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USE OF REINSURANCE IN JOINT VENTURES

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Joint ventures are becoming more and more common as companies enter the increasingly competitive marketplace of the 1990s. This session will explore:

- Reasons to use joint ventures
- How reinsurance accomplishes desired goals
- Advantages over other possible solutions

MR. MELVILLE J. YOUNG: Our first panelist, Tim Herr, is going to tell us a little bit about why one might want to be in the business of reinsurance in joint ventures. The next speaker, Karen MacDonald, is going to talk about the financial aspects; how one would look at joint ventures or block purchases from an actuarial perspective. The third speaker, Barry Shemin, is going to talk about implementation of the deal. At the end I'll give you a checklist of things that you should try to keep in mind, regardless of which side of the transaction you're involved in.

Tim is with Mutual of Omaha. He's been with one or another of Mutual of Omaha's companies for the last 12 years. He's managed the individual and small group health reinsurance activity for the past eight years, and recently has changed responsibilities. So he told me to tell you he's not doing any of this stuff anymore. He's in charge of their operation that looks at alternative distribution mechanisms. Tim has managed the acquisitions activities for Mutual and United of Omaha for the last three years, and the individual life reinsurance activities at United for the past two years. He's been involved with, and responsible for, divestiture activities at Mutual of Omaha. He graduated from the University of Iowa with a BS in math. He currently serves on both the ACLI and NAIC advisory committees on reinsurance, and recently he served on the ACLI assumption reinsurance task force.

MR. TIMOTHY J. HERR: Many of you may have read recent articles in trade publications like *The National Underwriter* or *Best's Review* that have trumpeted the steady acquisition and divestiture activity in our industry as a whole. From the selling side, we see companies making decisions to look for alternatives for lines of business that no longer meet the strategic direction of the company. Hopefully, these alternatives will generate capital and surplus as well as free up human resources that can, in turn, be dedicated to the "core" business.

Since I got my start in the industry in the early 1980s, it is an interesting adjustment from seeing companies try to do everything on their own to now hearing advice and direction along the lines of "Get Back to the Basics" and "Stick to Your Knitting."

From my perspective, these comments are prevalent through all lines -- life, health and accident, and property and casualty -- as well as individual and group. The exciting thing about what is happening is that everybody's situation is different -- there is not a consensus on what lines to get into and what lines to get out of. For most sellers, there appear to be buyers. I find I can't tell the buyers and the sellers apart. If everybody's doing this, headed a certain direction, they have opportunities to buy and to sell.

STRUCTURING ACQUISITIONS
I will begin with a brief run-through of the basic structures these transactions can take. Each structure has its own advantages and disadvantages that are critical to individuals developing an acquisition strategy for their company. I will not attempt to critique each structure at this point, but will save comments on the appropriateness of each structure as they apply to specific examples I will discuss later.

STOCK PURCHASE
First of all, we can look at buying companies -- lock, stock, and barrel. This is not going to be much of a joint venture activity.

ASSUMPTION REINSURANCE
The second structure we might look at would involve the use of assumption reinsurance. The general goal of assumption reinsurance is to transfer policyholders from the selling company to the buying company as effectively as if the entire company was sold. The intent is for the acquiring company to effectively become the direct writer. This has been under some scrutiny by the NAIC recently. The development of a Model Bill is now in front of the Commissioners' committee on this, and it introduces some interesting things for us to address with regard to assumption reinsurance.

INDEMNITY REINSURANCE
Finally, business may be acquired through the use of indemnity reinsurance, either with or without an administration agreement between the buying and selling company. Here the selling company retains primary liability for these policyholders as the policyholders remain directly insured by the selling company. No direct insurance relationship between the policyholders and the buying company (reinsurer) exists. However, by including an administration agreement, the buying company can service the policyholders -- but in the selling company's name.

Indemnity reinsurance really is the one that I see as the joint venture opportunity for acquisitions and divestitures. With the scrutiny that insurance companies are going to be getting, with regard to solvency, the seller is going to have a concern about the buyer on assumption reinsurance. It may well be worth their while just to keep the business in their name and set up some type of operation where the selling company passes the administrative responsibility and the liability onto the buyer, and yet maintains some semiactive role in keeping track of what's going on with the book of business.

WHY ADOPT AN ACQUISITION STRATEGY?
Granted, there are probably as many reasons to consider (or not to consider) a proactive acquisition strategy as there are companies. However, I will highlight at least a couple of scenarios that may exist to lead a company to look at acquiring business from another carrier as a possible alternative.

