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Session 4PD
Role of the Health Actuary in Mergers and Acquisitions

Panelists: Stephen K. Millar
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Summary: Four key processes are critical to a merger and acquisition (M&A) transaction: due diligence, negotiation, integration planning and implementation. The panelists discuss how these processes apply to transactions that involve the health area.

MR. STEPHEN K. MILLAR: I'm one of the panelists, and the other panelist is Jacqueline Rains, better known as Jacs. Jacs, will you tell us about your background, please?

MS. JACQUELINE RAINS: I have a somewhat checkered past because, over the past 20 years, I've been in three different industries. I've held positions in the insurance business as a life and disability insurance agent, and when I sold small group health insurance plans. I swore when I left that I had gotten my experience in the insurance industry and that I would never be back. I immediately found a position as a sales representative for Honeywell. I found myself at a company called Executive Life, and then moved from Executive Life to a few other places. I have had experience in the utility industry. During that time, I worked in various functions and capacities as a profit and loss manager for power plants, as a performance improvement consultant within the company, as a motivational speaker, and as a trainer.

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My checkered past has led me here, and now I'm with Wellpoint. I work as the vice president of integration planning and implementation. There was an Irish Fest held at the hotel, and the mugs had a message that was very appropriate for me. They said, "There are only two kinds of people in the world—actuaries and those who wish they were." That applies to me because I now associate with actuaries and report to our executive vice president of actuarial services each day. I want to make sure that you understand that my focus is going to be on integration planning and implementation (which is the larger picture) and the role that you play. Steve's going to focus more on the technical elements.

MR. MILLAR: I've been an actuary for 29 years. I started out in life insurance, and I was involved with probably the first mutual company merger. I did a lot of financial reinsurance back when the tax laws were advantageous under phased tax. I have worked on 22 acquisitions or sales of health insurance blocks. The time I have devoted ranges from the small acquisitions for which I just reviewed contracts to other projects in which I put in several hundred hours. I've probably worked a total of about 4,000 hours on acquisitions.

The goal of our session is to provide practical knowledge so you can be more effective in mergers and acquisitions. We're going to take the first hour and do kind of a point/counterpoint process, and then the last half hour will be for your questions.

MS. RAINS: One of the things we wanted to do is give an overall picture of the puzzle that represents mergers and acquisitions. In the center of this puzzle is the goal that we're all trying to achieve, which is a successful merger or acquisition. One of the things that's critical to that process is defining what is success in any acquisition or any merger, and that differs depending on what the purpose of the merger is. Sometimes the purpose is to grow your business. Other times it's to enhance an existing product line. In every case, it's to increase the value of the company and increase and reflect the value expected of the merger itself.

There are nine critical components as listed below.

- Urgency
- Shared Vision and Roadmap
- Clarity of Structure and Roles
- Leadership and Stakeholder Coalition
- Involvement, Participation, and Empowerment
- Communication
- People and Team Development/Culture Alignment
- Aligned Policies Processes Systems
- Measures and Feedback

These are the pieces that we have to always put together. If any one of these pieces is missing, such as communication, you run the risk of having associates and employees not know what's happening next in the merger and what their roles are going forward. It will cause delays that cost us money and reduce the value of the transaction. What it essentially does is it limits the capability to repeat the successful merger process in the future.

We wanted to talk a little bit about these pieces and how they've either contributed to the success of or detracted from parts of a merger. Steve is going to talk a little bit about the mediator's role.

MR. MILLAR: Recently I was asked to be a mediator for the closing claim reserve between a seller and a buyer. It's a very unusual role. In this deal, the insurance risk and the operations transferred to the buyer on the same date. The seller did not trust the buyer to report the claims fairly, and the seller did not consider an audit process. The seller insisted on a transfer of claim reserves at closing based on information up to the date of transfer. The seller also insisted, because of this lack of trust, on a mediation process that would be followed by an arbitration process. The seller agreed to all of this. The buyer agreed to it, but the seller had to pay a significant amount of extra money in order to build these provisions into this agreement. In addition, five months prior to closing the deal, the seller wrote a jumbo point-of-service case, and the experience was terrible.

I accepted the mediator role and worked with both sides. I submitted my final reserve and the mediation ended without an agreement; however, the seller paid another significant payment to the buyer to close the deal. The two payments from the seller to the buyer amounted to one-third of the seller's surplus. So, one company won because of the mistakes of another company. The seller had no experience in managing a sale, did not engage an actuary, did not engage a lawyer with experience, and made many tactical mistakes. In retrospect, that seller violated all these principles and all the principles that we normally think about as actuaries.

I refused the arbitrator role because I didn't want to lose my relationship with these people. We're going to talk about lessons we learned from our experience. Jacs, tell us a little bit about some of the lessons you've learned.

MS. RAINS: Some thing that I've learned over the past six mergers or so that I've been involved in is that you have to carefully assess the information against past experience. Follow the old adage—if it sounds too good to be true, it is. We have experience. We can recognize what we can and can't do, and what is and isn't possible. So when the projection comes forward that we can achieve so much more than they've achieved in the past simply by virtue of this, you have to stop and ask yourself, what does that really mean? So much of the merger today is focused on culture and the fact that if the cultures don't match, this merger is going to fail because we need the next excuse for why a merger fails. We couldn't just say that we didn't get the valuation right or we couldn't just say that we didn't get the synergy potential right or we didn't actually address the processes. Now we have to blame it on the culture, and while it is a factor, it's not a primary factor. Knowing the cultural differences and having mitigating steps that you take to address them can address the opportunity for that merger to fail because of the cultural differences. It gets you back on track to get to your synergy projections, your processes, and the key people that you need to retain.

Key people departing is another key area. You have to identify the people that are keepers and tell them up front so that you don't lose the critical resource. One of the things that Steve and I have both experienced in mergers is a key holder of a critical piece of information leaving the

company. Without communicating his intention, a key person decided to look for another job. When he walked out the door, everything that was known walked out with him, and there was no way to recreate that information. That created a significant gap in information needed by the buyer.

Additionally, mergers are on a process continuum. It's not that you do due diligence, then you do confirmation, then you have to sign a definitive agreement before integration and implementation takes over. Integration and implementation cannot be successful unless we have the full picture from the beginning. What was it you talked about in due diligence? What were you looking for? What were you asking? What information did you receive? How does that impact the merger? What expectations did you set up? Our job is to overcome any processes that we didn't see and any gaps that we identify. We make sure that the integration and implementation proceeds nicely and goes forward.

MR. MILLAR: We want to talk a little bit about what you can do differently, and you'll hear some undertones throughout our conversation. One of the biggest lessons I've learned is that the buyers make most of the mistakes. I've learned that as a buyer. When it comes to due diligence, bring a complete team of people. It's better to have too many than too few people. In my experience, clean-up situations like poor underwriting or poor management, are almost impossible to recover from. You think you can do it better than the other person, but if there's some poor underwriting that's going on, it just seldom works out as well as it does in your models.

