Insurance Mergers and Acquisitions

Role of the Actuary

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Actuaries play a critical role on both sides – buy-side and sell-side - of life insurance M&A transactions

This session will discuss the M&A lifecycle and current trends from the perspectives of a company actuary and a consulting actuary

Actuaries can be involved in a wide range of aspects of the M&A lifecycle — from strategy formulation through implementation

1 Before the deal — Strategy & Planning

- Strategy formulation and international/regional market education
- Initial assessment and review of alternative options
- Windshield appraisals of potential targets

2 During the deal — Due Diligence

- Financial and strategic due diligence
- Distribution due diligence and strategy
- Transaction structuring
- Buy- and sell-side support
- Negotiation support
- Regulatory filings

3 After the deal — Implementation

- Integration planning
- Purchase accounting
- Post-merger integration/ execution

The Actuarial Appraisal — What is it?

The appraisal value of a life insurance company can be broken down into three components:

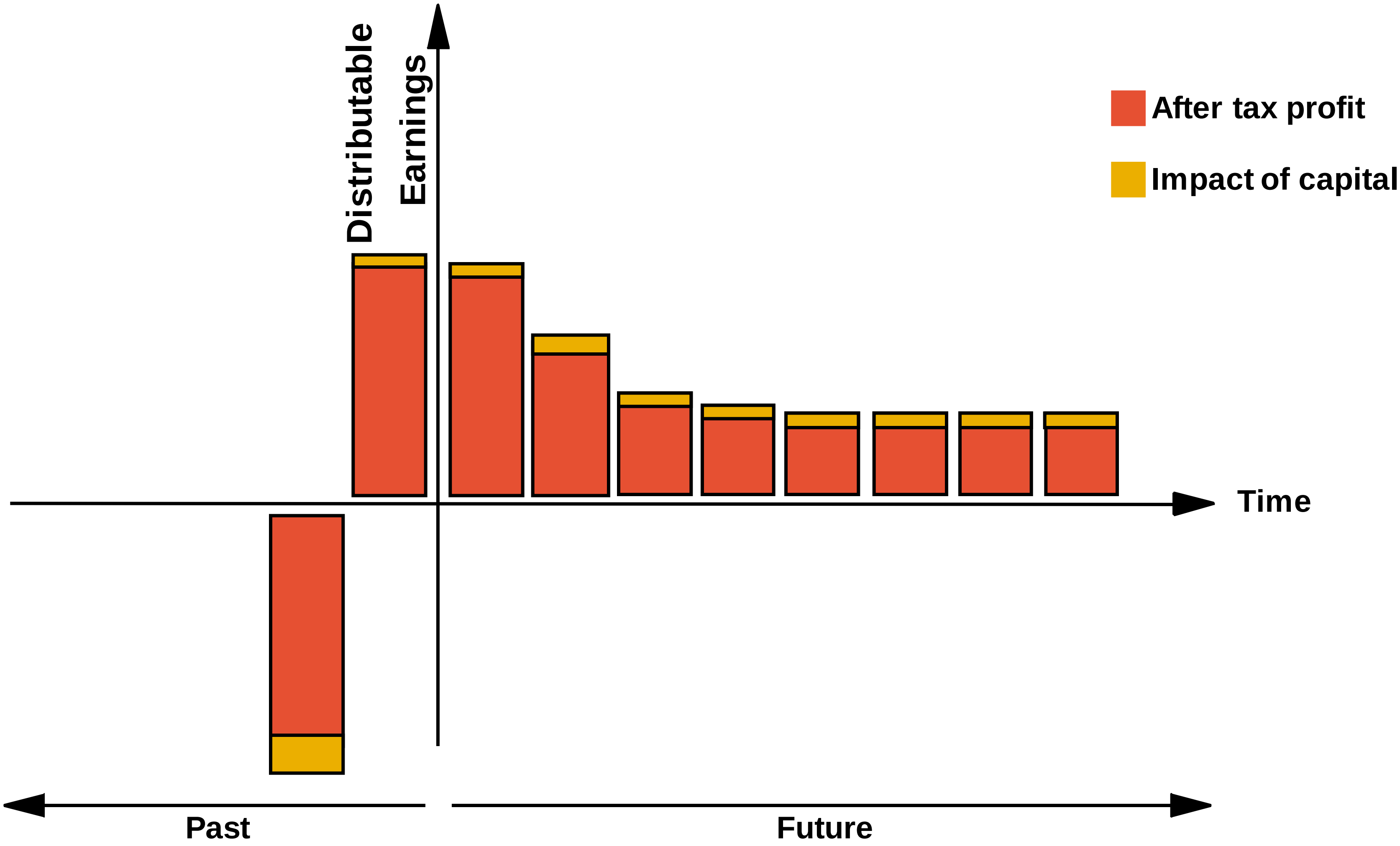
Excess of market value of assets over statutory liabilities	**Adjusted Net Worth**	Embedded Value / Appraisal Value
Discounted value of distributable earnings from in-force business	**Value of in-force business**	Embedded Value / Appraisal Value
Discounted value of distributable earnings from business yet to be written	**Value of future new business**	Appraisal Value

