4. The Sale Process

The sale process is a team effort. On the sell side, the team usually consists of the seller, their investment banker, the external actuaries and a legal team. On the buy side, the team consists of accounting and tax experts in addition to the previous disciplines. For a sale to be successful, the team on each side must be able to communicate the story of the company in a consistent, focused manner to their publics.

This paper focuses primarily on the actuarial responsibilities. There are a host of functions performed by the other members of the team that will not be well served by treating them here. Although no two transactions are alike, in this paper we consider a "typical" situation with multiple bidders in a voluntary sale situation; however, it is not uncommon for a single bidder to have an exclusive right to bid on a particular property for a period of time.

4.1 Buy vs. Sell

The objective of the seller is to maximize value; the objective of the potential investor is to optimize the transaction price while minimizing post-sale risk, particularly in the transfer of unidentified liabilities. As such, the process for the buy versus the sell side is very different. The sell side typically has three months or more and full access to the resources and data of the company to prepare their case, while the buy side generally has limited access to information and a limited time frame within which to submit a bid.

All things being equal, the seller is in a stronger position in transactions of this nature, as they have (theoretically) perfect access to information. This increases the risk to the potential investors, which inevitably decreases price. In order to maximize value, it is in the seller's interest to make the transaction as transparent as possible. This is true to the point of identifying and making provisions for any possible reserve deficiencies/asset impairments, as the potential investor may discount them more heavily than necessary if the work to quantify them has not been done by the seller. Finally, in order to encourage potential investors to maximize their bid, a post-bid review process known as "due diligence" is entered into which allows the winning bidder the chance to make adjustments to their bid based on any problems that might be uncovered in the course of the review.

4.2 Sell Side Preparation

Takeovers are typically not hostile in the insurance industry. In the absence of distress, the transaction is a managed process, with the investment bankers taking care of legalities, timing and other details of the sale.

Usually, the external actuary is brought in early in the process to perform the valuation. It is always necessary to visit the company to gather data, interview management personnel and establish contacts. Depending on the preparedness of company, it may be important to spend significant time on-site to develop experience assumptions, become comfortable with management, review operations, etc.

The investment of senior management time and resources is significant, so it is important to make efficient use of their time. A core group will tend to emerge from the company whose top priority is making sure the sale is a success. In addition to a full-time project coordinator, significant commitments are needed from senior members of the actuarial, accounting, marketing, treasury, legal, compliance and information technology areas. Coordination of efforts with the investment bankers and other advisors is needed to minimize the duplication of efforts within the company.

In the normal course of preparing the appraisal report, the external actuary will often come across inconsistencies in data or processes across departments that are not always obvious to the company's management team. One of the important roles of the external actuary is to detect and correct such problems in preparation for due diligence. Nothing can damage a sale process more than to have significant issues arise during the due diligence process for which the sell side is unprepared.

The external actuary should proactively seek to understand any significant tax, regulatory, or economic issues that could materially affect the industry or, more specifically, the value of the seller's business. To the extent that likely prospective material changes are not reflected in the base case, specific scenarios may be prepared to reflect other possible outcomes.

Communication plays a critical role during the sale process. After a draft of the appraisal report is developed, it is usually distributed to the people who were closely involved in its development in order to ensure consistency with the management view and obtain buy in from the parties involved.

4.3 The Bidding Process

Potential investors are attracted by a "teaser," then prepared and distributed by the investment bankers. Should a potential investor wish to proceed, documents are filed with the proper authorities and the bidder is provided with an offering memorandum with general company and market information upon which to base an indicative bid. At some point in the process, the bidders are provided with the actuarial appraisal report. This is sometimes provided with the offering memorandum; however, it is more often provided after the offering memorandum, but prior to the opening of the data room.

At this stage, the approved bidders are invited to spend time (generally one week) in the data room, reviewing information and interviewing senior management. Note that while senior company executives often speak English, the vast majority of documents, from policy forms to reinsurance treaties to systems documentation will be in the local language. It is important for buyers to identify individuals internally or contract externally a cross-section of talent with appropriate language and technical skills to adequately perform a review of company operations.

At a minimum, the data room contains the information used to create the offering memorandum and the actuarial appraisal. Each potential investor provides a data request prior to their arrival at the target company. There are few surprises in the type of information that is requested by potential investors and it is up to the seller to be prepared to provide it in an efficient and timely fashion. Likewise, senior management should be prepared in advance and made aware of the types of questions that they will be asked in the interview process. Depending on the number of bidders, the process of preliminary data room visits can take one month or more, which is an enormous time commitment on the part of management.

4.4 Due Diligence

At this point, final bids are submitted. These bids may be binding or non-binding as established by the investment bankers. Typically, the winning bidder is given extended access to the company records and personnel in order to follow up on issues identified in the initial visit; although in some instances, more than one party may be invited back.

The potential investor may dispatch a team of 50 or more individuals on-site for a period of up to two weeks, scouring the company for potential issues ranging from actuarial and accounting to legal and regulatory to information technology and human resources. Any material issues thus identified are then addressed either by adjusting the bid price or through the addition of specific clauses to the transaction document. There are many ways to resolve issues between willing buyers and sellers, including earnouts, straight price reductions, liability workout clauses, etc. The full range is limited only by the willingness of the two parties and the creativity of their advisors.

While it is important to carefully probe for undisclosed current liabilities, during due diligence it is equally important to consider areas of possible future risk. Embedded options and guarantees have proven costly to insurance companies around the world and should be investigated thoroughly. Class action suits, while not common in developing markets, are a possibility in such familiar areas as sales practices in the United States and pension misselling in the United Kingdom.