligence, is a team effort involving insurance and financial officers of the purchaser, and appropriate outside advisors. This effort should be coordinated so as to be no more disruptive than necessary and to be as effective and cost efficient as possible while still protecting the purchaser against buying a pig in a poke. The key elements bearing on the purchaser's decision to go forward on this valuation of the target should find their way into the representations and warranties contained in the purchase agreement. There will often be an interval between the signing of the purchase agreement and the closing, during which further due diligence can take place. This investigation is not designed to look for problems under the bed. Its purpose is to prevent surprises and to uncover problems before it is too late.

If, before the closing, the purchaser discovers that one of the seller's representations and warranties is not true, the purchaser can walk from the deal. If such a problem is not discovered until after the closing, the purchaser's recourse will depend on the structure of the transaction and how it was negotiated. If you are buying a company from a single seller, i.e. buying someone else's subsidiary, then you should be able to negotiate the right to go back to the

seller to indemnify you against misrepresentations you uncover after the closing. The seller will want to negotiate some time deadline for presenting any such claim, two or three years, and some deductible to prevent the nuisance of trivial claims. If you are buying a publicly held company, there is no practical way to go back after the sellers and, in a friendly transaction, you must rely on your investigation made prior to the closing. It is worth noting, however, that multi-billion dollar acquisitions take place by tender offer, where the purchaser relies on the target's published reports with no opportunity for due diligence.

I have also been asked to talk about legal aspects of acquisitions of life insurance companies by others. Now the shoe is on the other foot, and you are the target. Bringing about the acquisition of your company may be the intended consequence of your long-term strategic planning. You may conclude that your business can best succeed with the capital and other support of a strong parent. Or you may find yourself the unwelcome target of an unsolicited and unwanted take-over proposal.

Obvious targets are publicly held stock companies. Not so obvious are mutual companies. We have seen growing interest and regulatory receptivity to demutualization. And, in my own practice, I am seeing a number of transactions in which a mutual insurance company demutualizes for the purpose of being acquired. The purchaser, in buying stock of the newly converted company, may provide the cash or other consideration that is distributed to the former mutual policyholders. I'd be glad to discuss this further at the end of the hour.

Acquisitions of stock companies can take the form of stock sales or asset sales. Acquisition of the control of a stock insurer requires approval of its domiciliary insurance department under the Holding Company Act and may require prior approvals or courtesy calls in other key states. California may be one.

In a few cases ,it may be better to structure an acquisition as an asset sale through bulk reinsurance. If the purchaser has a properly licensed insurance company as a vehicle for the purchase, then the target's assets can be transferred to the new insurer, and the new insurer can issue assumption certificates to the target's policyholders. This kind of bulk reinsurance often requires the approval of the target's domiciliary insurance commissioner, both for the bulk reinsurance and for the liquidation or extraordinary dividend that will get the proceeds up out of the target to its stockholders. It may also require approval in the purchaser's state of domicile. Careful tax planning should be an early part of structuring such a transaction.

How should a company react to unsolicited take-over proposals? What advance preparation should it make? These are legitimate concerns not only of stock companies, but even of major mutuals considering conversion.

Preparation in advance is appropriate and may often be very important. An appropriate team of experts should be formed. Golden parachute agreements are often appropriate ways of preventing executive job insecurity and they have been much in the news. But in New York, the insurance law limits the ability of domestic life insurers to give their executives long-term employment contracts, even of the traditional kind.

Shark repellent charter and by-law provisions should be considered. The simplest is a classified board of directors, with a third of the directors being elected each year. Consideration should also be given to the now popular "fair price" amendments, which protect shareholders against unfavorable back ends of two-tier tender offers.

Because any change in control requires approval of the domicialiary insurance commissioner, his or her attitude toward the target and its management and toward the offeror will be important in his or her evaluation of the fairness of the proposed acquisition. In many states there will be a hearing on a contested offer, which could take a while.

While there are many aspects of this subject we could discuss, I will emphasize only a few key points. A board of directors has no duty to shop the company or to negotiate with anyone who expresses an interest in negotiating. The board must, however, carefully consider a firm offer that is made in writing. If the board of directors, after careful consideration of such an offer, and after receiving advice from investment bankers and counsel, concludes with the concurrence of non-management directors that the offer is inadequate, then the board has considerable freedom to resist the offer. On the other hand, if the board concludes that the company and its stockholders are best served by a sale of the company, the board should try to achieve the best price it can, whether from the original offeror or from a white knight or other purchaser.

These are complex issues, and today's rapid pace of change make it an exciting time to be involved in the financial services industry.

MR. CHARLES FEUDTNER: I'm sitting in for Dave Pollock, Senior Vice-President of Central Life who, unfortunately, couldn't be here today.

I'm going to discuss the merger that took place on December 31, 1981 between Central Life of Des Moines, Iowa, and Wisconsin Life of Madison, Wisconsin, with Central Life becoming the surviving legal entity. This is one of the handful of mergers that have taken place in the last fifty years between solvent life insurance companies.

In my talk today I'm going to give you some background on the two companies and discuss some of the results of the merger to date, and touch upon my role in it. Then I'm going to share with you an overview of a strategic management model that we've used in managing the merged companies. This overview will establish some concepts and vocabulary that we can use to analyze this specific merger and supply

some insight to mergers in general. Lastly, I'll share with you some generalized conclusions I've drawn from my participation in this merger.

Let's start with the background. At the time of their merger, Central Life was a much larger company when measured by assets; it had over $600 million in assets to Wisconsin Life's $100 million plus. As measured by surplus (Slide 1), Central was also a much bigger company, but both companies had very healthy surpluses of more than 10% of assets.

Total ordinary premium income tells the same story. As you can see from slide 1, both companies had surpluses greater than total ordinary premium income, indicating their slow historic growth and their basic conservative nature. But Wisconsin Life had $66 million in group premium. That was the attraction to Central Life to proceed with the merger. Conscious of its relatively slow growth, it wanted to expand into group to broaden its portfolio and explore the brokerage market where it was not active.

Wisconsin Life, on the other hand, had lost its president and was being managed by one of its board members who was actively recruiting a full time, knowledgeable, life insurance executive. In Roger Brooks, F.S.A., president of Central, he found his man.

So on this general basis, i.e., one company looking for a new product line and one company seeking more professional management, merger talks began in mid-1981.

Let's look a little deeper at this $66 million in group premium that served as the attraction to Central Life. Fifty-eight million dollars of that premium was on the group health side, and as you can see from slide 2, almost 3/4ths of that inforce was put on the books in the last five years. New business in 1981 was exactly twice that of 1980! Most of this business was written by brokers placing business with master brokers appointed on a geographic basis throughout the midwest by the rather small-sized marketing department that Wisconsin Life possessed. Those of you active in this marketplace will immediately recognize that sales increases of this magnitude were obtained by a very cost competitive set of products.

Throughout this period benefit ratios to premium income were deteriorating (Slide 3), and the flood of new business placed upon older manual systems caused backlogs that could only be cured by the massive hiring of more clerks to bail out those backlogs. But these new, relatively inefficient clerks caused the home office expense ratio to deteriorate. By 1980 these two ratios, which do not include the margins for commissions and overrides, plus taxes, licences, and fees, were approaching 100% of premium.

As I'm sure you've guessed, profits had turned to losses (Slide 4). From over $2 million profit in 1977, on a $15 million block of business, profits disappeared in 1980 with a published statutory loss

of $3 million. Indeed, while merger discussions were taking place in 1981, Wisconsin Life calculated a six month's loss of another $3 million.