CRITICAL MASS
The first is simply a "critical mass" issue. A company realizes it needs to generate larger volumes of business to support the associated fixed costs. While sales and marketing look at product design and new or expanding distribution systems, and the actuaries look at price and compensation issues, all in hopes of generating this premium income on a direct sale basis, there may be an alternative plan to help support the required growth.

For a company that recognizes the business in question as its "core" business and is inclined to keep plugging away, a proactive strategy to identify a company out there in the opposite position makes sense to the benefit of both companies and their customers.

Thinking about this need in terms of the transaction structures I mentioned earlier, a couple of points come to mind. At first glance, buying another company would not seem to be the best fit for a "critical mass" issue. A company wanting to leverage its existing facilities would not generally be interested in owning the physical plant, administrative systems, and people that would go along with buying a company. On the other hand, the assumption of the business could directly address the buying company's need. Making the other company's policyholders yours, and integrating the premium billing and collection, claim adjudication process, and other administrative processes for managing the business into your own systems would address your motivation for acquiring business head on. For a company that wants to leverage its existing facilities, I believe this to be the most effective approach. Unfortunately, the regulatory environment for assumption reinsurance has made these transactions significantly more difficult to complete -- potentially, to the ultimate detriment of our customers.

An arrangement through indemnity reinsurance would generate additional top and bottom lines for the acquiring company but would not affect the need to use existing capacity within your plant unless the selling company would also agree to pass administrative responsibilities to the buyer. The effectiveness of this approach under indemnity reinsurance is somewhat diluted by the fact that the business would have to be administered in the selling company's name. To the extent you're flexible enough to adapt this business to your systems at a reasonable cost, some opportunities are available in today's marketplace. I believe this is the response to a joint venture strategy that a divesting company, not wanting to totally divest but wanting to limit its involvement in a certain line, will want to take.

I might head in a different direction here for a minute. But it is a point worth making, I believe, and is probably most related to a company that chooses to acquire business and to supplement revenues to support critical mass levels.

It is easy to recognize that a single acquisition in relationship to the main concern is a short-term solution. There is still a need to generate new business on an ongoing basis. To the extent that blocks of business are acquired on a regular basis, this is mitigated -- but recognize that under any circumstances, the flow of new business is extremely spiked.

From the perspective of generating a more even flow of new business premium, there are opportunities for acquiring companies as a by-product of their activities.

Quite often, the motivation for a company to have begun writing a certain book of business does not disappear when it decides to sell what it has written. To the extent its distribution system is still looking for these products, the acquiring company will be in a good position to strike a deal to deliver products to that distribution system for future sales.

ENTRY INTO NEW LINE
Getting back to motivation, to acquire business from other companies, the second scenario I would like to address is the expeditious entry into a new line. In terms of transaction structure, buying an entire company already operating in the business you want to get into is an obvious approach. The delivery of products, distribution systems, administrative systems, and human resources to manage the business can be an attractive package for one eager to get in.

Assumption reinsurance is not necessarily ruled out in this instance and could be quite attractive. It is not unlikely to find a selling candidate that will include its administrative systems in the sale and endorse the buying company to its distribution system. The people resources may be less flexible in this situation and may be a critical missing link.

Indemnity reinsurance and a "joint venture" relationship may provide a much more prudent entry into a new line.

SUPPLEMENT TO DIRECT WRITINGS
Another scenario is to develop an acquisition strategy as a supplement to direct writings as a method of generating profitable premium growth for your company.

I believe much of today's acquisition activity is coming from players taking this approach. Recognizing that all companies have return on investment demands for the capital and surplus they deploy, I believe more and more companies are forming proactive acquisition units to compete with other activities for available funds. To the extent acquisition opportunities of any structure can be brought to the table that make sense in terms of strategic direction and return on investment, I would expect these opportunities will continue to be viewed favorably by the management of some players.

If I have a chance to speak later, I have some more specific things to talk about. To summarize, what I see is there are more companies that are headed down the path to concentrate their resources, both their financial resources and their people resources, on what they can do most effectively and most profitably. This does lead some to want to divest from lines of business and others to acquire lines of business. From my perspective, to the extent that you're involved in these types of activities, good luck is something you'll definitely need.

MR. YOUNG: Karen MacDonald, our next speaker, is Vice President of Transamerica Life. Her responsibilities include capital management efforts, financial reinsurance, special risk reinsurance, and corporate ventures. She has been active in several reinsurance groups, including the NAIC's Advisory Committee and the Reinsurance Subcommittee.