Another thing I would say is don't really buy a bunch of products that don't fit into your core business. I've done that, and I'll talk to you about some examples later. It just doesn't work because you're not ready to manage them. That's the way I see it. Jacs, have you already told us about challenges?

MS. RAINS: Some of the other pieces are really communication pieces. What are you hoping to achieve when you communicate? How much do you need to communicate, and what is it going to do? How much is it going to empower the associates that are going to work on your team to achieve the objectives of the merger? What processes do you have in place? How much have you templated so that you get consistent results during the merger process? And how much is everybody creating on their own so that, as an integrator, you have to ask what this means. As an actuary, are you reviewing information and getting the information in a way that makes sense to you, that you can analyze, and that's clean?

Finally, in terms of the plan, processes are very broad, and they're broadly defined in companies. Other companies have a very narrow definition of that same process. In order to be successful, you have to break it down into the components that make sense to the buyer so that you're measuring apples for apples, and you're looking at things in the same way. We'll talk more about that when we talk a little bit about product types later. Steve, tell us a little bit about some of the validation, valuation, and synergy aspects.

MR. MILLAR: When you look at buying a block or a company, the seller often gives you some information, but it doesn't really completely validate that the block is going to be profitable for you. As a buyer, you have to ask a lot of questions, but you have to find the information that wasn't presented by the seller—the due diligence process—and really dig in. Many of you probably know this. You've been involved with acquisitions, but it's your job as a buyer to really validate what will work for you, not what worked for them. We often think as actuaries that we have the job of valuing a block of business. It's really far broader than just actuaries. It involves finance people. It involves the marketing people. Keep the breadth of your due diligence really broad. I think the way you should approach the due diligence process or the buying process is if you're given an assignment by your company, do your work plus about 30% more in terms of the questions you ask. It has to be broader. What I always try to do is go beyond my original assignment. I look for things that I can tell my client that they didn't really ask me to work on.

You can put the word *synergy* in front of a board and get anything approved. Synergy is one plus one equals three, but you'd better be ready to prove it. You better be ready to document it. I've heard so many blocks of business were bought because of synergy, and if the synergy isn't there, it'll really hurt you. Synergy could come in so many ways—through more attractive discounts and because of a provider arrangement, marketing arrangements, and new products.

MS. RAINS: You know, the key is the integrator. None of us as integrators can do this alone. We generally capitalize on teams within the company that are in specialty areas. Typically, our experience shows that you need eight or ten teams of people working on things from finance to systems, to marketing, to communications, to human resources. You name them. Then you need any specialty groups that you have within the insurance industry to actually do the work, to make this happen, to get the membership in billing reporting. These are all of the things that we need to do as an industry. The challenge is my team has to deliver the synergies that are projected. So they need to be accurate, attainable, and measurable. We need to have templates that we can plug them into so we can show that we've actually achieved them. We get the challenge of delivering whatever has been promised to the board and that comes back to our teams.

Our speakers at this symposium mentioned that actuaries need to work in partnerships. You need to get to know your analysts and your board members and other people within your team. I would suggest you need to get to know the finance people, the business unit owners, the leaders, and truly partner up in order to be successful. They need to rely on you and the expertise that you bring to price the products profitably. They want to make sure that they're considering all of the associated risks with what they're introducing, and then to help to achieve whatever synergies are projected.

MR. MILLAR: We've been assigned four processes by the Society of Actuaries, and first is due diligence. I usually think of due diligence as the initial packaging of information by the seller and the review of information by the buyer.

MS. RAINS: I've always looked at due diligence on the buyer side. Am I getting the information I need? Is it accurate? Is it timely? Is it going to be attainable? Are the promises that they're making to us attainable, and have they been shown, by past behavior and past action, both financially and otherwise, in their existing business results?

MR. MILLAR: There's another form of due diligence, though, and that's the diligence of selecting buyers and selecting sellers. As a seller, I've always performed diligence on buyers by deciding which ones I want to consider as buyers.

MS. RAINS: As a buyer, obviously, we're looking at the sellers to see how experienced they are. Have they been involved in a merger or a sale before? All of that tells us how much we can expect to have in terms of a collaborative role going forward. Do we understand a common language and how much leadership we will have to take in that process? From the integration planning standpoint, we also work forward and take care of due diligence and input the data library contents and intimate knowledge of the deal and feedback from the past. We challenge the assumptions that are put forward. Mergers can't be successful, and acquisitions generally aren't successful, unless you say, "In the past we did this, and we've projected this, and now we found through two or three of these experiences that a nine-month period is consistently a 12-month period." We can apply that and modify the model. One of the things that Steve does is make sure that those things are incorporated into the negotiation.

MR. MILLAR: I'm going to focus on due diligence in negotiation, and Jacs will focus on integration.

One of the things that's important to realize is that we can't give you a cookbook. Every situation is unique. First, it's really unique whether it's buying versus selling. The skills of a seller are packaging, presenting, and influencing. Seller skills. The skills of a buyer are analyzing, planning, and implementing, product management, and management. When the deal is done and the agreement is signed, many of the key tasks end for a seller, but many of the key tasks just start for a buyer.

MS. RAINS: I have to take exception to that because the seller thinks they get off the hook. They really think they get off the hook once the deal's done. We sold it. They've bought it. Great! The seller also needs to be involved in the whole integration activity. They need to commit resources. They need to know that they'll be asked for resources. Their tasks have just begun at that point. So I take a little bit of exception to that.

MR. MILLAR: That's fine. Some people target buyers and sellers, and some people don't. You have to deal with them in some way. As I said before, I always target buyers because I want experienced buyers, and I want qualified buyers. I don't want somebody that's just fishing around.

MS. RAINS: We tend to look at collaborativeness in terms of the sellers that are there. Are they experienced? Do they know what they're doing? Steve and I have discussed this, and we figure that there are really about four ways that blocks of business get transferred within our definition based on what we're looking at. You transfer a business lock, stock, and barrel. We buy the whole company. We integrate every single part of that company into our existing company. We identify which products we're going to keep, which products we're going to get rid of, and which products are going to merge into our existing product base. We can also say, we're going to do a full or an interim indemnity assumption and a reinsurance process. We can do term and roll. We're going to terminate you and immediately roll you into a new product, or we're going to terminate you at this point, 60 days or 90 days from now. Then we have some risk associated with that because some folks might leave us during that time because they don't want to roll over. So we have to calculate the membership risk that we have there.

Finally, we have the stand-alone acquisition. We're going to buy the product, and we're going to leave it intact. We're just going to integrate those things that contribute to the financial reporting because we want to capitalize on the goodwill and the brand recognition of that product. They're known in the industry and we're not. They're known in a certain marketplace and we're not. We

want to make sure that we don't lose the customer base because we changed the name to an entity they're not comfortable with, familiar with, or do not have an established relationship with. We have all of those types of acquisitions, and what that leads us to is whether we're doing the company versus the product line. Steve's going to talk a little bit more about that.