Everyone at Wisconsin Life was convinced the losses were temporary and that adequate corrective action had already been taken. An independent actuarial consulting firm rendered an opinion pointing out the problems, but coming to the conclusion that proper corrective action would put the business back in the black. In addition, an independent computer model analysis of the savings to be derived by blending the two ordinary operations in Des Moines, while leaving only the relatively independent group operation in Madison, convinced everyone that a merger made excellent economic sense.

On this basis the merger took place, with the clear understanding that the then present group management team in place in Madison would remain and only minimal liaison with Des Moines would be necessary. Roger Brooks became president and C.E.O. of the combined Central.

When the annual statement figures were compiled, everyone was shocked to find that losses hadn't started to abate but had, instead, intensified to over a million dollars a month, and that losses of that magnitude were continuing in the first half of 1982. There had clearly been a loss of control.

Accordingly, in March of 1982 Roger sent in your missing speaker, Dave Pollock, F.S.A., Senior Vice-President from Des Moines to run the group operation. Dave, who had no previous background in group, quickly signed on two consultants to help him almost full time. A retired claims manager from CNA helped organize the inside shop, while I acted in the capacity of planning officer. From May of 1982 to the end of 1983, hardly a week went by without my putting in some time with Dave in Madison.

In addition, fellow senior officers from Des Moines spent a considerable amount of time in Madison, bailing water with Dave. And of course, the people at the old Wisconsin Life pitched in. A few key people were also hired, principally a new chief group marketing officer. It was, and remains, a total team effort with lots of midnight oil being burned.

How did that team do?

Naturally, I would have been reluctant to have accepted this substitute assignment if I thought things had not gone well.

As you can see in slide 5, Central incurred a loss of slightly over a million dollars for the second half of 1982 and achieved a slight statutory gain of $800,000 in 1983. Both of the figures were helped by some excess reserves released but depressed by several millions spent for new, computerized claims and administration systems. Therefore, on balance, I believe they reflect an accurate picture of the financial turnaround. With expenditures for the computerized systems continuing in 1984, we look for essentially a break-even year in 1984.

How was this accomplished? The answer to that is the subject of another panel discussion on group insurance, not one on mergers and acquisitions. I only want to single out those elements of the merger in general, and turnaround in particular, that bear on today's subject.

To do that it will be helpful if I present a brief overview of a conceptual model that guided us for the past two years and will give us here today a joint vocabulary to serve as the basis for my comments.

That model is one that lays out the interconnected choices that must be made in any business operation to give it a clear strategic direction and have each of the levels in the organization adhering to that strategic thrust for profitability.

On a simplified basis, for today's purposes, we can break those choices down into ones involving stakes, games, teamwork, and players (Slide 6).

To quickly grasp this model, imagine, if you will, that you're the possessor of $1,000,000 in stakes and that you're going to bankroll 100 expert poker players in a casino. You wish to give each player the minimal amount of chips necessary for him to stay in those hands he wants to call, in other words, he should never have to fold his hand simply because of a lack of chips to stay in the game. On the other hand, you want him to return immediately to your central control all excess chips he's won so that you can reroute them where needed.

Accordingly, you hire a group of runners to support your expert players by carrying chips to each player, as needed, and carrying excess chips back to you. This enables you to fund the greatest number of players for a given sized starting stake and increases your profit potential.

Using this method, you need to calculate the amount of stakes you should hold back, that is dedicate, for the games already underway in case the pot is raised in certain games. To be mathematical about this, you also need to calculate the expected amount and timing of excess winnings to be returned from the present games. This will lower your minimal dedicated figure. Naturally, you also want your poker players and runners to be on some reasonable incentive plan that rewards their winning and penalizes their losses.

This Casino story serves as a useful analogy for playing the insurance game. The details change, but the essence remains the same.

In insurance (Slide 7), we raise resources from stakeholders and reward those stakeholders by meeting competitive standards of return on those resources. Like our central financier, those resources are loaned to the players who play the actual games. In Central, this central financier is Roger Brooks, who sits above the senior vice presidents heading up the strategic business units (SBU) who play the actual game.

Dave Pollock heads the group game. Dave must present a sensible business plan that covers, among other elements, the customer value needs (CVN) he's going to serve with his end products and services (EPS), and the distribution systems he's going to use. Each time Dave targets different customer groups, he's got to reexamine his product portfolio for applicability to that group, the appropriateness of distribution systems, etc.

All of this has gone on extensively over the past two years, and all of this must be done in light of competitive pricing models that limit the margin in any premium dollar that can be used as income to the organization to cover the expenses of producing the support products and services (SPS) necessary, i.e., claims systems, administration systems, etc.

And lastly, jobs have to be defined to produce those support products and services. Good people have to be put in place in those jobs and given proper incentives for the value they've added to the operation.

Our model then has stakes, games, teamwork, and players. Let's use this overview model for a retrospective analysis of the merger (Slide 8).

From Central's perspective, they had ample surplus and stakes to play the new group game. Wisconsin Life had the game, the underwriting, claims, and administration systems plus the skilled, experienced players to play the game. As an added fillip, Wisconsin Life added $18 million to surplus and that was after the $10 million loss in 1981.

From Wisconsin's perspective, they brought the game that Central wanted, and Central brought good skills in the computer systems area which would be needed to modernize the manual operation. Central also brought Roger and his experienced team of senior officers to supplement the skills base of Wisconsin. And, lastly, and very importantly, Central brought more surplus, which in the light of the losses in 1981 and 1982, provided a tremendous cushion during the turnaround.

While I have not met anyone from the old Wisconsin Life who did not believe (prior to the merger) that the added surplus would not be necessary, I'm convinced that subconsciously, at least, they had the gnawing suspicion that added surplus might be needed, hence the added inducement to the merger. As this model indicates, there was, and is, a very good fit between the two merger partners.

Let's begin to generalize by digging in a little deeper at this concept of financial models, which has been an essential element of the work of Central's group SBU.

In slide 9 is a model for a profitable competitor in the group health trust business. This is a model of how things should be if a company is to be profitably competitive, not necessarily how they are at a given point in time. In this model, the income on new business

(premium and investment income) is measured against total expenditures (for benefits, taxes, licences, and fees, plus all expenses). The same analysis is made on the renewal side.

This model, at any given point in time, is the best guess as to the most favorable patterns that competitive market ratios allow.

On both new and renewal business, the profitable competitor is going to make a net gain. The added expense of new business should be offset by the impact of underwriting in the trust area.

Models such as this one were constructed for each subset of the group operation, and actions were put in train to make actuality conform to the models. For example, actual expenses, much higher expenses, were compared to the models. Dave Pollock never unilaterally made any cost reduction decisions. He let the numbers speak for themselves, and the team of managers made the tough decisions in their own areas.

But expense reductions and the substitution of more cost effective computerized claims and administration systems can't close the whole expense gap. Necessary fixed expenses simply can't be covered by the competitive margins in a block of business the size of Central's.

In slide 10, for example, might be the contribution to fixed costs from expense margins in four products at current size levels. The total for fixed expenses doesn't cover the actual fixed costs. Simply stated, the block has to be bigger; Central's group SBU has to play more games.

For illustrative purposes, let's say that the minimum size is $100 million in group health premium. Does Central have stakes large enough to play the larger game?

Certainly it does!

Would the old Wisconsin Life? I think not!

How can that be if there should be no loss in either the first or renewal years? Conceptually, if you never lose, you can play an infinity of games on meager startup resources.

What is it that Bobbie Burns said about Mice and Men?

Or Murphy?

Something always goes wrong and we need the resources to withstand those unhappy, if temporary, times.

A model such as this one, which does not plan on a first year loss, is decidedly different from this classic model (Slide 11) for the life industry's traditional ordinary life product, in which a minimum first year investment of 60 cents on a dollar of new premium is anticipated to be recouped by a series of persisting renewal gains.