MS. KAREN OLSEN MACDONALD: Contrary to what you said, I'm going to talk about pricing from a general rather than a technical actuarial perspective. But I think it's just as important to go through the general issues of the complexity of the types of transactions we're talking about. I was reading in the paper yesterday about the Disney deal with Henson. It's been getting a lot of press lately. *The Wall Street Journal* quoted sources close to the deal as saying that what had started out as a marriage made in heaven had turned into a deal from hell. It's my feeling, based on what I know, that probably their fatal flaw was in the pricing process. They probably failed to align the interest effectively. And you know, I think you just can't pay enough attention to this part of the process.

OVERVIEW

What I'm going to do is give you a little bit of background on Transamerica's perspective on these deals, so you'll understand what my biases are here. I'm going to give a list of some of the things you ought to consider if you're pricing a joint venture transaction. And, finally, I'm going to illustrate some specific applications. I will be focusing more on indemnity reinsurance joint ventures rather than on the merger and acquisition (M&A) arena that Tim was talking about.

TRANSAMERICA'S PERSPECTIVE

Our perspective is that Transamerica is a return on equity (ROE) driven stock insurer. Like most companies you know, we're always seeking to manage our capital to the best advantage. We found in recent years that there are more and more opportunities for joint ventures that enable us to do this. Some of the types of joint ventures that we've actually participated in run the whole gamut.

We've been a ceding insurer on some. One example of that is where we joint ventured with another company that had product expertise that we didn't have. Our field wanted the product, so we created a joint venture to make it available to them.

On the other end of the spectrum, we've served as assuming reinsurer in joint venture arrangements. In one big deal, over the course of the last few years, we've provided considerable surplus capacity along with equity money to a start-up niche marketer of interest-sensitive products.

We've looked at, say, 100 deals for each deal we've done. That's just the nature of the beast. I've been told repeatedly that my job is really to turn down deals. It gets kind of depressing to turn so many down, but they tell me that's my job -- to turn down the 99 that we really don't want to do.

PRICING CONSIDERATIONS

Let's move on to pricing considerations. I'm going to go over these from the perspective of the reinsurance deal. A lot of times the joint venture has a lot of other things going on. Some general things to think about:

- Pricing is really the best mechanism that you have for balancing the different things that each of the players is bringing to the party. You should view it as such. When you start thinking about it, if you notice that there's a great inequity between what the players have to offer, that should serve as a red flag that you're going to have a difficult time pricing a deal. At extremes, I see a lot of transactions where somebody's got a great idea and Transamerica's got the money. I can tell you, those deals just don't work. Ideas aren't enough. The other party has got to bring more than an idea.

- Every deal is different. I don't think there are any formulas.

- It's critical to consider what the objectives of the parties are.

- You need to look at the overall transaction to price the reinsurance.

- And finally, you should always keep in mind that it might be advantageous to structure your pricing so that you have the option of revisiting it in the future. Give yourself some escape hatches. Create some natural way to renegotiate if you need to.

One of the specifics to consider is what is the financial participation between the joint venture partners other than the reinsurance arrangement. For example, is there an equity investment or possibility of an equity investment? What about warrants or options that don't cost anything? If the reinsurer is really assuming a significant role, you might be able to get that. If so, that might affect how you view the reinsurance. Sometimes there is a loan guarantee element. A reinsurer can sometimes guarantee a loan as part of the deal. Management fees are also a factor in some situations: investment management, administrative management, and so on.

The time period is important. Is it a single-year deal or a multi-year deal? The longer term the arrangement, the tougher it's going to be in your deal -- your pricing structure -- to effectively align the interests of the investors. So you really might want to build in some flexibility to accommodate that.

What's the exit strategy? What are the provisions for a divorce in the event that the two parties can't stand each other down the road? What's it going to cost you to get out of the deal if your objectives change? Can one party buy out the other? If so, what are the terms? You really need to know all this to know where you're going with the reinsurance.

What are the other material deal terms? Are there covenants? Any exclusivity? How about a noncompete? What about the relationship between the field forces? Are there any synergies with your field force and your joint venture partner that basically make you a little more eager to do the deal? On the other hand, are there conflicts that mean that the deal really better be worth it to you to do it? Are there other business interests?

Another consideration that has become a lot more important in the last few years is the impact of the company ratings. Transamerica, for example, is a highly rated company from a financial strength standpoint. A lot of times we're approached by potential joint venture partners who would like to benefit from association, via reinsurance, with our financial rating. That can be fine, but it hasn't been cheap for us to maintain that financial rating. So if somebody else is going to benefit from it, don't give it away. Make them pay for it. In the past these deals were done too cheaply as a marketing device, and I think companies really can't afford to do that anymore.

