

Insurance Mergers & Acquisitions Reading the Tea Leaves

CLOSING THE DEAL (OR NOT)

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Insurance M&A

Often Turns Upon Actuarial Issues

- ◆ Target values can depend upon:
 - ◆ Sufficiency of reserves
 - ◆ Profitability of underwriting
 - ◆ Reserving practices
- ◆ Actuaries, whether in-house or independent, have a role to play at all phases of M&A transactions

Life of a Deal

- ◆ Retention of investment banker
- ◆ Letter of Intent (LOI)/term sheet
- ◆ Auction
- ◆ Due Diligence
- ◆ Data room
- ◆ Definitive agreements
- ◆ Disclosure schedules
- ◆ Administration and transition services agreements
- ◆ Regulatory approvals
- ◆ Closing

Purchase Price

- ◆ Risk-bearing entities like insurers and reinsurers
 - ◆ Statutory surplus
 - ◆ GAAP tangible net worth (TNW)
 - ◆ Premium for licenses
- ◆ Producers, TPA and other service providers
 - ◆ Multiple of EBITDA for last twelve months
 - ◆ Factor depends on business but may range from 4.0x to 7.0x
 - ◆ Impact of:
 - ◆ Contingent commissions and clawbacks
 - ◆ Risk bearing by claims administrators

Purchase Price *(cont.)*

- ◆ Earn-outs
 - ◆ EBITDA hurdle
 - ◆ Gross or net written premium
 - ◆ Loss ratios
- ◆ Purchase price adjustments
 - ◆ Purchase price often estimated for purposes of closing
 - ◆ Determining actual surplus or TNW as of or EBITDA for 12 months ending on the closing date

Representations and Warranties

- ◆ Reserves
 - ◆ Sufficiency—almost never given
 - ◆ Consistent reserving policies and practices
 - ◆ Conformity to statutory requirements
 - ◆ Roll-forwards v. full review for interim periods
 - ◆ Independent actuarial opinion
- ◆ Loss and combined ratios
- ◆ Extra-contractual obligations (ECOs)
- ◆ Claims and underwriting

Representations and Warranties *(cont.)*

- ◆ Reinsurance programs
- ◆ Financial statements
 - ◆ Exceptions from SAP or GAAP
 - ◆ Unaudited statements
- ◆ Actuarial reports
- ◆ No representation as to due diligence materials
- ◆ Materiality
- ◆ Date representations deemed made

Pre-Closing Covenants

- ◆ No changes to reserving policies and practices
- ◆ Establishing reserves in ordinary course
- ◆ Maintain/renew reinsurance program
- ◆ Interim reporting
- ◆ Continued due diligence
- ◆ Updating disclosure schedules

Indemnification

- ◆ Breaches of covenants and representations
- ◆ Special indemnities for certain items, such as:
 - ◆ Litigation
 - ◆ Claims
 - ◆ Adverse reserve development
 - ◆ Commission clawbacks
- ◆ Survival of representations
- ◆ Limitations on damages
 - ◆ Caps
 - ◆ Baskets/deductibles (a/k/a tipping baskets)
 - ◆ de minimis claims
 - ◆ Exceptions from limitations

IT

- ◆ Integration of claims administration with financial reporting
- ◆ Availability of data
- ◆ Conversion to acquirer system
- ◆ Transition services

Closing the Deal (or Not)

- ◆ Closing conditions
 - ◆ Bringdowns
 - ◆ MAE
- ◆ Waiver of conditions
- ◆ Indemnification for matters disclosed at time of closing

Questions



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