I should mention at this point that while the group SBU was turning around, the entire block of ordinary renewal business was transferred to Des Moines where it is being administered without any additions to staff. This clearly increases the renewal profit on that block of business and adds value to the merger and to Central.

This ordinary model calls for the reduction of statutory surplus through the investment of new business. This writing off of new business for statutory purposes confuses the industry's score keeping methods by which each company computes its stakes. GAAP helps, but is not responsive enough in measuring the changing fortunes at the 100 poker tables. Good luck, i.e. improved profit, is almost never recognized while bad luck, i.e. reduced profits, are recognized only if management chooses to do so.

Clearly a better method is needed to compute one's true stakes position to honestly evaluate which games can be safely played. One method that I like is the Intrinsic Surplus method (Slide 12). As an ex-New York State Insurance Department Examiner, I'm not suggesting that this be substituted for annual statement accounting, but I do believe such a method, in some form, is needed by company management to truly calculate its stakes and correctly evaluate the risks it has taken and can take in contemplating any merger or acquisition.

If a company buys a bond, the value of the bonds or mortgage are assumed to equal the cash outlay and total assets remain the same. Under an Intrinsic Surplus approach, investments in insurance policies would be treated as any other investment, such as a bond or mortgage. Instead of writing off the investment in new business, the new business investment would be capitalized as an investment in working surplus. This presumes, of course, that the investment in insurance was made at a competitive investment rate.

For each subsequent year after issue, in essence, the company would do a modified gross premium valuation of all business inforce to arrive at a working surplus figure, much like the figure from our gambling casino analogy: how much return do we really anticipate receiving from the games now being played discounted at current market rates?

Given that information, computed for a mutual company on a post policyholder dividend basis, and a realistic figure for the amount of stakes we have to dedicate to cover existing games, we arrive at a much truer reading of the free surplus we have to take on new games, either directly or through merger or acquisition.

Consider four hypothetical companies (Slide 13). Each has exactly $100 million of statutory surplus, including the MSVR, yet each is in a different position for playing games.

Company A feels, based upon the forthcoming reports of the C1 to C4 committees of the Society, that it needs $40 million in dedicated surplus to cover its contingencies, leaving $60 million free for possible growth or acquisitions. It also calculates that it has $40 million of value in working surplus that will be returned to statutory surplus as time passes. The sum of these three surpluses equals

intrinsic surplus. If all games were to cease and all chips cashed in, the intrinsic surplus should be what's left; no need for dedicated surplus and all working surplus returned to free surplus.

Company B, with a much smaller free surplus, possesses a much larger working surplus. As that source of funds flows back into statutory surplus, Company B can take on larger games. Given the certainty and timing of the return of this working surplus, it's conceivable that Company B has equal or greater latitude than Company A.

Company C has still greater latitude, while Company D may be flirting with insolvency and should perhaps be looking for a merger partner or acquirer.

With the magnitude of numbers adjusted, the profile of Company D fits the former Wisconsin Life. Wisconsin had sustained a loss of $10 million on a book of $58 million, or a 17% pre-tax loss. Does a dedicated surplus position of 30% seem adequate in such a situation? If so, the entire statutory surplus of $18 million had to be dedicated to the group health line. And, obviously, the value of the working surplus on a block of losing business isn't worth a heck of a lot.

Futhermore, if our prior analysis that to be truly profitable at competitive rates requires a block of $100 million, could the old Wisconsin Life have prudently taken the risk of so increasing the size of its block? I think not!

All of my reasoning for the last few minutes, leads me to the conclusion that every company should more closely examine the games that it is playing, or the games that it would like to play, to be sure it has adequate stakes at competitive pricing levels.

But stakes (resources) in the insurance sense are of two kinds: financial, and key entrepreneurial, managerial resources. If a company splits its financial resources, as we've indicated in slide 14, into three groupings; working, dedicated, and free, it can also, conceptually, split its key human resources accordingly. Almost all companies will find that all their key human resources must be classified as "working", that is, playing in current games. There are few dedicated human resources ready to be committed to the game when needed and almost no free human resources ready, willing, and trained to play the next game, yet invariably, once the merger or acquisition is completed, the senior partner will have to throw in key people. I stress that it should be a team. One new manager alone will undoubtedly be overwhelmed by the difference in corporate cultures.

Matching corporate psychological approaches is as important in successful mergers as pure economic business logic. Dave Pollock and I spent many a night discussing how a certain decision would work in practice in the different corporate cultures in Madison. Why acquire or merge unless the new entity works in practice as well as was designed to work in theory?

My advice is to have that team of "free" managers available before or at the time of merger or acquisition. They're certainly going to be

needed. A key part of merger evaluation is a measurement of the stakes (the resources levels), human and financial, that will be required.

Part and parcel of that evaluation of stake levels is an evaluation of the strategic focus the company intends to take over the coming years. This thrust defines the games it intends to play over the next several years.

Slide 15 attempts to compress into two dimensional space some of the strategic focuses that a company, let's say a life company, can take.

Moving in this horizontal plane, a company can attempt to grow by a "product focus" by which I mean that it will stay with present products and expand across geographic, demographic, or industry groupings.

Moving up this vertical plane, the company can attempt to add all the appropriate services demanded by its current market focus. It is willing to play new games; adding Bridge and 21 to its poker repertoire. American Express is moving in this direction with its definition of its market being, I sometimes think, the whole world.

Moving in a diagonal upward plane, a company could expand to sell whatever products and in whatever markets its distribution force can take it. An "Avon Life calling" approach, or a stricly general agency system approach.

Each of these directions is separate. Few, if any, companies can afford to move in more than one direction at a time; there are simply too many games that could be played. It seems to me the upward thrusts will require much greater stakes, both human and financial, than the straight horizontal thrust. Few companies will possess the stakes to move in this upward direction alone. To the degree your company is not one of them, and your company believes that the future belongs to such full financial services approaches, then it seems that you have to seriously consider a merger or being acquired into a conglomerate to gain access to such increased resource levels.

I also believe that too many insurance companies attempt to grow in the horizontal direction by geographic expansion long before they have achieved even minimal market penetration in existing markets. This "forced" growth pattern can also consume a considerable amount of stakes. In this direction the average sized company should consider merger with, or acquisition of or by, a regional partner.

I believe that the company of average size, with limited stakes, that truly wants to go it alone without benefit of merger or acquisition, should stay below the line and focus on a niche of some sort, be it a specialty product, or by gearing up to be a low cost producer of a commodity product such as Yearly Renewable Term Insurance, or by carving out a geographic, demographic or industrial niche.

With finite, limited stakes a company must shape and limit its strategic thrust (limit the games it will play) accordingly. Having

laid out that focus, the company should only look at those potential partners that fit the focus. It has devised a screen that sorts out the ones it wants to look at further from the mere distractions that will take the company in another direction. Why spend time checking out bridge players when you've determined you're going to stick to poker?

Summing up, success in mergers is a before and after proposition:

- o Be sure your company has a clear sense of the strategic focus it wishes to pursue.
- o Be sure the chunk you contemplate biting off is within your resource limitations, both human and financial.
- o Search diligently for candidates that truly fit your screen of criteria.
- o Don't just fall in love with the first company that comes knocking on your door, be hard nosed and suspicious.
- o Don't attempt to close the "perfect" deal. Don't be afraid to take a chance and make a deal, a less than perfect deal. You can always work hard after the deal is closed (a la Central Life) to make it a success.
- o Don't be afraid to throw more financial resources into the act after the merger or acquisition is complete to ensure success, and by all means be prepared to throw your best human resources into the acquired or merged company.

Every acquiring company needs its own Dave Pollock to lead a team into the new situation to, in that dictum made famous by Waterman and Peters, "do it, fix it, try it", to make it work.