The cost of capital must be considered in the calculations above

Adjusted net worth ("ANW")

- Adjusted net worth is valued at after-tax market value
- The starting point for adjusted net worth is statutory capital and surplus taken directly from the statutory statement
- Adjustments may consist of:
  - Asset Valuation Reserve ("AVR")
  - Interest Maintenance Reserve ("IMR")
  - Non-admitted assets — to the extent they have realizable value
  - Certain tax adjustments — such as material book to tax carrying value differences in the assets and the impact of the existing DAC tax balance
  - Market value adjustment — in order to mark-to-market any assets supporting surplus
  - Miscellaneous items more appropriately classified in adjusted net worth rather than the value of in-force business, such as unauthorized reinsurance

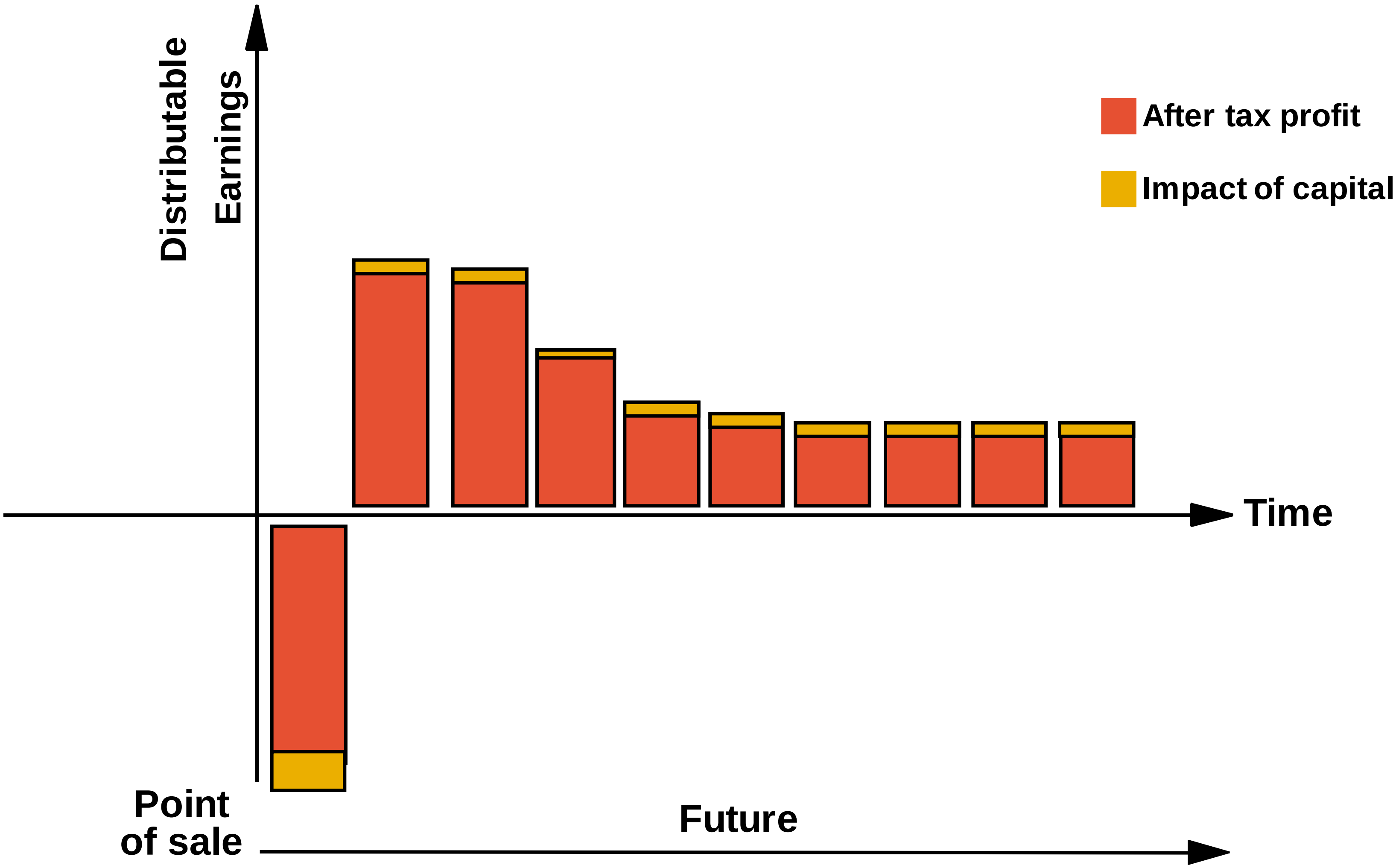
The value of in-force business combines expected future profits from all past generations of business