MR. MILLAR: There are a lot of pros and cons of each of those ways of transferring business, and they don't always fit every situation. Usually, when a company is acquired, you get to avoid the difficult and somewhat onerous assumption reinsurance agreements that many of the states have. These also vary by state. So you're going to have to research those or get your lawyers to research them. The difficult states are the ones that are usually difficult in terms of rate increases. Then you have other things that you have to consider. For example, under a small group block of business, if you get somebody else's business and put it inside your company, you have to lay the rates on top of each other and require all the small group reform. You can do that, if you can pull it off, or you can do a term and roll. Those things need to be considered. You need to look at the underwriting, rating, and policy benefits and see if they can be changed gradually or immediately. Look at the marketing relationships and the sales relationships and see which approach is the best to use. Basically, try to have as little disruption as possible and comply with the state insurance department.

When you do a product line transfer, you have some benefits. You'll get the combined management, combined accounting, combined financial functions, and combined corporate legal issues. When you do a company, you avoid the assumption reinsurance issues.

MS. RAINS: There are a couple of things. Certainly with assumption reinsurance, you have to ask yourself about the benefits and the cost benefit analyses. What are you doing this for? Is it a premium tax savings? Will you really experience that? Secondarily, it does apply more to buying the product line. So you're taking a piece of a business out of a larger business. There are other ideas and other things that are complex with regard to legal requirements in states besides the assumption reinsurance. You might have projected synergies based on eliminating

certain positions within an organization. However, the state might have a requirement that that position stay in place, inside the state, and not in your corporate headquarters 5,000 miles away. If you don't know that going into the deal, and you put it into your synergy model, guess who gets to find that somewhere else in the deal? It comes back to me. When I finish the implementation side, I say, "Listen, I can't eliminate this position because state law doesn't allow me to do so." I've got to keep that in place.

There are also some other items that contribute to complexity and the size of the deal. The number of regulators you're dealing with and the legal requirements on the integration side increase the level of complexity. Other considerations are the number of teams that will be working, the number of collaborations you'll have to do, and the number of assessments that will be done. Every time there's a new state, there are different regulations. So it's up to us to make sure that we understand the specifics, and the lawyers are the best people to partner with. So now we're adding another category of people we have to partner with—our lawyers. We need to make sure that we have that in place and we understand what comes next.

MR. MILLAR: The next topic is product size and type. The situations really are unique by product size. On one-life medical, you're going to be focused on the contract reserves. You're going to be focusing on the medical underwriting differences between the buyer and the seller. You're going to be focusing on the renewal provisions and the renewal practices. One of the main messages you should understand is that this is a lot more than just being a valuation actuary. You have to know all the things that a pricing actuary knows as well as underwriting concerns or else you have to communicate with those people. So I'm going to bring up a lot of points that go beyond being a valuation actuary.

On small group medical, the focus is going to be on state-by-state regulations, small group reform, the medical underwriting practices, the profit by duration, and the mix of business by duration. Then there are those medical groups by size that are kind of in that nowhere land where people underwrite in so many different ways. Some of them use experience rating. Some

use small group rating. I'm talking about generally the 50 to 100 life groups. I don't know how you guys all write that. Some people use some kind of a portfolio or a credibility approach. I think the valuation actuary plays a very important role in it because you really have to validate the results. This is the place where people have exceptional results if they use things like attending physicians' statements (APSs). They want as little of this business as possible, and they have tremendous results. I know people that are using different approaches and having terrible results. You have to work very closely with the pricing actuaries and validate the results.

I think the next size is really complicated. This would be large and jumbo medical groups. Experience rating formulas that people use are not consistent from company to company. They're not consistent with any company. Underwriters use different approaches within a company. So that means that you must do a lot of sample testing either as a valuation actuary or as a pricing actuary. You must watch out for the multiyear guarantees that can give you a deficiency reserve. You've got to dig around for that. You've got to be concerned about the government groups and similarly sized groups where you have to guarantee expense assumptions. You have to be concerned about expense charge concessions on these major groups, the so-called national accounts, because those groups will have concessions that are different than the regular pricing formula. Sometimes you'll get some deficiency reserves out of those.

On these larger cases, you also have to really measure the value of the provider deals. Another problem with the large group is deciding whether to even buy it or not. The brokers have so much control over the marketplace, and the margins are so thin that when you think you're buying something, you have to ask yourself whether you are really buying anything or is it going to move on you? You have to guarantee that the marketing relationship in that business will stick around. Sometimes it's important as an actuary to go to whomever is running the deal and say, "Let's make sure we talk to the marketers." The actuarial part is easy.

In the early 1990s, I sold a block of regional large group health insurance that was experience rated. I also sold it to a national carrier, and within two years, 90% of the business had lapsed because the brokers didn't want to deal with a national carrier. They wanted to deal locally. It just doesn't always work.

I worked on an acquisition within the last five years where there was $250 million of experience refund premium subject to a 40-page dividend resolution. Some of you probably think that's really foreign, but that is the kind of stuff that's out there. The stuff we did 10-20 years ago is still out there. You've really got to dig in and find out what is there. There's business out there with claim stabilization reserves, deficit carry-forwards, and all that. As a valuation actuary, it's not as easy to look at the claim reserves; however, this is one area where you folks, as valuation actuaries and as general actuaries, can really help, especially if you've been around long enough to remember working on that kind of stuff. Many people won't see that, and some small piece, the $250 million that I experienced, was really an aberration. We're going to get into a concept called stragglers later, and you'll see some more examples of that. There's less of that rated experience and refund business around, but there's still some of it.

Coverage types. There just aren't many long-term disability (LTD) buyers, and they know a lot more about it than most sellers. During the first acquisition I was involved in, we went in front of the board. The president said, "I think they know more about selling than we know about buying." The president was right. If you're going to sell an LTD block of business, one thing you might want to consider is shopping for active claims to see who will give you the best deal on the active claims. Then, keep it apart from the rest of the business.

Medicaid coverage. I've done some work in Medicaid the last few years, and it's really one of the neatest blocks of business, but one of the most complicated. You've got new enrollees that often have really high usage, and then the usage in some coverages just drops way off.

You also have multiple coverages within Medicaid, and you can't really combine them when you look at them because they are so different. Aid to Families with Dependent Children (AFDC) is so different. You really need to break things down into pieces when you're analyzing Medicaid. You need to study the claims patterns in terms of subrogation. There's a lot of subrogation with states, and if you don't study it, you might make a mistake in seeing how profitable the block is. I would say, if you're not a Medicaid actuary, find one that'll help you. That's what I would do. I'm not a Medicaid actuary, but I learned a couple of lessons by doing some valuation work on Medicaid.

Estate regulations change regularly. The benefits may change, and carriers add a whole bunch of people. I think we have the skills and the valuation actuaries to really analyze this business. You're dealing with the benefit differences between acquirer and seller. I've never been involved with a Medicaid risk. Actually, I have, but I didn't do the actuarial work on one transaction. Stop-loss is probably the most difficult and challenging sale or acquisition because of the broker control and because of multiple contract types that exist. There is somewhat uncertain profit, different ways of measuring that profit, and different reserving techniques. There are a lot of different reserve techniques out there and extensive accounting that is required. There is also the issue of integrating with the customers.