I'm sure that Central Life emerged from the merger surer of its sense of focus, more confident of its ability to enter into advantageous relationships, and far, far more confident of its ability to make any deal a good deal by simply working at it. Central is a far stronger, more confident company today than it was prior to the merger.

I'm delighted to have been a part of that growth process.

MR. MCLEOD: Jim, from your experience of mergers, how many or what percentage of them would you say have been successful?

MR. MACNAUGHTON: Do you mean successfully completed or successfully run after that?

MR. MCLEOD: The latter.

MR. MACNAUGHTON: I'm not sure if I'm the best one to answer that. I guess our experience is that in the event that people were fairly satisfied with knowing the business they were buying, not necessarily whether the business was as clean or as efficient, but at least what

business they were buying into, those have been fairly successful. Where they've found that they've bought something that they didn't know what they were really buying, those have had a pretty tough time I think. I think it's also fair to say from a non-insurance sector, those companies that directed their capital in too many directions have found that in respect to whether the business was successful or not, it wasn't successful to the organization as a whole and eventually, and today's time is a good example, they've had to pare back the number of things that they're doing. I think that's a good general statement.

MR. MCLEOD: May I ask the other two panelists what is the most important factor in a successful acquisition. Or to put it another way, what thing, if not done properly, is mostly likely to cause problems?

MR. FUEDTNER: I've given you the sum total of my experience with mergers. I do think the corporate culture between companies is very significant. Dave Pollock and I often sat around at night talking about how we would play in Madison as opposed to how we would play in Des Moines. So my background has been on the "after the deed is done let's make it work" side. I don't know which side is more important. I think that it's very important to have people to make it work.

MR. DWIGHT BARTLETT: This question is addressed to Mr. Feudtner. In that chart in which you showed growth strategies you said that few companies have the resources to play above the line. It seems to me that a lot of the more modest sized companies have approached that by, in effect, becoming the distributor for products manufactured by other companies. Could you comment on that. Is that, in your opinion, a viable strategy for medium sized companies to diversify?

MR. FEUDTNER: I think it's a very good strategy. If it's a life insurance company making its money on its products, I think it has to have a product to distribute. I personally believe the life insurance business could split into, I'll call it, mega agencies, and that agency like the American Agency system on the casualty side could finance itself totally, independent of any company, by selling many company's products. It's possible that a life insurance company could own that type of agency, or a few of them might share it, but unless the company has some interest in that marketing device, I think it has to make money on its own products. And I'm really saying, if you're going to be product driven, you have to have some niche. If you're small, you can push your product through any distribution system.

MR. MCLEOD: Dick, from your involvement, if a company is considering an acquisition, at what point should the different parties such as an attorney and investment banker be brought in?

MR. DUNHAM: I think that will depend a great deal on the particular circumstances of the company that's considering making the acquisition and its particular internal strengths. There are many companies that have considerable in-house ability to evaluate the financial, the legal, and other aspects of doing an acquisition. Other companies don't. I think that it is certainly possible to, and companies are legitimately concerned about not running up huge expenses during the

early preliminary exploratory phases. But, that can always be managed by having a clear understanding with the outside professionals just what kind of budgets they want to establish at the outset. I think that some good planning with the right internal or external expertise as to structure, as to what's available out in the marketplace, can prevent a lot of false starts.

MR. SAMUEL ECKLER: Would anyone in the panel be prepared to tell us something about the trend toward demutualization in the United States, and perhaps in Canada as well? There was a reference to I think two of them, by one member of the panel, and I'm curious to know where that whole situation sits at the moment.

MR. DUNHAM: I think that there are a number of strands to that trend. One strand is the numerous pressures on mutual life insurance companies that push in the direction of demutualization, and we've talked about them. Their tremendous need for capital, which they can't raise in the equity markets, the inability to use stock as a consideration for acquisition, as well as the restrictions that I touched on about the amount of diversification that can take place, consistent with appropriate protection of policyholder surplus from exposure to the vagaries of newly acquired subsidiaries.

I guess that some people say that the discipline of being a publicly held company, accountable to stockholders, has advantages and disadvantages. I think that with the fact that the New York legislature now has before it a bill to permit mutual life insurance companies to demutualize, (a bill that has a lot of problems in it, from my perspective anyway, because of some things that the New York department has included in that bill), there is going to be a trend toward legislation permitting demutualization. California recently enacted such a law, and I think that's going to happen on the life company side as life companies prepare to be even larger players in the new financial services industries. New York has for several years permitted demutualization of casualty companies and there have been quite a number of conversions across the country of casualty companies. New York has one that's on hold, Exchange Mutual in Buffalo, which is awaiting market conditions for the public offering that will finance the acquisition. And I think that there will be a kind of two tiers of demutualizations that we will be seeing in the coming years, the medium to smaller sized companies that are doing it in order to either survive if they're a troubled company, or a company with marginal surplus, or to be acquired or become a part of a larger financial services group. Then maybe, after some time, conversions of some of the larger life companies.

There are lots of hurdles, and I don't need to tell this audience that actuarial issues are very complicated in a demutualization of a life company. Not only valuing how much value should be distributed or made available to the entire body of policyholders, as the consideration for extinguishing their membership interests; their right to vote and to be members of a mutual company, also the very difficult matter of allocating that among the different blocks of business on a basis that's fair and equitable. It's very difficult, but I think it's doable.

MR. MACNAUGHTON: I'd like to add a couple of things. I think it's fair to say that the biggest mutual companies in the United States are all studying the question, and in some form I suggest that they will move towards stocking themselves, whether it is a complete demutualization or if they find it's more favorable from a timing standpoint to do it in some other form, some other stepped staged manner. There are a couple of things, however, that I think are important debilitating factors to the entire demutualization process, the first being the question that Dick was just talking about of valuation, more importantly who gets what and in what form, and I stress the what form. That ties into the second question, and that is how much capacity is there to buy stock of newly converted life insurance companies, and over what period of time? Recognizing that among just the 10 largest, I think there's an aggregate surplus of 18 or 19 billion dollars. Each one of those companies has several million policyholders. Divide several million into that number and you end up with a lot of small stockholders, and for those people that work for stock companies you know how expensive it is to service a single odd lot stockholder. So, there has to be something that can be done about that, and the more small stockholders that are uneconomical to deal with, the more stock you have to sell to somebody who's not potentially a stockholder now. It makes it a very difficult process.

MR. FRANK LONGO: Mr. MacNaughton, why do you think there have not been more mergers between mutual companies? Also, do you anticipate that the number of mergers will pick up considerably as deregulation proceeds?

MR. MACNAUGHTON: The first part of the question I think is a very practical idea theoretically, and I think that all of us would agree that if you leave the human side of a combination of mutual insurance companies away from that kind of transaction, it makes a lot of sense, theoretically. Unfortunately, we don't live in quite such a theoretical world. The practicalities of putting organizations together where you're dealing with opportunities for people to do what they do in their own organization, when you only need one of that kind of person, or, matching organizations where they have different styles, when they don't have to do it for any reason, up until recently, is a very difficult concept in theory to get across. To my knowledge there has only been one transaction that almost happened, and that was curtailed. I know there have been conversations among lots of different companies about doing it, but the conversations unfortunately unwind fairly quickly when you start dealing with all of the human and other kinds of matters that you have to deal with. Not because they're impossible to get over, but more because you don't have to do it unless there's a real financial problem that creates the need for that.

