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Role of Actuaries in Corporate Transactions

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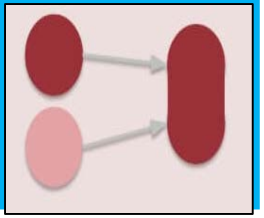
Contents

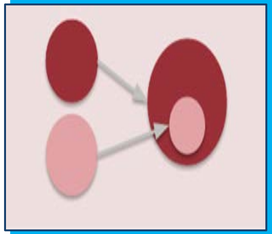
What is M&A?

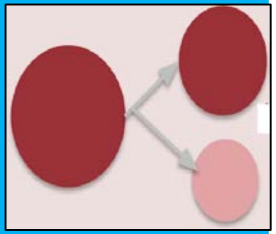
Major types of M&A transactions



A **MERGER** happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated.

An **ACQUISITION** happens when one company takes over another and establishes itself as the new owner. Legally, the target company ceases to exist as a going concern.





A **DIVESTITURE** happens, when a portion of the company, such as subsidiary or division, or a line of business, being separated or sold to another party.

Who is Client?

Deal strategy should be tailored to match the type of client

Buyer Types

- **Strategic Buyers -** Private or public companies that make acquisitions to enhance their current business.
- **Financial Buyers -** Financial institutions (investment banks, private equity) acquiring a company as an investment, typically a short-term focus of selling it after 5-7 years for profit.

Deal Types

- **Asset Deal -** Acquirer can "cherry pick" wanted assets/ liabilities such as employee retention and benefit programs to avoid acquiring unwanted liabilities.
- **Share (Stock) Deal -** Buyer acquires all assets & liabilities of the seller by operation of law, wanted or not. However, the buyer can contractually allocate unwanted liabilities to the seller.

M&A Terminology

Term	Definition
Buyer	The organization considering an acquisition of a target organization or business unit.
Closing Date	The closing date refers to the date when a company purchase and sale transaction is signed off and completed.
Day 0	This refers to the legally defined first day of integration.
Day 1	This refers to the operational first day of operation, usually accompanied by a marketing and sales promotional blitz.
Due Diligence	This is the process of conducting an analysis or investigation to determine the likelihood and viability of a proposed merger, acquisition, or divestiture.
Letter of Intent	A letter of intent (LOI) is the term sheet that a buyer puts forward to a potential target stipulating the purchase price, terms and conditions governing the offer.
Purchase Price	This is the price that the acquirer anticipates to pay for the target firm.
Transaction Service Agreement (TSA)	Transition Services Agreement is a legal agreement for services provided by the seller to the buyer beginning on Day One.
Target	The organization being considered for acquisition or divestiture.
Virtual Data Room	The digital compilation of all due diligence documents that's being provided by the target to the buyer to carry out the due diligence process.

M&A – Overview and Phases

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Typical M&A Process

Step-by-step process that nearly every M&A deal follows

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Compile a list of **potential targets**.
Detailed **screening** of potential targets based on value potential, strategic fit, and cultural fit

Seller release **Executive Summary** sharing enough information (about their product, the customers, the problem the company solves, and some high-level financials) to make Buyer to start with

Buyer and Seller signs **confidentiality agreements**
Seller release C**onfidential Information Memorandum (CIM)**

Buyer to submit a L**etter of Intent (LOI)**
Seller release documents in the Virtual Data room for Buyer to conduct D**ue Diligence**

Write the **Purchase Agreement**
Close the deal

Review and write the T**ransaction Service Agreement (TSA)**
Plan and execute the **integration** to capture the synergy and mitigate risks post-transaction

M&A Overview

Identification, capture, and realization of synergies from the M&A transaction

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Value Drivers

Value drivers determine price and structure of the transaction and define the nature and the scope from the transaction

Focus Areas

- Financial
- Tax
- Operations
- Human Resources
- IT
- Risk Management
- Legal

Human Resources:

- HR Services
- Organization Change
- Benefits and Compensation

M&A Phases – Using Actuarial Lenses

All risks and opportunities related to employee's benefits and compensation are identified and addressed

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Deal Kickoff — Sign and announce — Close / Day 1 — End State

Project Kick Off

Detailed screening of potential targets.