I sold a stop-loss block of business about a dozen years ago, and the process that I used was for the buyer to become completely comfortable with his general profit level to see if they wanted the block of business. Then we transferred the administration and the risk all on one date, January 1. For those groups with January anniversaries, there was a clean cut of the risk and the administration. For those groups that were not January anniversaries, in other words February to December anniversaries, experience was recorded for the whole policy year, that was on both sides of January 1. We split the risk based on the number of months that the seller and the acquirer were at risk, and we just split the profit and loss for that whole period. That was the easiest way to do it. If you think of doing it using any other method, you're probably going to have some real arguments about reserves. If you don't, you're probably not doing your job.

MS. RAINS: Larger transactions tend to use more approximations, and when they use more approximations, the level of complexity and ambiguity increases. What often happens is that an investment banker will do some preliminary due diligence for folks and put together some financial models. Our recommendation is that when the investment banker does that, you might not want to use the due diligence that they do as your base due diligence. You want to use it as a checkpoint for how your comparisons come to theirs. When you are thinking about your position in this deal, what does *on the menu* mean? *On the menu* means you're the acquired company. *Writing the menu* means you're acquiring a company.

As the writer of the menu, you have different obligations. Your obligation as a writer of the menu is to make sure that you're clear about your expectations, what's negotiable, and what's not negotiable, and that you communicate what your expectations are in this unique deal. As the person that's on the menu or the company on the menu, your responsibility and obligations are to make sure that you answer those questions honestly, truthfully, and that you provide as much information as possible because no deal is worth doing if everybody's going to look bad at the end of the day when it doesn't deliver the projections that you expected.

MR. MILLAR: Another thing I'd like to reiterate is that if you have an investment banker working for you, make sure you're comfortable with your staff on the due diligence that you perform because the incentive of an investment banker is far different than your or your staff's incentive. As far as the states are concerned, we pretty much went through that. We can't give you all the differences, but we suggest that you get your lawyers involved.

When preparing for a sale, it is most important that you have a good project leader and good team members. I think actuaries with broad management background, and valuation actuaries that have been pricing actuaries, can be good product leaders, as long as they know how to delegate. There's a lot of work in one of these, and if you start doing it all yourself, you're going to be working 24 hours a day or you're going to be missing something. Bring your best people. Get your best underwriters and actuaries involved, whether it's on the seller side or the buyer

side. As a project leader, you really have to realize that this is a business process, not an actuarial process. Actuarial is a subset of it. So get people from the following areas involved: finance, corporate actuarial, underwriting, legal, administration, tax, systems, and benefit design. It's a broad business process.

MS. RAINS: The buyer brings a project leader who's typically more of a generalist and has the capability to work across functions within an organization, to gather people together, to facilitate transactions and information/communication sharing, and to resolve conflicts that might occur.

The buyer should be bringing that type of person and representative team members from each of those critical core functions within the business to the deal. When they do that, of course, they're going to ask very pointed questions because that's part of preparing for the purchase of this deal and making sure that what is being sold is accurate.

That's one of the things to really consider in terms of being on the buyer side. Make sure you have the right person in that role. It should be a relationship builder that integrates a number of folks from various parts of the organization. You should know who those people are that Steve's referring to that have experience and have a lesser learning curve so that you can get right to the meat of the matter in terms of the activity. Steve, tell us a little bit about the best time for a sale.

MR. MILLAR: You have to decide that for yourself, but it's something you must think about. If there was a rule-of-thumb, it probably has something to do with things just starting to improve or being on the upward tick. It certainly would not be when they're on a downward tick. That raises the issue of cleaning up problems. It's really hard to sell a block of business if rate increases have been deficient and if you have operational problems. You have to get those cleaned up at least. I sold a block of one-life group coverage once. I went to 20 potential buyers. The best offer I had was to guarantee a 2% profit for a year, and to give them a million dollars. That was my best offer, and I took it. I just couldn't get stuff cleaned up. We worked on it for a long time. Sometimes you have to bite the bullet. I think that was a pretty good deal, and it was cleaned up in a lot of ways.

MS. RAINS: Sometimes the best time for a sale on the part of the seller is when you're getting ready to divest something that you've been managing for two or three years, and you just can't turn it to where you want it to be, but you recognize that there's someone out there. There's a buyer out there that wants that block of business or wants that type of business to augment their existing product line and their existing service. Therefore, it might be valuable to them and less valuable to you. Although it might not be profitable or on your uptick, it might very well be that you've got to do it before it goes down any further. You might have an interested buyer who wants that block of business to augment something that they're offering or to be able to compete in the state in which they do not currently have that product. So you have to really time it well and decide what your objective is as a seller in getting a piece of business on the block or getting the company on the block. Who are the right buyers for that? Who are the people that are looking for this? Those are the folks that are going to have the vested interest in buying it.

But, as a buyer, I'm going to be saying, why are they selling? What else aren't they telling me? What's hiding beneath the covers that I haven't seen? I'm going to be asking for a lot of support in terms of financial analysis, risk analysis, and assessment. Are the ratios that they're presenting accurate? Do they track with what they've been showing? Do we have a pretty good understanding of how they define their membership and their claims? Is it similar to ours? Are there big gaps? Do we have to analyze those? If there are gaps, how are we going to get to the same definition? How are we going to move them to our way of talking about our business? So those are the things we're going to look for as a seller. This is especially true when we're selling a block of business that hasn't been profitable. If we're trying to get rid of a piece, we're divesting a piece, and we're divesting a company.

MR. MILLAR: The next item for the seller in preparing for a sale is to set out all loads and management assumptions. I do some valuation work as a valuation actuary, and I'm amazed at how many hidden loads that the actuaries own. Management has no clue. I have one client that gives her loads different names like extra load and contingency load. It's the ones that aren't obvious, the ones that aren't set out for management. Those are the ones that are a problem when you come through an acquisition because, when you start selling, you've got to tell

management for the first time. If the first time you tell management is in the middle of a negotiation, like I did once, you might get pulled out in the hall and asked, "What are you trying to do?" This happened to me. I said, "I'm trying to get my load out of that. You're in trouble." Before the sale, all your loads must be explicit. If you have extra morbidity in a contract reserve or if you have extra load in a claim reserve, at least tell management. Tell your management or you are going to give it away. Let's say you are using some interest rate that's just obtuse in a valuation situation. Let's take LTD. If you had a 2% interest assumption or LTD claims, what do you tell management when it comes time to transfer that reserve to somebody? So, that's really an important item for a pricing actuary and for a valuation actuary. How many of you have loads that you don't tell management about it? [No hands were raised.] I don't believe you at all.

MS. RAINS: They're hiding it.

MR. MILLAR: You don't steal a reserve because you give it back. To thine self be true.