The second question that you asked, yes, we think there will be a substantial contraction of the industry in the next several years. Let's categorize that as the 1980's, which I guess has only 5½ years to go. That's not a very long period of time considering the number of companies, volatile interest rates, and the likelihood of products continuing to change as quickly as you all have decided to change them. It's difficult for a smaller company that doesn't have

personnel or the capital to dedicate to research and development, if I can put it that way, to keep up with the companies that do. With the markets changing as quickly as they do, you have to be able to do that, and that's a natural reason. I guess the second reason why we think the acquisition activity will accelerate, is as companies see that they need either additional ways of getting to their market, whether it is trying to distribute a new product or new products, or it's trying to gather more assets to manage themselves and make a spread. They see that it probably is at least as cost effective, and maybe cheaper, but certainly a lot more timely, in other words quicker, to buy something that already exists than to try to build it yourself. That's an argument that lots of people make when they look at an aquisition and say I'm going to spend X billions of dollars to be involved on this acquisition. That seems like a lot of money; I could start it up more cheaply myself and go out and pay X number of dollars for these great people and systems, and etc., etc., and it would be cheaper. Well, most people that I know of have come to the conclusion that the timing just doesn't work out, and in fact there are a lot of things that people buy that you just can't duplicate. All of those reasons I think will cause the big companies to continue to accelerate the activity.

MR. RICHARD ROBERTSON: My question is for Jim MacNaughton. Consider a situation where a company has made a decision that it's going to make an acquisition. Presumably it's set certain parameters and objectives. It then comes to you and asks you to help them do this. How do you go about it, what do you do?

MR. MACNAUGHTON: You're talking about buying a company, or selling a company?

MR. ROBERTSON: Buying.

MR. MACNAUGHTON: Let us assume for a second that the acquiring company knows the business or the segment of the business that they want to get into or expand into. I hesitate to use examples, so we'll talk generically for a second. They know approximately what they need in their own organization from a magnitude standpoint to be meaningful. I stress that for a couple of reasons; one, meaningful to your own organization, so you're really adding something to it from an operational or business standpoint, and secondly, meaningful enough to senior management, who are necessarily going to pay attention to any acquisition transaction. So the magnitude is important as well. If you have those two things well in mind, there are three or four steps that are general and there are subsidiary steps within each general one.

The first is to identify, assuming that you've identified the area or business or product or whatever it is that you want to acquire. Identify those organizations which have what you're looking for, leaving aside for the second the practical aspect of whether they might be interested in combining with you. Stage two in the identification process is to whittle down the potential targets who would fit into your organization best, meet the size requirements, and therefore the cost requirements. Thirdly, and probably most

importantly, is a company which presents a reasonable likelihood that they would sell. I stress that because people spend an awful lot of time on studies and outside advisors fees, which are probably not as expensive as inside people's times and efforts in worrying about trying to acquire a company and then to find no way, no how, never. That's a pretty expensive lesson. Stressing a company where there is a reasonable likelihood that they would positively accept an overture given certain circumstances.

Once you've identified a reasonably narrow universe, I would suggest that through a fairly detailed financial analysis and operational analysis, outside of any conversations with the target, you narrow the field down to as few as one, and one is preferable at a time if you're serious about it. Then decide, once that's done, what the best way to make an overture to that company is. It can be done through a number of ways; through a director of your company, who has a good relationship with somebody on their board, or it could be your senior officer calling the senior officer of that company and just suggesting they talk about things of mutual interest, or it could be through an intermediary if that's the best approach. It's generally best to do it where somebody knows somebody else, and they can have a conversation where there's no risk of saying what you really think, and concern yourself whether you're doing it properly according to game strategy, or whatever it is.

Response of an initial meeting will generally tell you how successful you're going to be after that in really pursuing or not pursuing.

MR. LONGO: Mr. MacNaughton, does the anticipated entry of banks into the insurance business have the effect of bidding up the price of life insurance companies today, or is that too far off to have any effect currently?

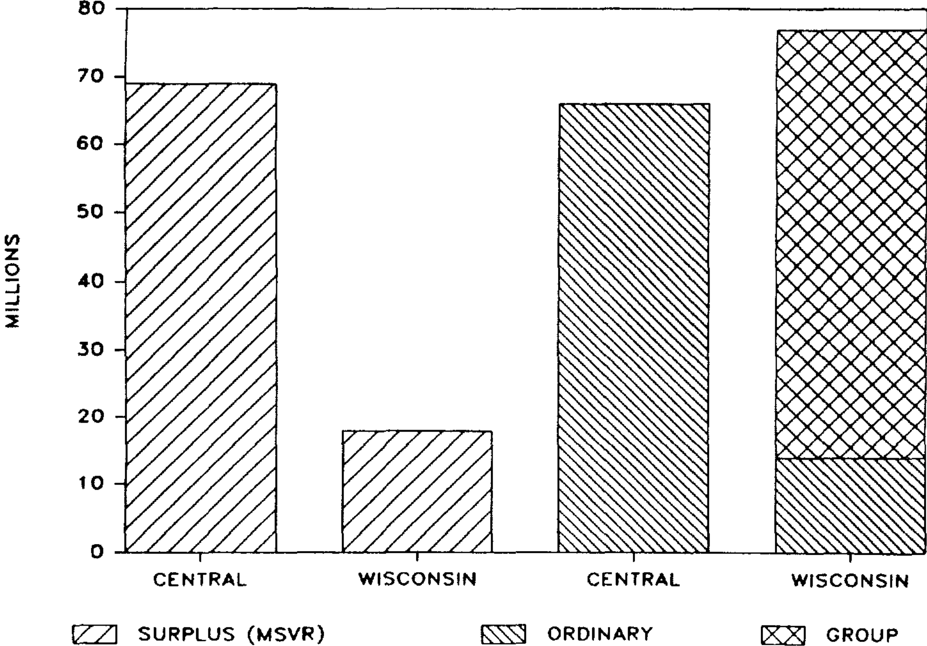
MR. MACNAUGHTON: I think it's too far down the road to have any substantial effect now, especially in light of the problems the banking industry is having with their own business. Dick may want to comment on the DeWind Commission in New York. Generically, the DeWind Commission suggested that the banks in some manner would be able to get into the insurance underwriting business and brokerage business. It seems to me, and I don't know that I've read anything different than anyone else has read, that with the problems with the banks, the pressure on regulators, or the pressure that certain people that might have, to push through some of this legislation is going to be a lot more difficult. I know that different things were coming out of Congress recently about change of attitudes and relaxing the ability of a holding company, for instance, to be in both businesses. We don't see that that has had any effect. I think that the uncertainties are still too great. I also think, in this market with the way businesses and earnings are going, that people are much more cautious today then they might have been a few years ago when things were a little bit better.

MR. DUNHAM: I agree with you Jim about what you said about DeWind. DeWind tried to address permitting banks to come into insurance the way that commission could on the state level, proposing that New York

banks be allowed to acquire insurance companies. That becomes, in my view, more dubious as in the current environment we see that the banks themselves are having their own troubles, and exposing the bank itself to the insurance business I think raises questions about their safety and soundness. Allowing a bank holding company to buy an insurance company is really a federal law problem that Congress has to address, and I think the factors that Jim has mentioned create greater hurdles for that happening.