Ensure overall Talent / People / HR strategies are aligned with overall corporate strategic objectives

Actuarial Due Diligence

Seller opens up a Virtual Data Room ("VDR") for Buyer to provide all information-to-date

Buyer learns and validates information about Seller before final purchase

Uncover comp & benefits and insurance risks / liabilities

- **One-Time Cost - Analysis and modeling of payments, funding, and liabilities triggered or accelerated upon transaction**
- **Analysis and modeling of run-rate HR, compensation and benefits costs**
- **Provide input into purchase agreement terms to reflect the desired deal economics**

Create a final report highlighting key findings, implications and risks

Transaction Planning

Define and review Transition Service Agreement (TSA) and exit criteria

Evaluate buyer and target programs and policies

- **Identify the synergy opportunities and**
- **Associated cost**

Plan for Day 1 readiness

- Define Buyer's philosophy and standalone HR operating model post-transaction
- **Talent & workforce transition**
- **Retention planning, including assessment of equity awards**
- Define communication strategy

Integration Execution

Execute critical Day 1 requirements

Implement go-forward combined programs & policies (e.g., insurance, benefits, mobility, performance)

- **Buyer should be able to successfully provide benefits and compensation to all employees on Day 1**

Integrate all HR plans, processes, policies and systems

Ensure adherence of Transition Service Agreements

HR Due Diligence
- Role of Actuary

Key Expectations and Deliverables

A Buyer wants to pay the “right” price for an asset (e.g., company, investment in a company)

Expectations

- Uncover financial, operational and compliance risks and liabilities associated with employees
- Provide data for the negotiation process
- Quantify items impacting the deal cost
- Ensure the transaction documents are worded appropriately to mitigate risks and provide contingencies
- Provide incremental estimates to cost model (i.e., run-rate and one-time costs)
- Identify high risk areas and hidden integration/divestiture/carve-out issues
- Identify early priorities/goals for integration/divestiture/carve-out planning

Deliverables

- Summary of findings highlighting key findings, implications and risks
  - Employee Matters
  - Cash Compensation
  - Executive Compensation
  - Health and Welfare programs including Defined Benefit Obligations
  - Cost analysis associated with HR function
- Inputs to negotiate and word legal transaction documents (purchase agreement and disclosures) appropriately
- Preliminary integration/divestiture/carve-out plan

Focus Areas

Provide high level recommendation on financial matters related to employee benefits and compensation

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Project Kick-off → **Due Diligence** → **Transaction Planning** → **Integration Execution**

Identify one-time cost, run-rate and purchase agreement terms

Compensation and Benefits

Compensation structures, and philosophy

Performance metrics in variable compensation plans

Any non-statutory employee benefits

Accounting, funding and accrual policies for all compensation and benefit plans and programs

Any retention plans currently in place or contemplated

Defined Benefit Obligation

Analyze recent actuarial valuation reports (IAS 19R or AS15R, as applicable)

Determine and analyze key actuarial assumptions, provisions, obligations and the funded status of all defined benefit programs (Gratuity, Superannuation, Leave Encashment etc.)

Executive Compensation

Significant aspects of key executive employment agreements, long term incentive arrangements, annual bonus plans, change-in-control arrangements and other executive benefits

Identify Key Performance Indicators under variable compensation plans

Analyze “all-in” compensation for top executives

Severance, Change in control Provisions

Number of Target Company leaders with CIC agreements

Potential change in control payments which may be triggered by the Proposed Transaction

Severance provisions

Any plans to reduce the workforce and expected severance

Outstanding Equity Awards

Treatment of unvested equity incentives as per CIC agreements or employment agreements, equity incentive programs, proxy statements, and purchase agreements

Potential Impact

Enables the acquirer to plan ahead to mitigate some of the issues and risks:

- Payments, funding, and liabilities triggered or accelerated upon transaction
- Changes in run-rate HR, compensation, and benefit costs post transaction
- Purchase agreement terms that do not reflect desired deal economics