MS. RAINS: Steve has really covered setting out the loads. The buyer is going to validate that, challenge it, and test assumptions. They will make sure, when they go in front of their board and say this is the right deal, that they understand all the loads that you've put in. That leads to another issue that happens that has to do with the stragglers and the loss leaders and what people are going to do with this. Steve has some good examples of some of those activities from past experience.

MR. MILLAR: I've been around for 29 years. Some of us probably remember group permanent or Section 79. It was life insurance where the employee pays the increase in cash value. The group pays for the term insurance. There's still some of that stuff around, and you have to watch for stragglers. I came upon an indemnity block of business where hospital dates of service were regularly moved forward for the valuation system to model the effect of extension of benefits. I don't know how many people have ever done this, but it created a 15% extra load in the reserve. I've encountered that within the last four years. So, there's a lot of odd stuff out there.

I had a client that was providing stop-loss coverage to an HMO based on their bottom line results. If they would have given a million dollar bonus to the president of the HMO, it would have cost my client an extra million dollars. We probably all have some individual medical or $15,000 lifetime maximums or $50 daily hospital benefits. I have a client in Minnesota that hasn't increased their medical conversion rates in 12 years. Don't tell me you don't have some of this stuff. Everybody that I've ever seen has some stragglers, and you have got to get them out on the table. When you're buying, you've got to get them out on the table.

MS. RAINS: I call that the buyers beware syndrome. That's the integrator mitigating the items that you don't want. Be willing to kill a deal if you're going to have to take them no matter what. Again, if you don't know how to manage it or run it, and you haven't done it before and don't really want to do it, figure out a way to carve it out of the deal if you can. It's tough to say this isn't worth doing.

It's an all-or-nothing proposition. We recently had an experience where we said we would take all but one thing. We asked them to find another buyer for it. We agreed to buy the rest once they took that one aspect out of the business. It's a tough line to take, but once it's taken, people understand that they either have to do that or you're walking away from the deal completely. It changes the tenor of the deal, and it allows you to have control. As the buyer, you're the person writing the menu. Write it the way you want it to look because you have to be prepared to deliver to the board what it expects.

MR. MILLAR: Seller's offering memorandum. Focus on the business and the systems. Don't tell us about the chairman. Don't tell us about the golf course. If the people aren't involved with the sale, don't give us any bios. This is a document that has to be realistic but also sound good. I think actuaries can do that. It has to tell about the successes of the business. It has to tell about the improvements. Don't use words like revolutionary industry leader and then tell them you're for sale. It just doesn't work. Tell about the coverages, volumes, and locations, and stay away from the details of the rating and the underwriting. The purpose of this document is to get people

interested so that they'll come in the door. Get enough people interested. You can pick which ones you want to come in the door. You need a positive report on management practices. Keep it at the management level. There are general things about underwriting, and general things about rating, and not too much detail. Convince the reader to take a closer look. You're not trying to consummate a deal. You're trying to decide who can come into your data room.

MS. RAINS: The purpose is to get the buyer to go to the next step, which is reviewing the offering memorandum again and focusing on the business and systems to be sold. What am I looking at from a buyer? What do you think I'm looking at in this regard for business and systems? How does the business relate to our business as it exists today? Are the benefits that are presented real? Do the distribution channels, customers, market projections and truly state-of-the-art commentaries that get me to go to the next step hold water? Can I validate that? Can I see that? Can I look at the actuarial practices and say they are consistent with what we would do. These are not consistent, and we have a learning curve here about what they're doing? Can I focus not only on the numbers but the rationale behind them? What is the reporting, how is it going to mesh, and how is it going to challenge the buyer's methods to come and take over the company that we're bringing in?

I want to provide some migration recommendations. We can do this. Here's what we're going to have to do in the integration phase to make it work. We wanted the business for a reason. It's business oriented. We want to make sure that the compelling business reasons, market growth, competitive positions, and new product offerings, are what we are keeping, modifying, or deleting. We really want to know what's going to contribute to whatever our ultimate objective was. In the center of the puzzle was mergers and acquisitions, with success defined by the financial expectations that we've delivered synergy to our board. So when we get to one plus one equals three, these items are what get us there—knowing what we were going after and communicating that vision clearly.

On the accuracy, we want a time-and-date stamp. We want to know that that information is not stale. We don't want recycled information. We want current, accurate, up-to-date information. Finally, we want to make sure that the results clearly paint that pretty picture. They should paint a good picture, otherwise you're not going to pay attention. You're not going to go to that next step. As an integrator, we need to see it in action. So we're going to ask for some observation time. We're going to want to meet with people. We're going to meet with the management team in the confirmatory due diligence phase. We're going to ask some tough questions and make sure that it makes sense. What is it going to deliver for us? Again, when we ask those tough questions, we're not trying to kill the deal. We're trying to understand what we're going to have to do to make the deal work. We really don't want to kill the deal because once it has gone through the financial analysis and being attractive enough, it's not our job to say this is not what we want to do, unless we encounter a red flag. We do want to know what it's going to take to get it integrated and be successful in the new company.

Finally, we want to compare the compelling business reasons to the numbers. Do they track? If you have these business reasons, and you have these numbers, does it make sense? Are you going to achieve that? If you say you're going to be the market leader, that they've grown 1% per year and they still only have 5% of the market, you're probably not going to make it the market leader overnight. That might not have been the right compelling business reason. Let's make sure that we track those two things and be sure that they make sense. That's part of taking a closer look at an aspect of the deal.

MR. MILLAR: Our next item is seller-initiated projection models. You see these once in a while. I've never created one as a seller. I've been in about six sales situations, and when they are created, they kind of come in three forms. For an exceptionally well-run company, you almost say to yourself, I don't know if I can really improve this very much. Then you have to look for the synergy that goes beyond. Add it to your distribution system or add it to your customer base. Is there something outside of what that company is bringing to you where you get the one plus one equals three? I saw one in the mid-1980s where the company was regularly

losing $15-20 million a year, but it had a consulting firm say that under our management, the company would make $2 million a year. You just can't believe them. They're useless. Why even create them? It's almost an embarrassment. Then, the rest of them really don't seem to help me very much. As a buyer, I've got to create one that works for me.

MS. RAINS: Yet I've had the opportunity to see some seller-initiated models that do what I call a check and balance against my excited internal buyer that wants this business at any cost. They think they're going to turn it around, and they know how to make it happen. They're going to make it profitable. It's going to be great. It's going to augment their product line. They can do a whole bunch of new marketing and they'll have great new distribution channels. This deal is great! Their project and projections are really high. In that case, the seller's projection is a more realistic activity. So we use that as a check and balance to make sure that we control those internal people. I see a couple of smiles because I know you all have had that experience. I know someone in the business that you're in has said, "We've got to go buy this block of business or this company."

MR. MILLAR: As an actuary, if you're going to write one of these, be positive and somewhat realistic but don't create distrust in the buyer. It's not going to work for you. Don't waste your time if you make it look better than the business has really been. I don't know many people that really put much trust in these. As a buyer's actuary, scrutinize, scrutinize, scrutinize. That's all you can do.