What are the risk reward preferences of your particular company? How much do you want the deal? What are the alternatives? How difficult is it going to be to put together the deal? This could affect how you price it. Are there more than two parties involved? Are you dealing with the Japanese?

Moving on to a couple of specific applications I mentioned before the ceding insurer example. In that instance, we were real anxious to offer something to our field, but we didn't have any administration. We didn't have any underwriting capacity. We really didn't know anything about it. But we wanted to give it to the field on our paper. We didn't want to make an investment, because we thought there'd be no payoff when we started the venture. So, we found a reinsurer that had the expertise we lacked, and we structured a joint venture. In pricing the joint venture, it ended up that our role in the deal was just as a marketer. The reinsurer took back all the risk, basically priced the direct product for us, and got all the profits. That was fine, but even in this deal, we did maintain future flexibility. We said, well we can't sell it now, we don't want to invest in it now. But if our field likes it we might want to do more with it in the future. So we built in options in our joint venture agreement that would let us assume a larger role over some sort of phase-in period.

The other example is on the reinsurance assumed side, which was a much more financially significant deal for us. This was a situation where we hooked up with a niche marketer with a lot of credibility in the marketplace, who was starting up an operation and expected to grow at a faster rate than he'd be able to fund on his own. So, we ended up funding a lot of the growth via a traditional coinsurance arrangement. We also participated in the equity. In this deal, because of the balance of the contributions, we were putting up a lot of the money. We ended up with a commensurate share of the returns. I hope that by keeping these examples in mind, your next deals will fall into the category of marriages made in heaven.

MR. YOUNG: Barry Shemin, our third speaker, is Senior Vice President at John Hancock. Barry is responsible for Hancock's annuity and long-term care insurance products, and for its reinsurance assumed business. He joined Hancock in 1968 and has worked in the group pension and group insurance areas. Recently, he was heading their individual life insurance organization. Barry's a graduate of Brown, and has an MA from the University of Michigan. He's Chairman of John Hancock Variable Series Trust, and he's Director of the Employee Benefit Research Institute Association of Private Pension and Welfare Plans, National Electronic Information Corporation, and various other John Hancock subsidiaries.

MR. BARRY L. SHEMIN: I'm going to talk about the implementation side of joint ventures or partnerships. I'm very happy to have a chance to do this, because one of my pet peeves is that people tend to pay a lot more attention to the strategic fit between the entities in a joint venture than they do to the implementation fit.

So I'm happy to try to redress what I perceive as a bit of an imbalance in the process of structuring a relationship that really does deliver what the parties expect.

Now, why is paying attention to good implementation at least as important as finding the right strategic fit? Well, for one thing, it is my opinion that business initiatives of any kind fail in the marketplace on account of poor implementation at least as often as they do because of a flaw in the strategy. This is particularly true in the fragmented financial services industries, where 5% market share is fantastic and almost any strategy can find a market niche if it's implemented well.

Second, the decision as to which joint venture opportunities a company wants to pursue often is made mostly on strategic grounds. So when one moves to the next step, it's not atypical to have done a reasonably good job of thinking through the strategic pluses and minuses, but not to have begun thinking about the pros and cons of implementation.

It's also true that partnerships are new to many companies in the insurance industry. So as they become more prevalent, there are going to be many companies that are implementing a joint venture for the first time.

Experience is important here, because working through the issues inherent in any partnership relationship requires a different style than we are typically accustomed to using within our enterprise. Of course, we often have to go through negotiation processes to work out differences between work units within a company, but we also know that in the background there is a management infrastructure that serves to set the ground rules and is a route of appeal if difficulties can't be resolved.

Joint ventures or partnerships don't have this infrastructure. Instead, we have two entities, each of which is motivated by long-term or short-term economic considerations, and sometimes constrained by internal political issues. This different environment requires a different style to resolve the many implementation issues that will inevitably come up.

And finally, many partnerships involve getting into a new area for each of the companies, whether it be product, market, or distribution. That often means that the people in each entity may not have a deep enough knowledge of that new area to avoid making mistakes in all the little details that are a part of implementation. We all come to the table with certain unstated assumptions about the business environment, and those assumptions may not be true when we're trying to get into a new product, a new market, or a new distribution system.

So for all those reasons, paying attention to how to implement a venture is at least as important, in my opinion, as paying attention to finding the right strategic fit.