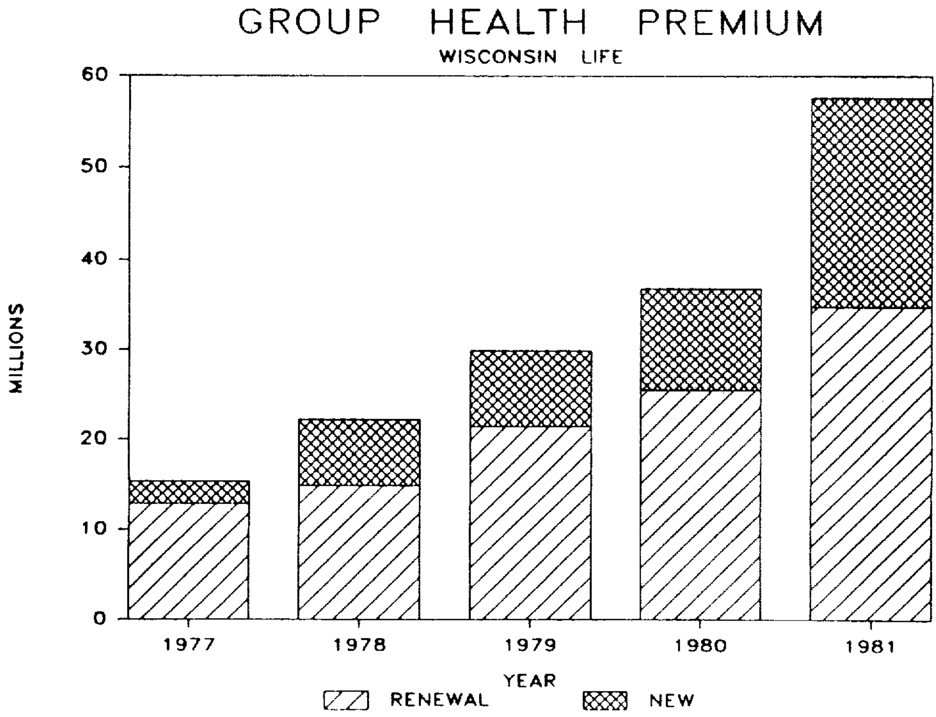
MR. MACNAUGHTON: Dick, do you get the sense from the contacts that your firm or you have with legislators that, in fact, that's true, or is that just kind of a personal speculation?

MR. DUNHAM: I guess I have to say that from my own personal experience, it's only a speculation. In other words, I haven't had conversations with legislators on that point.



SLIDE 1

SLIDE 2



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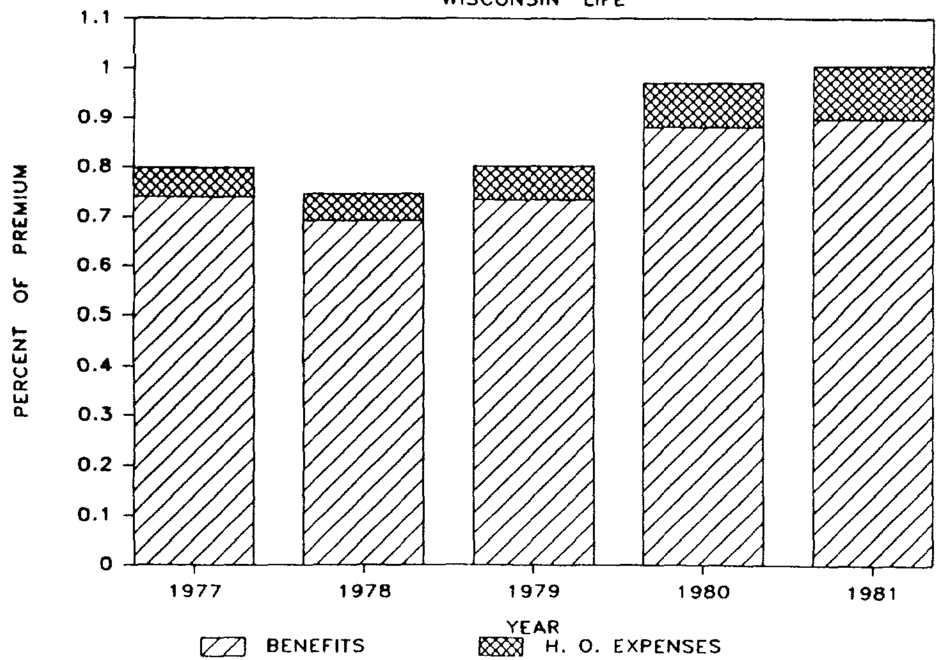

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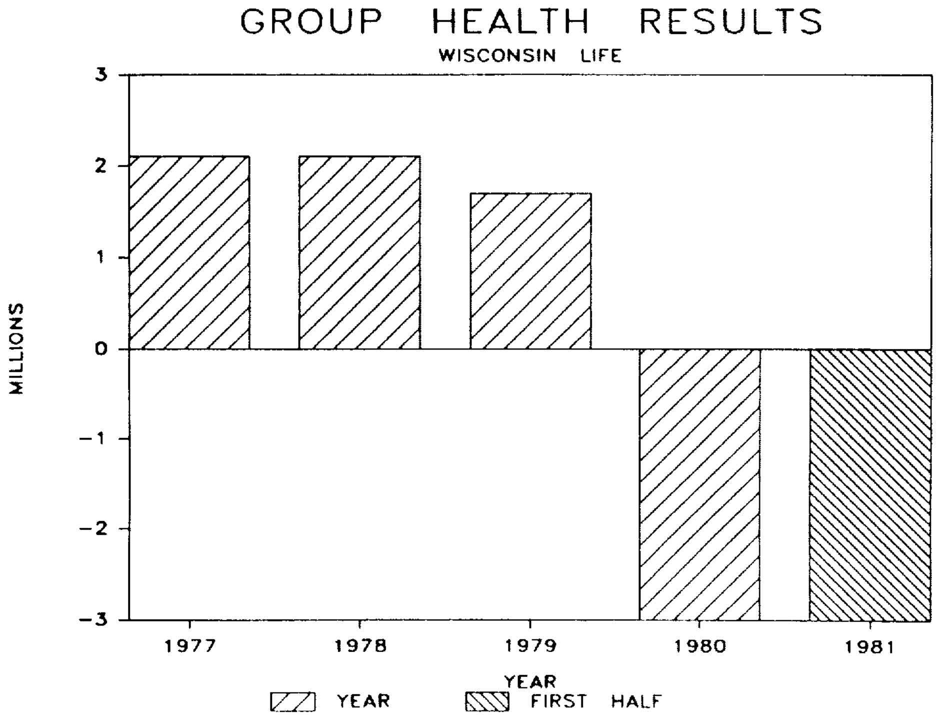