MS. RAINS: I mean clearly I have to consult with the actuaries or my team has to consult with the actuaries. At our General Session, one of the admonitions was to learn how to communicate. Actuaries have a very special language that is part of this profession, and 90% of the people out there have no clue what the mysterious profession does. They don't know what the language means, or how it relates to how this business is going to be successful. When we're trying to integrate, our job is to work with you to understand it. Your job is to communicate it in layman's terms so that we translate that into business plans and projections and models and help people on

the other side understand. Your partners need that, too. The admonition for communication is more along the lines of translation than it is for communication. You clearly can communicate well what the language means, but the question is, can you translate it so that the person who isn't within the profession can understand it and apply it to the business at hand?

MR. MILLAR: The next item we're going to talk about is a seller's data room, and this is the next level of information beyond what was given out in that prospectus. It is really valuable to get all the pricing actuaries and the valuation actuaries together to create some teams. Give them the new and renewal underwriting information. What are your processes that you set in place? What are your goals? What are the key rating processes? Build a set of topical files. Give them some of your assumptions, but don't give them everything. What makes your business tick? Why is it making money? You have to decide about the level of assumptions. At this point, don't let people go in and steal your stuff. That happens the next time they come in. You start sorting them. On your contract reserves, your policy reserves, and your deficiency reserves, you can lay some of that out. Restatements are always valuable. Set out your claims inventory.

I was involved with an acquisition that had $700 million of claim reserves, and it was in five claim triangles. They did their claim triangles four different ways, but they always compare six months of paid data with six months of paid data. It was six-month ratios. I decided I'd run it with three-month ratios. They didn't give me any back claims inventory information. So I kind of wondered what was going on. I ran it with three-month ratios, and I came up with a $70 million difference, which is real money after a while. I demanded the claims inventory information and found out that once the prospective deal had been announced, claim payments slowed. I don't rely too much on people's claims inventory. I have a program where I can put in two, three, four, five, or six, and I'll get my claim reserves based on two, three, four, five, or six–month ratios. I have all the completion factors or lag factors right next to each other, and I can see how their backlog is changing. Watch for that kind of stuff.

The next thing is durational morbidity, reinsurance, and expense assumptions. You've got to get that stuff on the table for them. Show how it fits into the total profitability. Provider agreements are really important, and they're becoming more important in recent years. You must get provider stop-loss capitation. Provider stop-loss is a big deal because the people that do it internally and don't do it externally don't necessarily have the best master files in terms of how much risk they really have. They don't have all of their contracts neatly sorted into a pile that they could give to you because they vary so much by market. I don't know how many of you are in that business, but you could send a couple of actuaries to just to work on those things for a few weeks.

As valuation actuaries, we must adjust the risk-based capital in an acquisition in terms of the combined risk-based capital needs and the surplus that will be required by the buyer.

MS. RAINS: I take a little bit of exception to that because the next slide has to do with buyer due diligence and getting started. The integration team wants to be involved. They have to be notified of the progress. They want to be involved in the interview process and data requirements. We've talked a little bit about the project leader being a strong generalist and pulling together subject matter results. We've also talked a little bit about looking at the offering memo. At this point, we're now looking at what makes the business tick and be so attractive, and we are providing comments to the due diligence team.

The next piece is the functional and topical team members. Here's where some breakdowns often occur. During the due diligence process, we'll have some projections from a business unit. The person who's actually going to be responsible for running this later will say, "I can achieve these synergies. I'm going to merge these three operations and move people to my existing location. We'll get some facility synergies." It all looks good, so you go back for a confirmatory meeting. They say, "Yeah, we can still do that." We close the deal, and guess what? You hear, "We can't move the operations. We don't have the facility space." These people are really good,

and they're talented, but they just can't do it." You've got to get the signoff. This is where we say, "These are the promises you've made. Are you going to live up to them?" You get one more chance in confirmatory to make your adjustments. You've got to get those folks to signoff, and the biggest challenge as an integration team is getting them to live with what they agreed upon to get the deal done. There is that excited buyer syndrome that I talked about a little bit earlier. You really want the deal. You think you can work your way out as long as you get additional income. If you get more revenue, and if you sell more business, it'll all work out in the end. You believe that your per member per month (PMPM) will be right, and that you will have all the customers and claim service representatives that you want. So that's a real challenge from an integration standpoint because then we don't have valuation models that match what our ultimate delivery is. The question that is always asked is, Was it the integrator who didn't do it, or was it the valuation model that didn't do it? It's a little bit of both because we have to all take responsibility for that.

Finally, on the data requirements, the integration team has the obligation to tell you what we need. So many times the integrators say, "If you'd only put this in the data library, we could have been successful." The data library people say, "If you'd have only asked us for it, we would have given it to you. Why didn't you tell us you needed this? You knew it didn't work last time. You should have told us." Who's at fault? We're both a little bit at fault because it's an interlocking puzzle, and we have to be collaborative, and we have to share what we learn. I call it the issue repeat avoidance mechanism, also known as don't make the same mistake again. You have it within your power to not make the same mistake again on the next one. Don't allow a data library to not have the information you need because you didn't ask for it. Steve has some approaches to this subject.

MR. MILLAR: I'll tell you about a mistake that I almost made. A company I worked for bought a block of business in the mid-1980s. They had a travel accident block, and it was a good block. It was running well, but we didn't have the experience of managing it. We decided we'd take it and get into that business. It didn't integrate with our distribution system or with much of anything. It operated alone. The people that sell that stuff are pretty independent people. One

day a plane crashed in McDonald's parking lot, and I said to the president, "The plane crashed in the parking lot. If it would have crashed into the building, it would have cost us $2 million and several million dollars for the reinsurers." A week later I received a little note from the president that said, "Steve, will you find a buyer for that block, please?" So, don't take stuff that doesn't fit. Another thing I would say is when you go into this due diligence process, get really prepared ahead of time. I keep a list of about 250 items, and I have to update them. Some of them are as ancient as can be, but it's okay for me because I operate somewhat alone. Pulling your team together and getting assignments made is probably the best thing to do.

MS. RAINS: Due diligence really should have been continuing instead of getting started because now you're visiting the data room. As actuaries, you're going to validate things like loss ratios, confirm reserves, and project necessary reserves. You assess the need for and calculate policyholder dividend reserves (PDRs). Essentially, you're going to have others that are participating right along with you. There are the business unit owners, and the folks that are going to run this business. They're going to participate in a function-by-function analysis and ask what it's going to take to make this thing go and how innovative they can be. They're going to ask you to help them as your underwriting actuary friends, and they will ask you to tell them if this new product is going to work in the current environment. How will we price it?

After the visit, we're still interested. We're integrators, and we want to see what's going to steer us away. We're going to have the mitigation meeting. We're going to have the finance department and the actuaries build the models to make sure that they make sense. That's going to be incorporated into the ultimate financial picture that creates the offer. At the preliminary offer standpoint, the integrators want to be involved. Again, we want to get to this blue box because we want to understand what commitments were made at the beginning. What was the basis for this deal to be done? Then, how are we going to achieve it when it's done? There will obviously be a preliminary offer, and there's usually some counteroffering that goes back and forth. We want to see those changes. As integrators, we don't want to reinvent or go back over old ground. We want to know what ground was covered so that we're not asking questions that have been answered.