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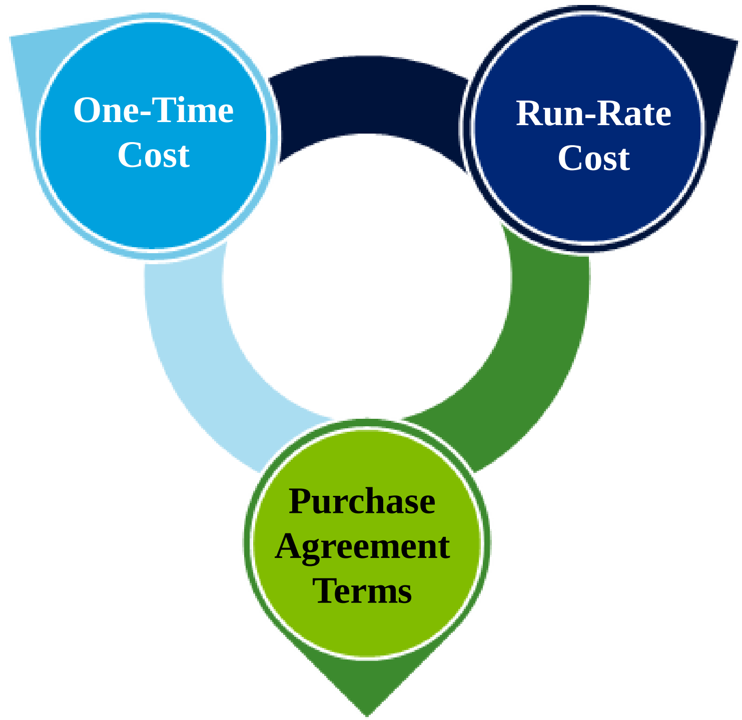
- Change of control payments under executive and employment agreements
- Equity compensation plans – accelerated vesting and payout
- Retention, Severance and/or recruiting costs
- Deferred compensation acceleration or cash-out

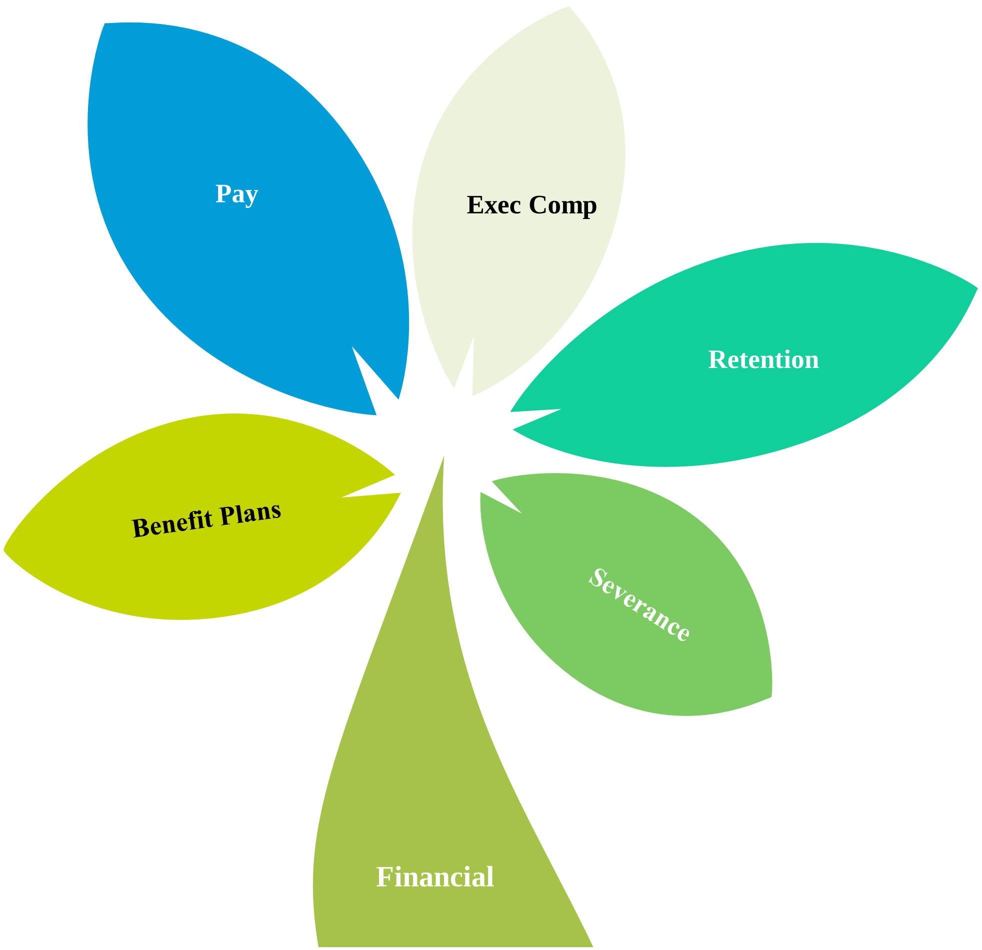


- Run-rate cost impact of integrating or standing up compensation and benefit plans
- Cost differential in HR policies

- Employee matters covenants and changes anticipated under integration (comp / ben continuation)
- Compensation / benefits triggers for potential purchase price
- Assumptions for any liability transfers
- Confirmation that all plans are scheduled
- Required transition services and related costs

Opportunities to Negotiate

Can we identify potential liabilities or cost impacts?