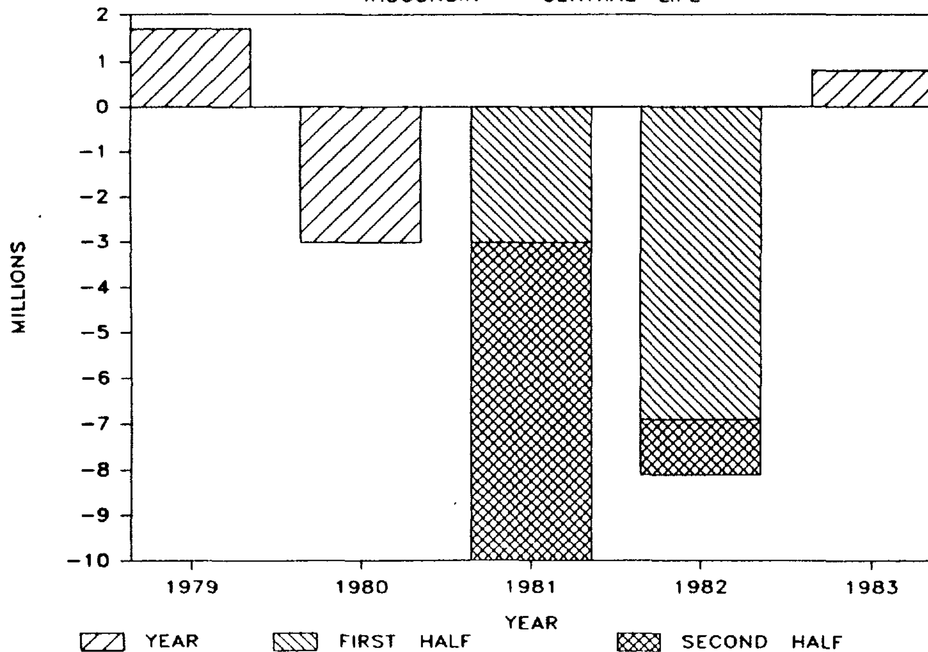

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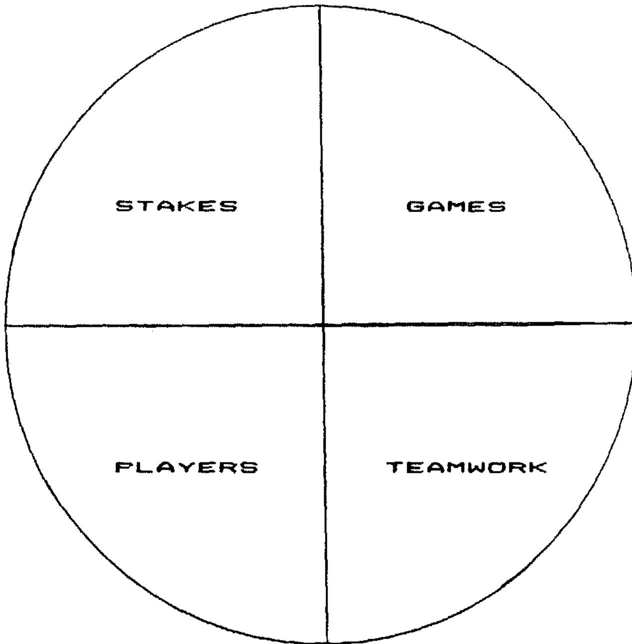


SLIDE 7

STRATEGIC MANAGEMENT WHEEL

STAKES	GAMES
RAISE RESOURCES	BUSINESS PLAN
STAKEHOLDERS	C. V. N.
STANDARDS	E. P. S.
LEND RESOURCES	DISTRIBUTION

PLAYERS	TEAMWORK
JOBS	FINANCIAL MODEL
PEOPLE	INCOME
INCENTIVES	EXPENSES
VALUE ADDED	S. P. S.