MR. MILLAR: I look at this whole process as peeling an onion. You get a document, and you go in for your first step of due diligence, and then you go in for a second step. None of it's done until you get the onion peeled. You might have a second wave during the negotiation process when you get more and more information, and then you start looking at contracts, administration, detail systems, underwriting, reserves in detail, and assumptions in the reserves. And then you start building your own full projection. Model and set out all of your assumptions.

MS. RAINS: The integration team now understands these assumptions. We're going to start putting a communications plan together after the deal is done, and we're going to communicate that to the owners that are out there. At this point, we find ourselves at the negotiation meeting and having some actuarial involvement.

MR. MILLAR: You might start talking about things like running out the claims. You're going to transfer some reserve. You might think that you always want to run out the claims, but there are times you won't want to do it. The $700 million deal that I was involved with never went through, but it would have been kind of crazy to run out all the claims on that thing. Transferring a reserve would have been a much more efficient process and an easier decision. It would have made more sense in terms of the total dollar value of the deal; we could accept a variance of $10, $15, $20 million on a deal that size. It didn't really matter a lot.

I was involved in a deal before I sold. I had to give the guy a million dollars. They sorted every hospital claim in excess of $10,000 and reviewed them. They put every claim that they wanted me to approve for extension of benefits in a pile, and one day I reviewed every one of them. Now, that's a real obtuse way to sort your liability, but it worked on the small deal. It wouldn't work at all on a big deal. The reason I went with that approach is because he was the only buyer I had, and that's what he wanted to do. It was a very honest, straightforward company.

At this point, you have to make sure that when you come to your policy reserves you know what your loads are. If you're going to put them on the table, you want some money and to know that you have extra loads. You're going to have some hidden mortality or an extra mortality

assumption. If you think there's some retained earnings in your reserves, you've really got to get that on the table, and that's hard to get out of the negotiation if you have retained earnings in those reserves. You have to decide this yourself. The decision of whether to transfer the reserve depends on the situation. You really need to study the claims transition. You need to know both the buyer's and the seller's systems and how claims are coded. Some claim systems record hospital claims exactly based on how they come in the door, which is based on service data. Some systems don't do things this way. This isn't as big an issue as it used to be. I remember the extension of benefits when I sold one company. It was well above 3%. Now you see extension of benefits assumptions and people's valuation work at 1% and lower. Some even had half a percent. Because of the state regulation, there's no real extension of benefits assumption that should be in some of the Medicaid benefits. Whether you're a buyer or seller, you need to get to that.

Another thing that's really important is you need a detailed inventory of what you're buying, whether it be by policy form or whether it be by funding provision. I was working with a solid block of business one time, and I counted up the number of policies by each size. Every time we counted it up, we had 41 more policies than I could reconcile. What about this funding method? They would still sort out the 41 more policies. They had 41 policies that had no members. They kept them on the books, and when members would get added on, they would just put the numbers in without any underwriting. I certainly had to tell that to the buyer because there were 41 policies that most people wouldn't even consider taking. There were policies that were out there with no members.

As far as other coverages, life is pretty easy to sell. You can usually split the claims. LTD is not as easy to sell, but STD is easy to sell. I don't really know much about long-term care. The basic principles apply to Medicare supplement and Medicare risk in terms of your policy reserves. I think what you really have to do is make sure that, as a buyer, you don't get a bunch of things that you don't want. If you get them, you know about them. You need to be sure the price is adjusted.

MS. RAINS: From an integration perspective, what I'm looking at is, once all these decisions are made, I'm going to be analyzing the systems implications. What are the training needs? What are the staffing needs? Do they make sense for the model? What's going to be the cost to achieve this integration now? Then we actually can mechanize all of the things that have been decided upon. What measurement tools are going to be in place? When are we going to track these things? Up to this point, the integration team has been in a support role and asking a lot of questions so it can do this right when we sell the deal. Now they're going to take a leadership role, and they're going to involve, in an ideal world, the due diligence team leader to make sure that we don't lose any of the continuity and make sure that they're always there with us. They can answer the questions, and they can clarify the needs.

Then we have some creating teams. You're always going to have a steering committee team that's going to make some ultimate decisions. If people can't come to a decision, the steering committee will make them. They're going to assess some cultures and the differences. They're going to utilize some project management disciplines. Everybody does it differently. Some people call it a work plan. Some people use Microsoft Projects. Some people use Word documents. Some people use very detailed project plans. But there's some way to track the key milestones that you must achieve in 120 days that are financial and required. There are key milestones that you achieve after that depending on the type of integration. Remember, we talked earlier about full integrations or partial integrations, so that's going to be reflected on that management structure.

Finally, it's now the job of this team to communicate all of the synergy expectations with regard to this deal. Who is responsible and how are we going to get there? Then make sure it gets included in the financial projections.

We see that the actuary is critical in four areas: product offering analysis, pricing/underwriting, trend analysis, and membership. The actuary is critical because product offering, risk assessment, and benefits and recommendations are what's going to keep the business unit on track. As for the pricing and underwriting, it's critical to create a profitable product. In terms of

buyers' trends, it's critical to say what's different about my trends versus the people that we've just bought, and how does it translate into the new business that we've got going, and how do we model that? A critical part of our business is the membership reporting and understanding that function. Being able to translate that into our business is key to our success in financial activities. Finally, we're reinforcing that message that was given earlier today about being a partner and making sure that it's done.

MR. MILLAR: You can't do this alone as a valuation actuary or as a pricing actuary. You need a team, no matter how good you are, and I think you need one other thing. You always have to report back on a plan or you won't learn. You'll find out that it won't turn out exactly the way you plan or sometimes not anywhere near it.

MS. RAINS: We had some lessons learned in common. So we want to make sure that we share those with you. One of the key factors is resourcing a merger appropriately. We typically take one person who's currently very busy doing their real job in the real world, and we ask them to now do merger work in the merger world. Eventually that just becomes part of their real job. We want the experienced people. They don't have a learning curve because they've done it before. It becomes something that we actually performance evaluate. They do enough of them so that it becomes part of their regular job, and that wasn't really something they signed up for. Many mergers find that they get resource constrained and can't deliver because the people aren't able to get the work done that's necessary due to the fact that they're distracted by their existing job.

The next thing is planning the organizational structure early. In the absence of communication about what the organization structure is, how many people have been with companies that have been acquired at one point or another in your life? And how many people have had really clear communication messages about what that acquisition meant and who their leadership was going to be? I'm not seeing any hands yet. That's really scary because, in the absence of that communication, we create scenarios in our own mind about what's going to happen to us and our

leadership team. We stop working, and we don't process claims, and we don't do billing, and we don't do all of the activity because we can't possibly focus on it. The first two letters in merger are *m* and *e*. It's all about what's going to happen to *me*. Communication is critical when planning the structure. The organization structure creates the leadership structure that then puts in place what needs to happen during the integration process.