Now, if you're going to give implementation issues the attention they deserve, it's a good idea to start as early in the game as possible. For example, when you're developing your strategy, it's a good idea to think about your company's ability to hold up its end of the bargain. What will your company have to change or do differently so that it can fulfill its responsibilities under the partnership?

Later, when you're evaluating partners, it's important to think about their ability to implement their piece of the action. This is part of the due diligence process, but also involves making subjective judgments about the track record of your proposed partner and checking its references.

Some strategies don't involve choosing long-term partners, but they involve evaluating specific deals -- blocks of business, for example. And here it's important to think about the special attributes of the deal that could cause implementation difficulties -- special product features, compensation arrangements, or other aspects.

Finally, when you're ready to close a deal, you should have an implementation plan already in place so that you can get started on it right away rather than waiting until then to figure out how you are going to implement the deal. It's not at all uncommon in the process of developing an implementation plan to get some unpleasant surprises that you'll be glad you discovered before finalizing the terms of the deal.

With that as background, I'd like to discuss three specific examples and comment on some of the implementation issues to expect and how to structure your project team to surface these issues and deal with them. These examples aren't exhaustive, or even representative, but are just to give you an idea of the thought process.

The first situation I would like to talk about is from the point of view of a company that would like to enable its agents to offer long-term care insurance, and would like to get a stream of the profits from the product, but doesn't want to manufacture the product itself. This company might have observed the growing demand for long-term care insurance and the favorable marketplace positioning of their field force, but be concerned about the potentially large fixed costs, its lack of expertise and, perhaps to some extent, the unknown risks.

One way of accomplishing its objectives would be to private label the product through a manufacturer, but this can involve significant regulatory delays as well as high fixed costs. So a preferred alternative might be to strike a national sales agreement with another carrier, together with a reinsurance agreement whereby the manufacturer would cede a portion of the business back to the distributing company. What are the kinds of implementation issues that you have to worry about under this arrangement?

First, and probably most important, how are your agents going to receive the training in the long-term care product and how will you market it so they will feel comfortable with it and generate sufficient sales to make the effort worthwhile?

In order to make an effort like this work, you would typically need to provide agents with information about identifying the target customers, how to approach them, marketing support tools -- like telephone scripts and perhaps a seminar package -- and product information.

Because the target market for this product is older, underwriting tends to be more difficult and take longer than for life insurance. So, to use their time effectively, agents need to learn how to screen applicants who are likely to be declined. They also need to be prepared for, and know how to deal with, the sometimes lengthy requests for information from retired individuals. Lack of understanding of these factors has led to a number of disappointments of companies trying to get into this business.

Now the manufacturer can provide support in these areas -- in particular, marketing materials, product information, seminar scripts, and some training support. But it's likely that your company would have to play a role in on-site training of agents and in sales promotion within the agencies to make this product a success.

Compensation can also be a problem under this kind of arrangement. Because the manufacturer must cover its start-up and training costs, and because long-term care insurance is subject to loss ratio restrictions, the resulting compensation will almost always be less than the life insurance compensation agents are used to. A key question here is whether the profit stream expected to flow back through the reinsurance agreement should be taken into account in setting the field compensation structure.

These issues mean that representatives of your marketing, training, and sales departments need to be integral members of the team developing a deal of this type, and you need to feel comfortable that you can devote adequate home office and field resources to make the program work.

Finally, it's often advisable to appoint an internal product champion who will be able to coordinate your sales and marketing efforts with those of the manufacturer, and to act as an advocate with the manufacturer to ensure that your agents get the kind of service they expect.

The second example I would like to discuss is from the point of view of a buyer of a block of life insurance business. The main point I want to make here is how important it is to fully investigate all of the administrative and systems issues as early in the game as possible.

It is possible to view these acquisitions as financial transactions, and we actuaries can get very refined in developing assumptions for mortality, persistency, and investment return. But it is not at all uncommon for the expense assumption to be some very rough combination of per policy cost and up-front conversion costs. In practice, these costs can be heavily influenced by how smoothly the block can be assimilated administratively and by whether you plan to acquire the seller's systems or convert the block to your existing systems.

If you're acquiring the seller's systems, what interfaces will you have to create to your upstream and downstream systems, such as premium billing and collection, compensation, financial reporting, and tax reporting? Is their system as fully functional as yours, and if not, what will be the impact on ongoing operating costs? How will this system be modified to reflect changes in regulations or other operating procedures?

If you plan to convert the business to your existing system, what special features does the product have that may not exist for any of your existing products? What kind of shape are the data in? How compatible is the data organization with that of your system and what historical information needs to be transferred?