Benefit Plans
Can we negotiate away the DB pension plan? If not, how much should the purchase price be reduced?

Pay
How much will it cost / save Buyer from bringing the pay level at Seller to the pay level at Buyer?

Exec Comp
How much of the equity compensation will the Seller executives lose because of this transaction?

Retention
How much will it cost to keep the Seller executives from leaving the organization with a huge equity payout immediately after transaction?

Severance
How much will it cost to realize synergies?

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Transaction Planning and Integration – Role of Actuary

Focus Areas

A Compensation & Benefits strategy aligned with the new organization's strategy is key to a successful integration.

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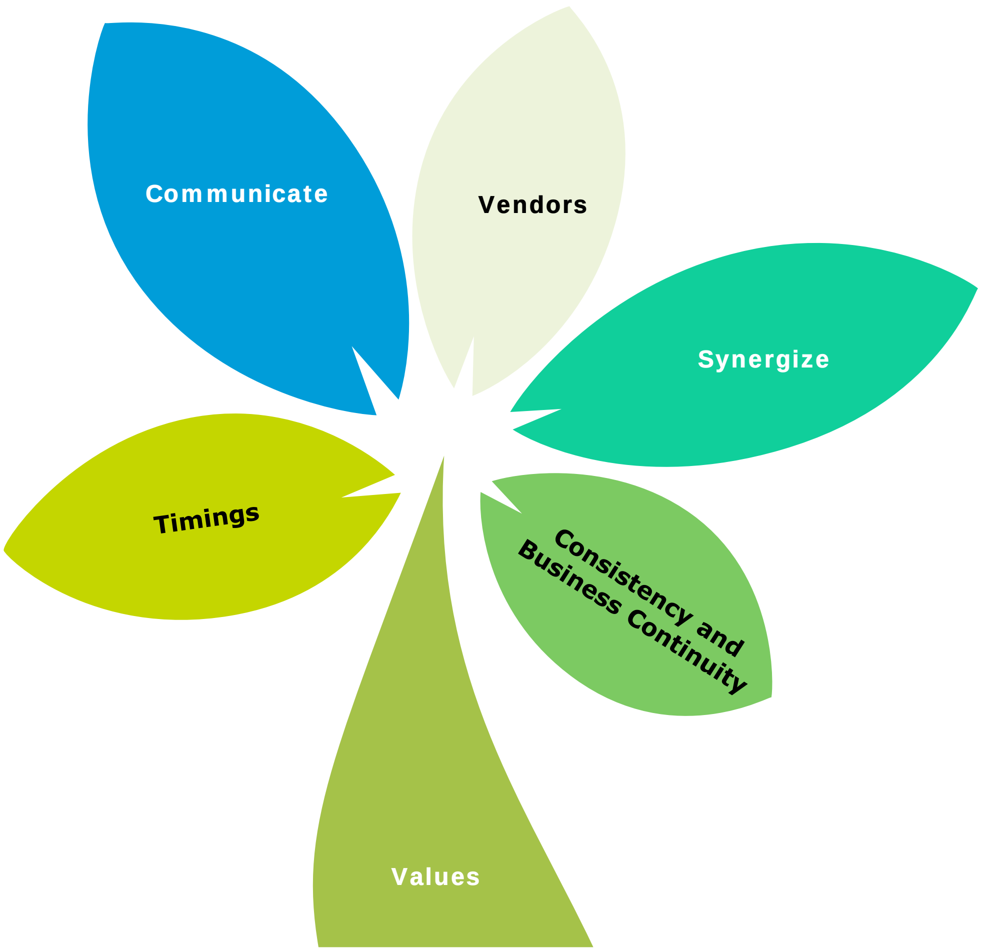
M&A Strategy and Project Kick-off → Due Diligence → Transaction Planning → Integration Execution

