

GN23(ROI): LIFE INSURANCE COMPANY TAKEOVERS

Classification

Recommended Practice

Legislation or Authority

The City Code on Takeovers and Mergers ("The Takeover Code").

Application

Actuaries involved in takeovers involving life insurance companies, whether they are employed or are acting as consultants.

Version	Effective from
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1.0	25.04.95
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1. INTRODUCTION

- 1.1 Although a number of actuaries, particularly consultants, have a wide experience of life insurance takeovers, for many actuaries employed in a life insurance company the experience may well be new. Actuaries may provide advice on a range of actuarial and (if a manager or director) other subjects to their clients, much of which may be private to those clients. This Guidance Note is primarily concerned with guidance about the valuation of a company and, in particular, with information which will or may be transmitted to shareholders.
- 1.2 Takeovers involve complex negotiations. There may well be tight time-scales and a need to take decisions when mentally tired or without the chance to consult colleagues. These pressures are even greater should the takeover be contested, particularly if hostile.
- 1.3 When the takeover involves an offer for a public company, the Takeover Code applies. The Takeover Code also applies to offers for private companies in certain circumstances. Members should ensure that they are familiar with the relevant parts of the Takeover Code. The Code is formulated in terms of general principles and members are strongly urged to discuss its interpretations in a particular case perhaps initially with the relevant merchant bank or legal adviser and, if appropriate, with the Takeover Panel executive.
- 1.4 The purpose of this Guidance Note is to assist all members who are involved in a life insurance takeover, to understand where there may be professional problems and to advise them on best professional practice. In particular, references are made to the *Memorandum on Professional Conduct* and to *GNI(ROI): Actuaries and Long-Term Insurance Business*, as well as to the Takeover Code.
- 1.5 Members who become involved in a life insurance takeover are advised to refer at an early stage to *Life Assurance Takeovers - A Report by a Working Party of the Institute of Actuaries and Faculty of Actuaries*, dated 15 October 1993, for further information on this subject. This is available from the libraries at the Faculty and Institute.

2. CONFLICTS

- 2.1 The Takeover Code makes it clear that the Board of Directors of a company and its advisers have a duty to act in the best interests of the company's shareholders. In addition, the professional guidance requires an Appointed Actuary, who is also a director, to consider particularly carefully whether these two roles conflict. In particular the Appointed Actuary should take into account his or her responsibilities, *inter alia*, to policyholders as set out in *GNI(ROI): Actuaries and Long-Term Insurance Business*.
- 2.2 The Takeover Code requires financial advisers to be mindful of conflicts of interest. This may mean the appointment of an independent actuary (who may be the usual external advisor to the company) to provide a formal, independent valuation of the company. The meaning of independence is covered in more detail in Section 3 below.
- 2.3 Should there be a possibility of conflict in terms of the Code, the actuary should seek advice as in 1.3. If there seems to be conflict in the light of professional guidance, the actuary should seek advice from the Professional Guidance Committee.

3. INDEPENDENCE

- 3.1 As mentioned in paragraph 13 of the *Memorandum on Professional Conduct* (the Memorandum), for a member in a particular situation to describe the advice offered as independent, the member must be free, and be seen to be free, of any influence which might affect the advice or limit the member's scope.
- 3.2 In the Takeover Code, independent means, *inter alia*, independent of the other party. As many companies retain consulting actuaries, it is possible that such a firm could be advising both the bidder and the target. Even though it is normal practice for such a firm to withdraw as adviser to the bidder, the bidder may object on the basis that information about it might become available to, and assist, the target. In additionally limiting its work in this way, the firm may feel that the target might become unnecessarily vulnerable and it might have to decide to step aside and not be lead actuarial adviser.
- 3.3 The Takeover Code also covers the position of multi-service organisations. In the case of members, this could apply where a firm acts as consultants to the pension scheme of a party involved and is asked to act for the other party with regard to the takeover. Whether the Takeover Code is applicable or not, the firm in question must consider whether its actuaries abide by 3.1 above.

4. EXPERIENCE

- 4.1 As mentioned in 1.1, the experience of a takeover may well be new to many of the actuaries involved. In such a situation it is essential that members who do not have the relevant knowledge and experience to undertake such work should seek the co-operation and guidance of an actuary who does. Paragraph 15 of the Memorandum covers this need. Firms which wish to give advice to companies in takeover situations should ensure that there is at least one person with a good working knowledge of the Takeover Code, particularly of those parts relevant to valuation.
- 4.2 When a takeover arises, all the Appointed Actuaries involved should consider quickly whether they have the relevant knowledge and experience. If an external actuarial adviser is appointed, the respective roles should be clarified as soon as possible.