The value of in-force business is the present value of distributable earnings from in-force business

- Requires models of assets and liabilities for all significant lines of in-force business
- Spreadsheets or simplified valuation techniques may be used for less significant businesses
  - Depending on the nature of the business, stochastic projection techniques may be required for some product lines or a simplified allowance for the expected cost of material options and guarantees may be appropriate
- Based on best-estimate assumptions
  - Operational
    - Mortality
    - Persistency
    - Expenses
    - Product charges and fees
    - Taxes
    - Capital
  - Financial
    - Investment returns
    - Inflation
    - Discount rate

The value of one year's new business is the present value of expected profits at the point of sale



The value of new business is calculated in a similar manner to the value of in-force business…

- …Except that business expected to be written in the future is valued
- Products and amounts of business projected will be developed to be consistent with current operating plans
- “Value” emerges to the extent that the statutory internal rate of return (on an after tax, after cost of capital basis) exceeds the risk discount rates employed
- The value of new business generally reflects the business expected to be written in the 5 to 10-year period following the valuation date
  - New business production, profitability and future growth assumptions are often hotly debated between prospective buyers and sellers

In most actuarial appraisals, the cost of capital is reflected in both the value of in-force business and value of new business

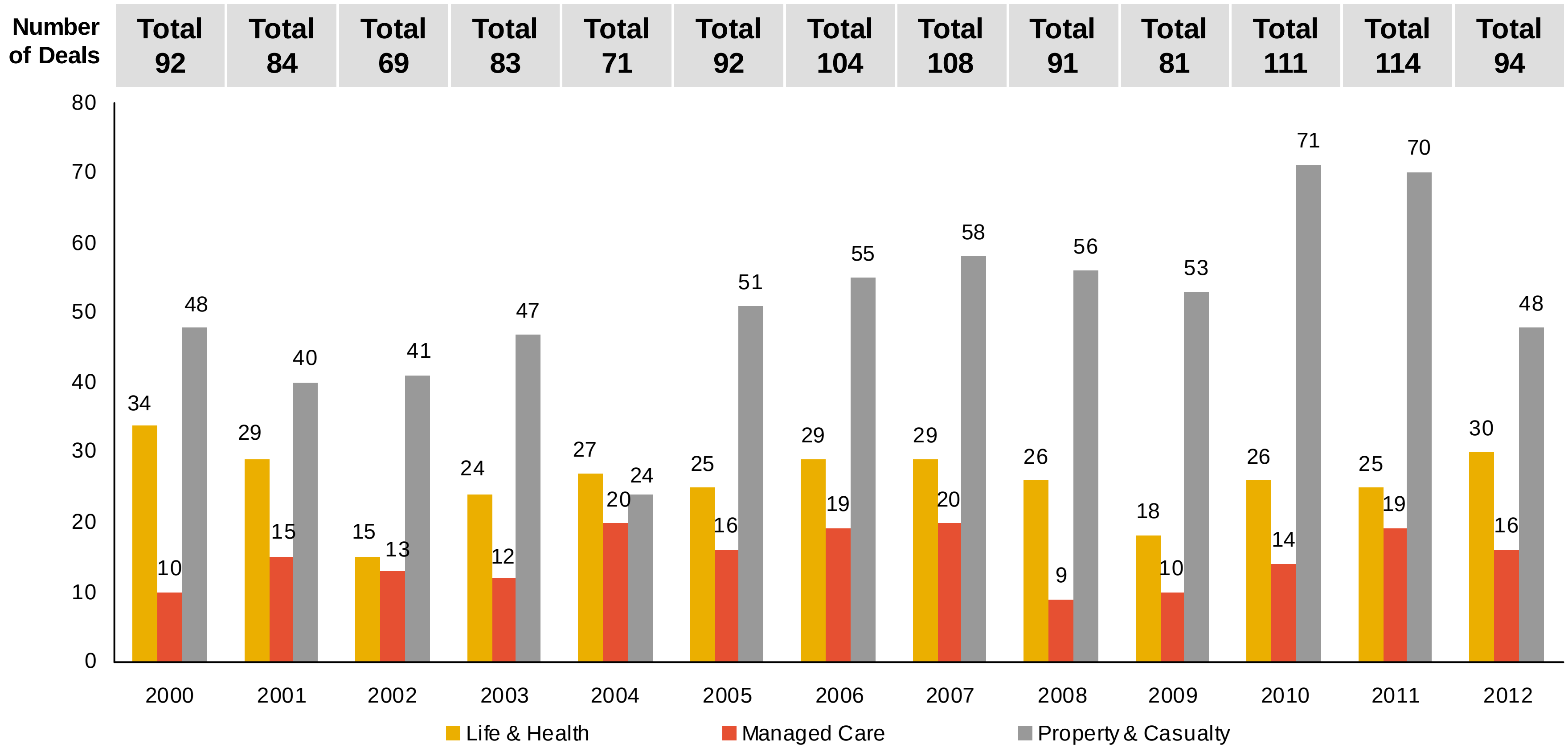
- A certain level of capital and surplus must be retained as target surplus
- A cost is associated with holding target surplus if the after-tax yield rate on assets assumed to support target surplus is lower than the assumed discount rates
- The cost of capital is derived as follows: Present Value of After-Tax Release of Target Surplus less Initial Target Surplus Amount
- Required capital can be defined as a percentage of the NAIC risk-based capital ("RBC") formula
- A typical level of RBC used in appraisals is 300% of Company Action Level
- The cost of capital is calculated separately for the value of in-force business and the value of future new business

Life M&A Trends and Perspectives

Insurance M&A transaction activity varied from year to year over the last twelve years… but it is on the rise again

Total Number by Year by Target Sector (2000 – 2012)

(Each Year Total = Number of M&A Activities Announced)



Note: Only includes deals where the target is based in the U.S. Reflects data at deal announcement event. Terminated deals are included. Multiline categorized based on Buyer Insurance Sector.
Source: SNL Insurance M&A Transactions.