SLIDE 8

CENTRAL

STAKES	GAMES
SURPLUS	WISCONSIN GROUP

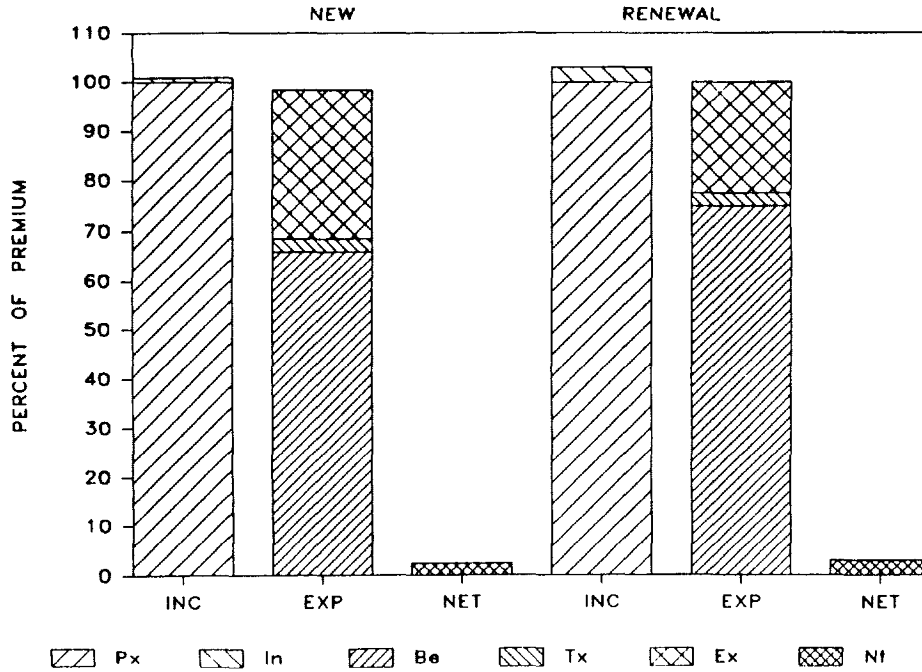
WISCONSIN SURPLUS	

PLAYERS	TEAMWORK
WISCONSIN PEOPLE	WISCONSIN SYSTEMS

WISCONSIN

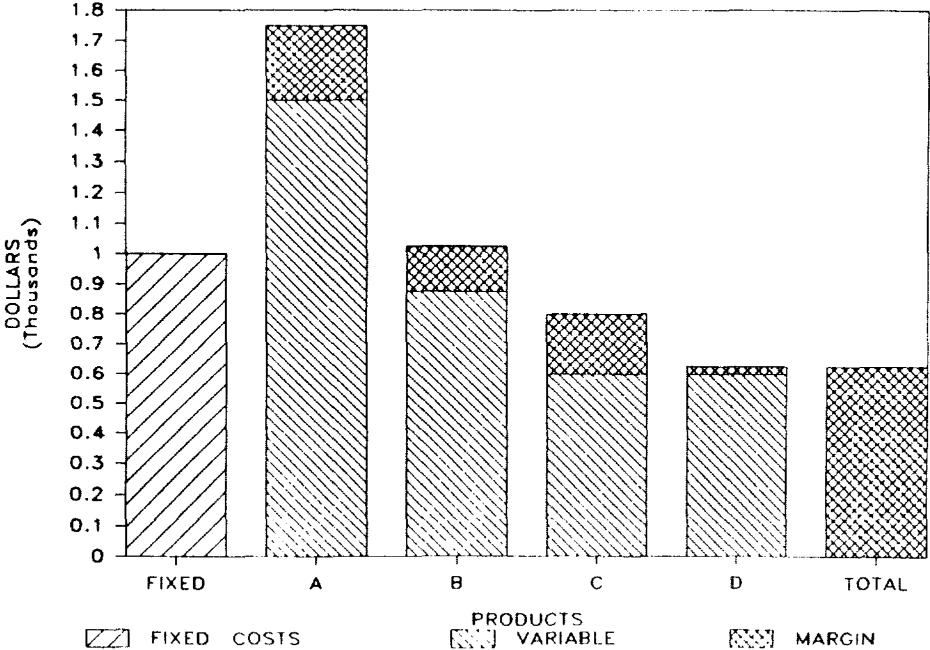
STAKES	GAMES
CENTRAL SURPLUS	GROUP

PLAYERS	TEAMWORK
CENTRAL PEOPLE	CENTRAL SYSTEMS

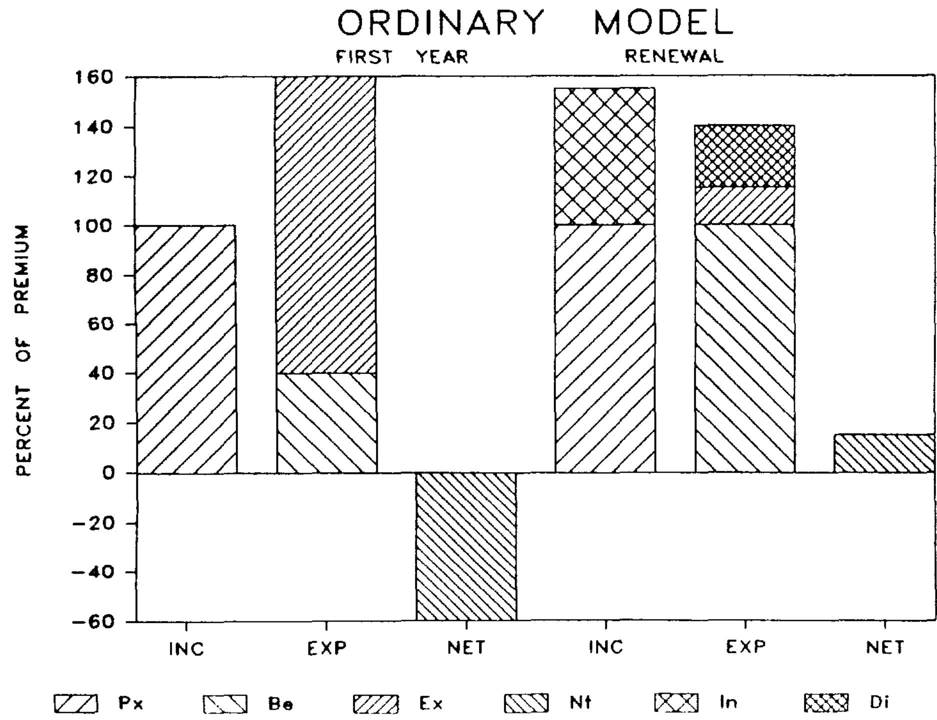


SLIDE 9

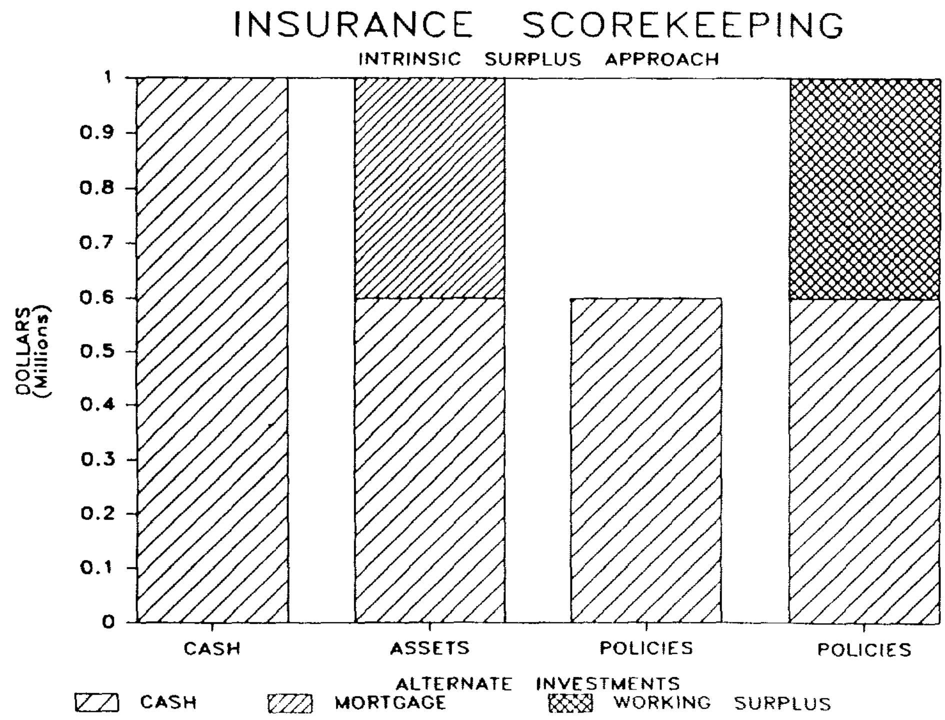
SLIDE 10



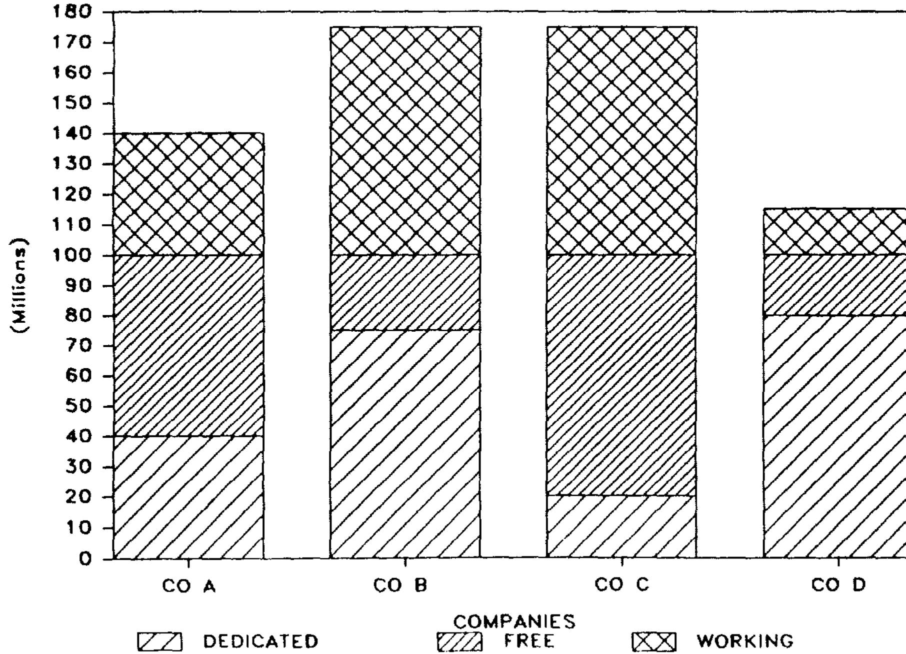
SLIDE 11



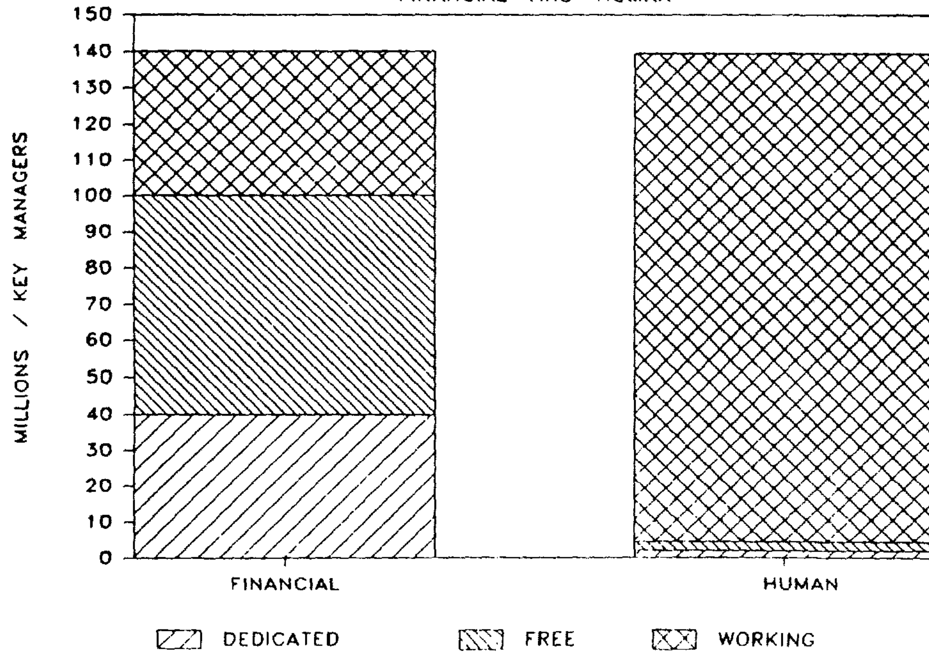
SLIDE 12



SLIDE 13



SLIDE 14



SLIDE 15

GROWTH STRATEGIES

MARKET FOCUS	GEOGRAPHIC	INDUSTRY	DISTRIBUTION FOCUS
	DEMOGRAPHIC		

BANKING

STOCK BROKERAGE

INSURANCE

LIFE INSURANCE

CURRENT POSITION

PRODUCT FOCUS

COMMODITY PRODUCTS

SPECIALTY PRODUCTS

PRODUCT FOCUS	GEOGRAPHIC	INDUSTRY	NICHE FOCUS
	DEMOGRAPHIC		

FOCUS STRATEGIES