In either case, what time pressures will there be to implement the change, and will the selling company have staff available to help you make the transfer? Obviously, the team evaluating the block should include strong representation from your systems and policyholder service staffs.

The final situation I would like to discuss is that of a company which has decided to acquire a private-labeled variable life product for its agency force. This company might be looking to provide a full line of life products under its name to maximize agent productivity and retention, but be concerned about systems and regulatory costs.

Some of the issues here are the same as the long-term care example. The variable life product needs to achieve a sufficient volume of sales to cover the up-front costs. Field training is an important issue -- your agents will need to become comfortable with investment matters, particularly how they work within an insurance policy, to enable them to feel comfortable selling the product.

There are also some additional issues in this type of partnership. Does your company want to manage some of the investment funds? How long will it take for your company to receive special authorizations to write variable life in many states? Are enough of your agents National Association of Securities Dealers (NASD) registered or will some special efforts be required?

How will the various functions be apportioned between your company as direct writer and distributor, and your partner as manufacturer and reinsurer? Although you will probably want to do the underwriting, the manufacturer's infrastructure will probably be used for policy administration. Your employees can process policy change transactions or the manufacturer's employees can do so. You could do premium billing and collection or the manufacturer could do so. You would probably want to pay death claims, but you might have the manufacturer issue checks for other types of benefits.

Because of the options available under this type of arrangement, your choices here are going to be heavily influenced by your comfort level with the various functions or your need to be consistent with other products you are offering versus the potential efficiencies that can arise from using the manufacturer's infrastructure and expertise.

The design of the reinsurance agreement and the related servicing, investment management, and selling agreements will be heavily influenced by this allocation of responsibilities. As a result, the team created to develop a joint venture of this type needs to have heavy legal and administrative representation, some investment participation, and the usual representatives of marketing, sales, and actuarial functions.

As I hope you can see from these examples, there are many different kinds of situations. Although they might be grouped together from a strategic point of view, they can be very different in terms of the implementation perils. It's important to think of these perils up front, to let them influence your strategic decision, and to structure the team accordingly so that the venture meets your expectations.

MR. HERR: Some of the things that I want to talk about are just steps that you need to take to make one of these opportunities work and to bring a deal to a place where you can be satisfied with the results.

HOW TO GO ABOUT ACQUIRING BUSINESS

First, a company interested in acquiring business must establish a set of basic criteria and characteristics they hope to find in a potential acquisition candidate. Some key things to consider are the following:

1. Do you want an entire company -- or just the business the company has on its books?

2. What size block of business can be taken on? There are capacity considerations in terms of the number of new policyholders and the number of additional policy forms that will be involved. There are financial considerations in terms of the amount of surplus that can be committed to these activities.

3. Product mix is important. What do you want? In terms of individual health, some companies only want Major Medical or Medical Supplement or Disability Income (DI). Others are looking to achieve a mix of business. Of course, it seems lately that a lot of companies only want to sell their long-term care.

4. Geographic mix? Where are you licensed to sell business? Where do you want to accept business from?

Getting the word out that you're interested in buying business is not a problem. Getting things presented to you that you really want to see might be a little more difficult.

However, if your actuarial and accounting consultants know you're interested, if your reinsurer knows you're interested, if a couple of intermediaries or deal brokers catch on, you will see plenty of opportunities. However, I would also encourage direct contact with companies you view as potential partners in a deal.

Do a preliminary evaluation of the acquisition candidate. When obtaining initial input from the seller as to what is for sale, there is some basic information that should be garnered:

1. Always be interested in the background or motivation for the sale. This is the first critical step in understanding the needs of a potential partner in a deal.

2. Initial thoughts on the structure and timing of the deal are important. Looking for partners realistic in their objectives on this point is important.

3. Collect basic information like policy forms, rates, and historical experience over a period of 3-5 years.

4. Last, but probably not least, I believe it is important to understand what the selling company expects financially from the deal. The "sticker price" as determined by an independent actuarial valuation often establishes the mind-set for

what the seller wants out of a book of business. Some buying companies do not even want to see the actuarial valuation or know the expected price based on the theory that they are going to put their own value on it and that's all that matters. However, I believe there is merit in knowing what you are up against from the get-go. To the extent that the valuations are substantially different, it may be in the best interest of the buying company to not make an offer that may be viewed as frivolous.

Evaluating the candidate for fit into your business practices is critical to the ultimate success of a deal. The aggressiveness, or lack of aggressiveness, that the different companies may have in the marketplace, in and of itself, can make the fit or not.