Never underestimate the power of people, systems, and processes to enhance or derail a merger. You will have a much more successful merger if you get the people in line, and they understand the shared vision and how this is a benefit. You must also give them the systems necessary and provide processes and templates and help them. It's going to be enhanced. You're not going to derail. Think about a situation in which any one of those systems fail—and you can't send your e-mails, and people can't get the work done. Guess what? If you don't have processes in place to help people, they'll make up their own, and it won't be consistent. Once you get there that strong leadership is going to be the place. Those decisions will get made and those resolutions will get done.

What we see is the art of integration and the art of mergers and acquisitions (M&A) activity as meeting all the business projections while respecting and balancing the cultures and the processes and the procedures. If you don't do all of that and meet that nine-piece puzzle, you're not going to have a successful integration.

MR. DAVID W. REIMER: You mention underpowering the implementation of a merger. How about overpowering? I've been in situations where you took the top people and integrated the merger. When they were finished, there was no place for them to return. Can you speak to that a little bit, too?

MR. REIMER: What is the appropriate way to do it? Are there things you've seen that are appropriate?

MS. RAINS: I think the question is, can you overpower a merger? Can you take people that are at too high a level or in too powerful a position and put them in charge of a merger and then not have something for them to go back to? There are three things that need to happen in that case. The first thing we need is an assessment. When we give this person a new role in a merger, what are we going to have them move into afterwards? We clarify that up front. They are important enough to be in the merger, and they're critical because they have got the relationship skills, the generalist knowledge that we need, and the connections into the different parts and functions of the organization. We think they must be critical enough to be a retainer or a keeper, and we want to make sure that we communicate what that role is. So we have to identify the role they'll play during the merger, and what they're going to move to. That also incents that person to want to be focused on achieving the goals of a merger.

We might find ourselves in a situation where we've overpowered it or we haven't planned for a person to have a role afterward. I certainly experienced this in the past. It puts us in a very difficult place. We probably also didn't plan any sort of retention bonus or any stay-on bonus. Then we end up doing that in the background. We might find that this is a high-powered person and a critical leader, but, because of the merger itself and needing to move forward, he or she can't have a role afterward. The next process is we have to tell them up front what their critical role is. How are we going to compensate them for staying and helping us with that, and what might happen later? Is there any sort of consulting or follow-on work that they can do after the merger is complete and the role has been eliminated?

The last piece is that we have to control the communications that come from the people that are selected for the merger team, as well as the people who aren't on the team or who leave. We determine the timing on that. Oftentimes, a merger gets derailed because the management on site or the management on the team communicates things poorly or ineffectively or too soon or too late or they don't really support the merger. They say, "If it were up to me, I'd do it differently, but the new company is taking over. I can't control it. I have no control. I'm just a pawn. I'm just getting some work done. I'm a pair of hands." You have to control those messages so that if

you give them a vital role, they don't then derail that vital role based on the message that goes on. Then, if it happens, you have to really address that. Decide the role up front, and then decide, if there's no role, how you're going to utilize that person. By controlling the communications, you can address some of the overpowering. Do you find that that works for you?

FROM THE FLOOR: Yes.

MR. MILLAR: I think a bigger worry is, if you're a valuation actuary, you're on the seller side. What do you do? I've experienced a situation where I didn't have a job. So I went into consulting. You can't be sold or bought.

MS. RAINS: That's certainly the worry on the corporate side, right? Everybody knows that in a merger, the corporate side of the house usually goes to the people that have just bought the company. What happens is there is a lot of jockeying. What you also might see in terms of powering that merger and making the integration team work is someone who volunteers because he knows that if he volunteers, he has a higher likelihood of staying with the company than if he doesn't volunteer. So, you want to take advantage of those folks, too, because those are people that we call early adopters. They know it's going to happen, and they want to stay with the company. They're going to contribute their resources.

You also want to do some core competency assessment on those people who volunteer and make sure they're the right people. That's a third way to deal with how you power the merger and make sure that it's successful. You look for the volunteers because the volunteers definitely want to be part of the organization. You must figure out why and how they're going to contribute to it. Those are the early adopters, and you always want to be aware of them. They're also people who will communicate. If you don't accept them, what are they going to communicate? How do you control the communications? We always look at that.

MR. MILLAR: I think one of the main messages you should walk away with is the fact that the average experience in this room is probably more than 20 years. You weren't always a valuation actuary, and you probably are much more than a valuation actuary, too. You're probably a valuation actuary who does some pricing. You do a lot of things. Your experience, and not only your role as a valuation actuary, is extremely valuable in an acquisition—you have the ability to integrate all those things and pull them together. So you might start looking at reserves and at pricing because you have this wealth of experience. Don't think of yourself as a valuation actuary. Think of yourself as an actuary and a business person, and you'll do well at this. Any other questions or comments?

MR. ROWEN B. BELL: You talked about some of the difficulties involved in assumption reinsurance. Assumption reinsurance versus an outright purchase are often options available to you. Can you talk a little bit about some of the difficulties with respect to outright purchase? A few years ago, at a previous company I worked with, I was involved in a situation where the seller was a subsidiary that was structured as an independent company. They wanted to get rid of the company. We were interested in all of the business and all the people that the company had. We weren't interested in the contingent unknown liabilities or things that their agents might have done in the past. We were willing to hire all the people. We were willing to do assumption reinsurance in all the business, but we couldn't price this liability for the actions of employees in the past. The whole deal ended up falling apart more or less on that point.

MR. MILLAR: You shouldn't have to price for that. In two pages of legal documents, you can protect yourself from that. It's a legal problem as opposed to an actuarial business problem. I've seen it done. One other possibility is if I want the business. You sell the company and its charter belongs to somebody else who's looking for a charter. Tell that to the seller. Actuaries probably don't have the background to protect themselves, but lawyers know the right words to protect them from that. They just deal with acts prior to a certain date that are performed by employees or the agents of the company.

FROM THE FLOOR: Someone has to remain liable for that. The seller wasn't interested in remaining liable for those actions, and we weren't interested in becoming liable for them.

MR. MILLAR: If the seller isn't liable, then you're probably never going to get a deal.

MS. RAINS: Right.

MR. MILLAR: Because you don't want it.

MS. RAINS: That's the time to walk away from the deal. I have experienced that in two or three deals in the past where the sellers didn't want to assume the liability that was rightfully theirs and didn't need the transfer. It was basically put on the table by the lawyers involved. They say, "You can take this document, you can sign it, and you'll take the liability and be responsible for it, or my client has to walk away because we will not assume that liability."

MR. MILLAR: It's unknown.

You can set some crazy number like $100 million or $200 million, but then you're not going to get anywhere with that either because they're not going to give you the money. You almost have to walk away if they won't. They're going to be stuck with it themselves. They'll soon realize that there's going to be no buyers under that situation.