

## M&A A COMPANY ACTUARY'S VIEW

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CAS Loss Reserves Seminar, Sept. 2011

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### M&A: Company Actuary's View

1. M&A Strategy considerations
2. ERM considerations
3. Financial Projections
4. P-GAAP
5. Actuary's roles

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### M& A Strategy considerations

Market Cycle Timing



Timing Considerations

- **Hard market**
  - Anyone can underwrite
  - Acquisitions are expensive
- **Soft market**
  - Survival of the fittest
  - Targets are cheaper

Good acquisition depends on what you pay for it

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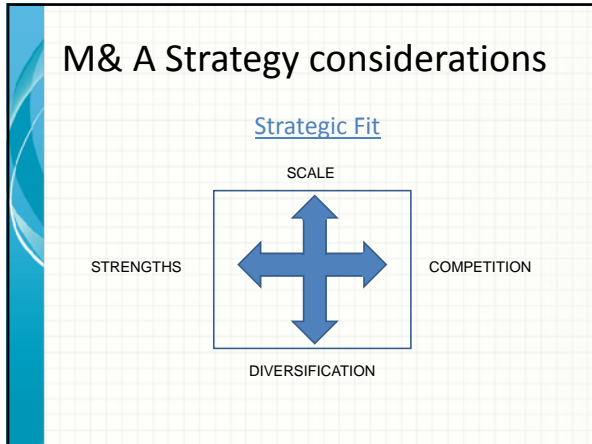
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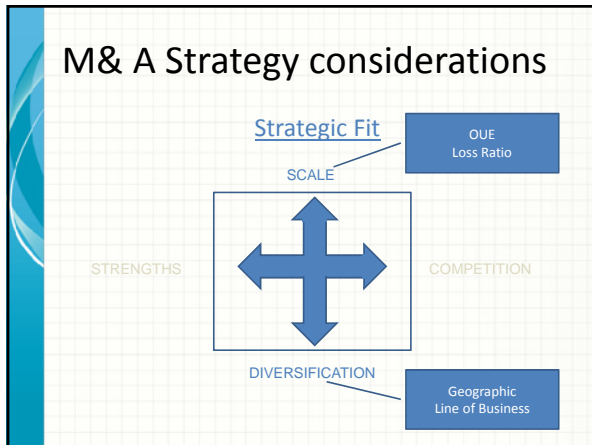
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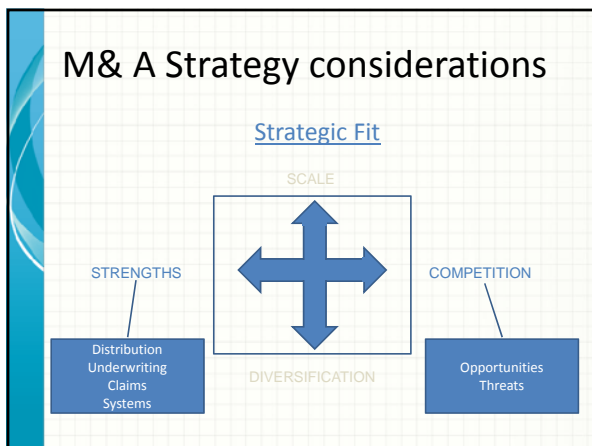
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### ERM Considerations

- UW risk
- Reserves risk
- Market risk
- Credit risk
- Operational (implementation) risk

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### ERM Considerations

- UW risk
- Reserves risk
- Market risk
- Credit risk
- Implementation risk
- Changes in UW history
  - Pricing
  - Tiers
  - Selection
- Changes in claims handling
  - Case reserves adequacy
  - Large losses
  - Trend
- Changes in reinsurance
- Other changes

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### ERM Considerations

- UW risk
- Reserves risk
- Market risk
- Credit risk
- Implementation risk
- Market risk
  - Investments are marked to market at time of acquisition
- Credit risk
  - Reinsurance receivables collectability

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## ERM Considerations

- UW risk
- Reserves risk
- Market risk
- Credit risk
- Implementation risk

- Distribution
  - What would the agents say?
  - Cross selling opportunities
- Staffing
  - Culture fit
  - Consolidation
  - Locations
- Systems
  - Integration

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## Financial Projections

- Accretion analysis
- Financing
- BCAR impact
- Economic Capital impact

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## Financial Projections

	Acquirer 1,000,000	Proforma Acquisition 200,000	Consolidated 1,200,000	Preliminary Acquisition 250,000
NPE				
Loss Ratio	60.0%	55.0%	59.2%	60.0%
Expense Ratio	30.0%	30.0%	30.0%	40.0%
Combined Ratio	90.0%	85.0%	89.2%	100.0%
UW Margin	10.0%	15.0%	10.8%	0.0%
Operating Leverage	1.10	0.90	1.07	0.90
RDE - Underwriting (pre tax)	11.0%	13.5%	11.6%	0.0%
Investment Yield	3.5%	3.0%	3.4%	3.0%
Investment Leverage	2.50	3.00	2.58	3.00
RDE - Investments (pre tax)	8.8%	9.0%	8.8%	9.0%
RDE - pre tax	19.8%	22.5%	20.2%	9.0%
Income Tax Rate	35.0%	35.0%	35.0%	35.0%
RDE - After tax	12.8%	14.6%	13.1%	5.9%

Operating Leverage: Premiums to Surplus  
Investment Leverage: Invested Assets to Surplus

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## Financial Projections

- Sources of funds for acquisition:
  - Issuance of new shares
    - Combines surplus of acquirer and acquired
    - Puts pressure on EPS
  - Cash
    - Consolidated surplus approx. equals parents surplus
    - Bolsters EPS
  - Debt
    - Combines surplus of acquirer and acquired, but . . .
    - Debt to equity higher with rating agency implications

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## PGAAP

- Central estimates – loss reserves
- “Reserves Risk Premium”

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## PGAAP

- GAAP: 141R
  - Fair Value of Balance Sheet (point of view of acquirer)
    - Central estimate of reserves
    - “Reserves Risk Premium”
- Reserves Risk Premium
  - Methodology not specifically defined
  - Present value of RBC required to support runoff of reserves
- Accounting treatment for RRP
  - GAAP; not statutory
  - Amortization: Projected paid loss pattern at time of acquisition

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## Actuary's roles

- Strategy
- Due diligence
- ERM
- Financial Projections

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