Impact the identity, health and overall well being of employees

Global Considerations	Compensation Harmonization	Benefits Harmonization	Retention	Financial Model
Develop a country by country harmonization roadmap as timing will likely vary by region and country Coordinate the benefit programs within employment negotiations Align transitions with unions / works council negotiations and timeline Identify benefit programs to follow consistency across the countries	Identifying any visible compensation inequity by country Leverage the integration to review and align job architecture Ensure performance metrics are aligned to short-term integration needs and the combined long-term strategy	Harmonization of benefits design will likely result in increased costs, however significant value can be recaptured through harmonization of administration and vendors Prioritize opportunities to renegotiate rates and take advantage of the scale of the combined organization	Identify and develop work plan for the retention strategy that should map to the level of business risk tied to the individual based on: • The criticality of their role • Marketability Ensure the programs is designed to keep key talent through the pre—and post-close turbulence	Proactively develop mitigation plans to manage unforeseen cash requirements and financial volatility including: • Understated pension funding, • Understated liabilities triggered by change in control, • Misunderstood provisions adding cost, and • Inefficient benefit program contracts that generate excess costs

Values to Create

Leveraging current state to align the future business objectives of the combined organization



Timings
Coordinate timing of Total Rewards harmonization with employment negotiations

Communicate
Communicate early and often, the compensation and benefit changes to leaders, managers, and all other employees

Vendor
Prioritize opportunities to renegotiate rates and take advantage of the scale of the combined organization

Synergize
Consolidate administration and vendors necessary to deliver new programs and any concerns/issues related to compliance

Consistency and Business Continuity
Rationalize global rewards plans and retain critical talent to maintain business continuity

Key Issues for Considerations

India – Key Retirement Benefits and Treatment upon Transaction

For non-statutory benefits, Seller and Buyer to negotiate either to retain or transfer obligations.

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Employee Provident Fund	•The Employee Provident Fund (EPF) Act provides for the following three schemes: •Provident Fund (PF) Scheme •Employee Pension Scheme (EPS) •Employee Deposit Linked Insurance (EDLI) Scheme **•The PF funds in the Seller's account under EPFO transfer as-is in the Buyer's account under EPFO given that the Buyer is not self-managing the PF**
Private Provident Fund	•Seller may self-managing the PF and guarantee the interest rate at the same rate offered by the EPFO. • Subject to investment risk and scheme becomes DB in nature. • Plans are funded and assets reside with in-house trust subject to investment restrictions. **• PF fund can either transfer to Buyer's account under EPFO or Buyer's in-house trust.** **• Ensure that the appropriate allocation of statutory contributions and interest were made by the Seller before taking over the accounts.**
Superannuation / Pension Plans	• Legacy pension plans which may be DB or DC in nature •Plans are typically funded and assets often reside in trust or life-insurance policy. **•Buyer can continue the arrangement or the Seller can either retain the risk or cash out the accrued benefits.** **•For DB plans, liability needs to be identified and quantified and ensure the transfer of appropriate funds** **•Need communication with employees regarding the treatment of these benefits.**

India – Other Benefits and Treatment upon Transaction

For non-statutory benefits, Seller and Buyer to negotiate either to retain or transfer obligations.

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Gratuity	• DB in nature • Typically the plan is funded and the assets reside either in trust subject to investment restrictions or as an insurance policy. • **Liability needs to be identified and quantified and ensure the transfer of appropriate funds** • **Need communication with employees regarding the treatment of the past service**
Leave Encashment	• The company typically provides encashment of unavailed earned leave on separation subject to eligibility, annual entitlement and maximum carry forward limit. • Typically the benefit is unfunded and are paid from usual business operations. • **Either Buyer need to assume or Seller to pay out accrued PTO.**
Long Term Service Awards	• The Company may have an arrangement to provide awards on completion of some milestone years. • Usually the benefit is unfunded and are paid from usual business operations. • **Buyer can continue the arrangement or the Seller can either retain the risk or cash out the accrued benefits.** • **Liability needs to be identified and quantified and ensure the transfer of appropriate funds** • **Need communication with employees regarding the treatment of these benefits**
Healthcare Benefits	• They are typically employer funded benefits ranges from group health insurance coverage to reimbursement of pharmacy and outpatient bills with healthcare providers. • **Benefits for target employees typically terminate at closing and Buyer provides new set of arrangements.**

Global Considerations

Harmonization of diverse rewards policies, consideration of global regulations, works council requirements.

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North America

- Consider WARN Act (US) for any significant headcount reductions
- Employee contracts may be required when transferring acquired workforce
- Provide in lieu of notice pay of termination to satisfy notice requirements (Canada)
- Impact of Unions and associated health and welfare benefits

EMEA

- Pensions benefit liabilities
- Redundancy laws and provisions
- Workforce transitions and transfer laws
- Works Council consultations and employee notifications

APAC

- China data security
- Severance complexities
- Changing market regulations
- Globalization, including global mobility
- Union mobilization due to low wages across Southeast Asia

Thanks!