CRITICAL SUCCESS FACTORS

When all is said and done, there are several critical factors that will weigh heavily on the success of an acquisition. Without weighing too heavily on the technical financial factors, there are several things that can make the financial success more likely and allow the deal to be completed to the general satisfaction of both parties:

First, know what you want. It is not worth your time or the other company's to fish around with something that is never going to fit. If you are "just looking," be up front -- most sellers will not mind, but keep their expectations in perspective.

Second, understanding the selling company's motivation for sale is important. Often it is easier if you can scratch where it itches for the selling company and it will improve the chances of completing the deal.

Third, a very key concern is motivating the selling company to manage the business until the end. Too often it is a natural tendency to pull up early and let things slide when they see a buyer in the wings. Constant reminders of this are not inappropriate.

Fourth, communicate with the "other" parties in the deal -- the agents and policyholders are usually getting their information through the rumor mill and seldom is the information they are receiving any help to the process. Timing is critical and both the seller and buyer need to tell their side of the story. I believe this communication is necessary without regard to the structure of the deal in any situation where the agent's and/or policyholder's relationship with the selling company will change. The problems avoided down the road can benefit the relationship and ultimate success of the arrangement enormously.

Finally, dedicated resources on both sides of the transaction to support the effort to implement and manage any ongoing relationship are critical. Anything less than dedicated effort has a high probability of generating problems. Unfortunately, divesting and acquiring business has not become a mainstream-enough activity in most companies and the result is part-time attention to these activities.

MR. YOUNG: What's happening in our industry is we've had, for the last several years, companies just looking to be doing things better. There was a time in our industry that many companies felt that they didn't have to worry too much about doing things well. Those times are gone. So everybody from the largest company on down is looking at how they can better run their organization. Part of that includes getting out of lines of business or forming relationships with other companies that are better in particular lines or have more critical mass, etc. So, it's an area that we need to start focusing on.

Following is a joint venture checklist:

WILL THE JOINT VENTURE MAKE MONEY?
All joint ventures entail entry costs that the partners share: for example, computer tie-in, staff training, and product filings. A company needs realistic projections of sales volumes and anticipated profits to justify the effort.

IS THERE A POSSIBILITY OF A QUID PRO QUO?
Most insurers focus their efforts on their best products and markets. The provider of one product could be a customer for another. Very often you're going to try to be putting a deal together, and it looks like you don't have an interested party. We've put some things together where we had two parties that weren't necessarily interested in talking to each other about selling something to the other party, but each wanted to buy something from the other party. We were able to put together some deals in this case where there was a quid pro quo, so don't take no initially.

WHAT IS THE PROVIDER'S TRACK RECORD?
A high level of expertise enhances the likelihood of success and also of the partner's continuing in the business.

HAS THE PROVIDER PARTICIPATED IN ANY OTHER VENTURES?
Interviewing current or past partners can provide useful information. Private labeling in the insurance business is a relatively new phenomenon; therefore, many companies lack experience as providers. If a buyer is a test site, a more careful analysis of systems capability is required.

IS THERE A CORPORATE CULTURE FIT?
Partnerships require high levels of mutual trust and comfort. The parties must be compatible with respect to the fundamentals, such as how they treat customers and invest funds.

HOW COMMITTED IS THE PARTNER TO THE JOINT VENTURE?
Financial strength and long-term focus are important; start-and-stop efforts can be costly and disruptive. Contact should be established at a high level and frequent communication encouraged.

HOW WILL THE BUYER'S AUDIENCES REACT TO THE VENTURE AND TO ITS CHOICE OF PARTNERS?
Important considerations are whether the agents will respect the partner's expertise and service capabilities; how the agents, regulators, and rating agencies will view the financial strength of the partner; and whether the additional products will help solidify relationships with the clients.

IF AGENT CONTROL IS IMPORTANT, CAN IT BE MAINTAINED?
A company may prefer that the provider be invisible to its customers and agents. To maintain control of these relationships, companies can use dedicated toll-free numbers, direct access to off-site mainframes, lock box premium collection, and a facility providing for maintenance of existing agent communication and compensation procedures.

ON WHOSE PAPER WILL THE PRODUCT BE WRITTEN?
Client ownership and legal performance responsibility are key issues. The importance of the "invisible" partner's ability to perform the obligations of the other is critical.

WHAT IS THE QUALITY OF THE BUYER'S SALES FORCE?
The provider's profits and reputation are linked to the business being developed. The buyer's sales force should meet the same standards as the provider's.