5. RELATIONS WITH OTHER PARTIES

- 5.1 A takeover, particularly a contested takeover, is liable to cause differences of opinion between the parties and some of these may be made public. As covered in paragraph 17 of the Memorandum, members should recognise that there is room for such differences and must avoid any action which would unfairly injure the professional reputation of any other member.

6. DISCLOSURE

- 6.1 It is important that members abide by paragraph 11 of the Memorandum. Members must ensure that they can be identified as the source of the advice and, where a third party is involved, that the advice is not presented in a way which is misleading. In the course of a takeover, members may provide advice to their client on a range of subjects and using alternative assumptions on a confidential basis but not intended for wider disclosure. They must ensure that any advice which they provide, and which is intended to be communicated to shareholders, is appropriate for that purpose.
- 6.2 Paragraph 14 of the Memorandum covers the need for members to include in any report information, appropriate to the circumstances, as to its scope and terms of reference, the assumptions made and the methods and data which were used. In particular, in a report containing an actuarial valuation, all or part of which is to be transmitted to shareholders, the member should provide the information contained under 6.7.5 and 6.7.8 below in the suggested opinion letter in paragraph 6.7. The underlying principle is to enable shareholders to see the extent to which the value could be sensitive to difference assumptions and hence to make a decision concerning the offer, and thus the need to comment as covered in 6.7.9 below. It is not the intention to provide sufficient information to enable another expert to calculate a different value on different assumptions.
- 6.3 The responsibility for all documents issued to shareholders rests with the appropriate Board of Directors. However, under the Takeover Code, the merchant bank adviser takes responsibility for ensuring that the rules are observed. Legal opinion is usually sought to ensure that the sources of information contained in the document can be identified. The purpose of the verification procedure is to ensure, so far as possible, that documentation is accurate, complete and not misleading and that statements made by the Board of Directors are reasonable. The Board of Directors is entitled to rely on the advice of experts and to hold them responsible for it. Consulting actuaries may therefore wish to retain their own legal advisers.
- 6.4 Although an actuarial valuation is not a profit forecast in the terms of the Takeover Code, the detailed notes on disclosure of assumptions in profit forecasts apply to such a valuation. Members should take careful note of these requirements if they are advising a company which is producing a formal actuarial valuation.
- 6.5 In considering assumptions, the actuary should take particular note of the Takeover Code Rule 28.2 - The Assumption (Takeover Code, 4th Edition, July 93). Although the Directors of the company are responsible for the assumptions, they have a right as explained in 6.3 to rely on professional advice. Equally the actuary must be satisfied that the assumptions in a valuation to be transmitted to shareholders are reasonable. The actuary should not present a valuation for this purpose which contains assumptions which he or she is not satisfied are reasonable.
- 6.6 The actuary should consider sensitivity - whether there are certain assumptions which, if varied, lead to significantly different results. As explained in 6.5, the assumptions used should be reasonable as judged by the actuary. In the event the outcome may be different and it is a requirement that the shareholder be given enough information to form a view on 'vulnerabilities' to which the valuation is subject.

- 6.7 It is possible that an actuary will be required to give a formal opinion and that an actuarial opinion letter might be printed in a document issued to shareholders. This opinion letter is likely to contain a summary of a fuller report produced for the Board of Directors. The contents will be influenced by the circumstances of the case. The following are, however, some of the matters which the actuary should, where appropriate, cover in it where its main or sole purpose concerns the value of the company:
- 6.7.1 The name of the party instructing the actuary.
 - 6.7.2 The terms of reference.
 - 6.7.3 A statement of the data used.
 - 6.7.4 A statement that the valuation has been made assuming a continuation of current management and in a manner consistent with the operating record of that management (or otherwise if this is not the basis of valuation).
 - 6.7.5 A statement of the principal bases and assumptions. These should include the detailed assumptions underlying both the value of the in-force business and the value of future business. Where base profit figures or multipliers are used in calculating the value of future business, the detailed assumptions should be included. It is not the intention to provide sufficient information for a third party to recalculate the valuation.
 - 6.7.6 A statement that the actuary believes the assumptions are reasonable.
 - 6.7.7 A statement as to how tax has been allowed for in the valuation.
 - 6.7.8 A statement of the resulting value showing, as appropriate, the separate constituent parts, normally shareholders' funds and the value of the in-force business (taken together these two are usually referred to as the Embedded Value) and the value of future business (when all three are taken together they are normally referred to as the full Appraisal Value). Care should be taken in discussing these elements as alternative descriptions of them are sometimes used.
 - 6.7.9 A statement concerning key assumptions, variation in which would result in significant changes in the value.
 - 6.7.10 A statement concerning the position where actuarial advice not related to valuation, or guidance or opinions which were not strictly actuarial, was being given.

7. CONCLUSION

Members are reminded that, if they have any doubts about their position, competence or experience, they should seek advice from a senior actuary by communicating with the Professional Guidance Committee.