Summary of Life M&A Deals Since July 2012

Deal	Ann. Date	Deal Value ($MM)
Global Atlantic Financial/Forethought	09/26/13	undisclosed
Resolution Group/Allstate (Lincoln Benefit)	07/17/13	600
Berkshire/Hartford Life International	06/27/13	285
SCOR/Generali	06/03/13	902
Global Atlantic Financial/Athene/Aviva	05/01/13	undisclosed
Protective Life/AXA	04/10/13	1,060
American Enterprise/Lincoln Mutual	03/05/13	undisclosed
Berkshire/Cigna	02/04/13	undisclosed
Prosperity Life/SBLI Mutual	01/30/13	undisclosed
Athene/Aviva	12/21/12	1,550
Guggenheim/Sun Life	12/17/12	1,350
Prudential Financial/Hartford	09/27/12	615
MassMutual/Hartford	09/04/12	400
Enstar/HSBC	09/06/12	180
Guggenheim/Industrial Alliance	08/16/12	undisclosed
Athene/Presidential Life	07/12/12	415

*Statutory basis, where available.

Source: SNL Financial, PitchBook Data, Inc.

Buyer motivations

- General Buyer Perspectives
  - Several of the deals involve distressed properties and/or highly motivated sellers, where the purchase price is significantly below book value, with the opportunity for significant upside
- Private Equity Perspectives
  - A number of deals are in part motivated by PE firms wanting assets under management, believing they can earn substantially higher investment returns than were achieved with the previous investment philosophy
  - Most deals include some kind of an improved capital positioning (e.g., offshore entities, capital “arbitrage” regarding investment vehicles)
  - Some deals are motivated in part by tax benefits
- Insurance Company Perspectives
  - Some insurers have been able to improve diversification and/or grow in areas that have been difficult to achieve through organic means

Seller motivations

- Sellers are looking to exit from non-core businesses either in terms of product types (e.g., The Hartford sales of two businesses, Allstate sale of Surety Life, Sun Life Financial) or regions (e.g., Aviva) or distribution systems (Allstate sale of Lincoln Benefit Life)
- Some sales have been designed to improve the risk profile and/or capital positioning of the remaining entity
- Some sellers have had few other options outside of a sale
  - In certain cases, existing management has maintained a degree of control and continued involvement following the transaction

A few continuing themes may fuel further activity

- Many deals have included multiple prospective buyers involved in a competitive environment
- New potential sellers may emerge, emboldened by prior deal results
- Prospective buyers who were not the winning bidder in a previous deal may have increased motivations and pressure from investors
- Private Equity firms are expected to continue/expand activities
  - Potential for further activity from firms like Guggenheim and Athene Re, to further build off of their existing platform
  - Athene Re "wannabes" emerging
  - Some PE firms are seeking run-off blocks and a quick turnaround, while others are considering growth opportunities
- Several foreign-owned insurers have emerged who are seriously considering expansion in the U.S.

Regulatory oversight

- Regulators are concerned with PE and Hedge Funds acquiring insurance companies
- PE horizon too short-term focused
- PE and insurance objectives are not aligned
  - Maximize financial returns in the near term vs. ensuring retirement benefits for policyholders
- Before approval, the regulators are seeking:
  - Transparency
  - Disclosure
  - Enhanced capital requirements
  - Better understanding of the PE philosophy in the insurance/annuity marketplace

Regulatory oversight (continued)

- The Guggenheim/Sun Life transaction closed with the following capital and transparency requirements introduced by the NYDFS:
  - Guggenheim required to maintain Sun Life New York's capital at a minimum of 450% RBC
  - $200 million trust fund established, to replenish capital if it falls below 450% RBC
  - Trust fund will be separate from Sun Life New York's other funds, and held for at least 7 years
  - Any changes to plan of operations including investments, dividends, and reinsurance will require prior approval from NYDFS
  - RBC level reports must be filed quarterly
  - Additional items on corporate structure and operations must be disclosed to NYDFS

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