WILL THE JOINT VENTURE TAKE BUSINESS AWAY FROM CURRENT SALES?
The venture's primary purpose is to augment production from existing outlets. It would be disastrous if new activity resulted in reduced sales in those outlets.

ARE THE PROVIDER'S PRODUCTS COMPATIBLE WITH THE BUYER'S MARKETS?
Some products are designed for particular markets. Other markets might not exhibit the characteristics necessary for successful sales and profitability. Again, I think this is an area we all will be spending more time with, if we aren't right now. Let's take some questions.

MR. GERALD KOPEL: Nobody has mentioned fronting regulations, and what problems they present. Could somebody comment on that?

MR. YOUNG: I haven't seen one of these things not work because of that. There are various states that have various rules and regulations. You have to keep them in mind; for example, Massachusetts has the rule that the ceding company has to keep at least as much retention as its reinsurer. There are ways to make that less onerous. But typically these things are done for both parties, so that both parties have a significant risk in the arrangement. I haven't seen any that are more extreme than 80/20 sharing of the risk. I suppose there are some. But the normal one is that way. And so it really isn't a fronting arrangement. It's two parties sharing in a business.

MS. MACDONALD: Jerry, we did have one arrangement where we were able to negotiate a declining percentage with the insurance department. So there was a fronting issue, but we started off with 100% and scaled down over a five-year period.

MR. HERR: We've had the same issue, and we've been able to negotiate 100% in New York.

MR. YOUNG: Well, there are some special problems in New York, and sometimes they'll recognize those.

MR. HERR: I think it relates to our company. There are other things we can't do in New York, because Mutual of Omaha is licensed as a health company in that state. New York takes a position that that's a guarantee association issue, and they have allowed companies to end up with 100% of the risk through indemnity reinsurance mechanisms.

MR. THOMAS J. MITCHELL: Could someone comment more specifically, or speculate more specifically, on the difficulties, or tightening up, in assumption reinsurance regulation that's likely to take place?

MR. HERR: Regarding the Model Bill, having participated in the task forces for the ACLI and NAIC both, I was quite pessimistic in the beginning because of the breadth of the issues and the seeming impossibility of bringing it all to conclusion.

The Model Bill that's out there seems reasonable. There's a minority opinion that was published on the Model Bill, and there are some recommendations in that that would make it very difficult to do deals through assumption reinsurance. I don't believe them to be practical. But most of the feedback we seem to be getting suggests that the type of notice that we're requiring for novation, from policyholders, won't be so onerous that you won't be able to get it. Probably a critical factor there is having some type of a deemer clause. As drafted right now, it does have a deemer clause. Getting positive assent from everyone isn't practical.

There were numerous issues that were raised with regard to primary and secondary liability. As a group we wanted to stay away from that, in that putting a bug on your annual statement based on the financial situation of the buyer really puts the seller in a position of having to manage and monitor that business forever. Although the buyer may be very financially sound today, down the road the buyer may not be, and that secondary liability may come back. None of that has shown up anywhere in any of the model regulation that's out there.

Those were probably two of the major issues. I think the bill out there right now is fairly practical.

MR. YOUNG: On that second point there was a strong feeling by some people, not necessarily myself, that having the alternative of not seeking approvals, if that could streamline the process, might be something that should be allowed as an option, because there were situations where the buying company is an extremely strong company. To streamline the process, the selling company may be willing to accept the possibility of a contingent liability, putting a probability on that close to zero. But, the real benefit that's coming out of this is that once there is a bill on the books in the various states, the fear of contingent liability will be pretty much removed in those states. Anyone else?

MS. CAROL A. MARLER: We've talked about a couple of the audiences for companies doing these joint ventures. In particular, we talked quite a bit about the effect on the agency force and also how it's perceived by the state regulatory agencies. I'd like to ask how these arrangements are viewed by the reporting agencies, the rating agencies, and by the investment bankers?

MR. SHEMIN: Well, I think it depends a lot on the arrangement. Generally, my experience with rating agencies is that they're very sensitive to a company's strengths in the particular businesses that it's in. They don't place a lot of value in being in a lot of businesses unless you can also be reasonably strong in each one. They worry about some businesses more than others; there are major players they feel a lot more comfortable with than they do with minor players. So I think, generally, the idea of a partnership where you might be hooking up with someone who's a major player -- in a particular market if it's a distribution arrangement or a particular product if it's a manufacturing arrangement -- would be something that rating agencies would look on favorably.

MR. YOUNG: You have more efficient use of one's resources. That's fatherhood and apple pie. Or should I have said blueberry pie?