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Ethical Dilemmas in M&A Due Diligence

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Agenda

- Introduction
- Case Study Synopsis
- Key Issues to Address
- Professional Considerations
- Due Diligence Process & Impact
- Suggested Next Steps to Address Key Issues
- Communication to Leadership
- Possible Long-term Consequences
- Impact on Successful Execution of M&A
- Conclusion

Introduction-Mr. Navin Iyer



Navin Vishwanath Iyer is a Consulting Actuary and Founder of Prime Actuarial Solutions. He is also a qualified Chartered Accountant. With close to 2 decades of experience in the actuarial space spanning across both Insurance and Employee Benefits, he brings diverse experience across multiple markets viz., India (including the sub-continent), Middle East, US, UK and Australia.

The firm is engaged in multiple assignments ranging from reserve and solvency certifications, reporting, IFRS17 consulting, product development and pricing, peer-review, with profits actuarial work etc. The firm supports several companies in India and overseas.

Navin is currently the Consulting Actuary for Postal Life Insurance (PLI) that manages an AUM close to INR 130,000 crores. He is responsible for all aspects of actuarial work for this entity.

He has been engaged as a With-profits Actuary and Peer Reviewer for several leading insurers in the Indian market for past few years. He is also working as a Certifying Actuary for a leading Life Reinsurer and is engaged in reserving for FRB's in India. He also serves as a Consulting Appointed Actuary to several Companies outside India. He was also actively involved in supporting insurers towards their QIS 1.0 submission.

Navin worked with several leading Insurers (PNB MetLife, Kotak Life, Canara HSBC Life) in leadership roles before starting his practice 6 years ago.



Case Study Synopsis



- Actuary at ABC Pvt Ltd Consulting Firm has specialization in General Insurance
- Our client InsuranceforAll is considering merger with AllInsured Company Ltd
- Conduct Due Diligence Evaluation of Actuarial Practices, reserving & financials of AllInsured Company Ltd.
- While doing so discrepancies & irregularities were observed which could potentially lead to misleading portrayal of financial health
- This is discussed with Mr.XYZ (currently part of All Insured's senior management & and ex-employee of ABC Pvt Ltd) and it has been assured that inconsistencies noted have an offsetting impact and won't change results materially
- This is discussed with Senior Actuary of ABC Pvt Ltd who has recommended to draft report as advised by MR. XYZ, considering their past relations

Key Issues to Address

- What Professional Conduct Standards shall help navigate this situation?
- Highlight Key Issues in Due Diligence Process which impact-Behavioral/Transparency/Stakeholder's Interests
- Steps to be taken to address Discovered Issues/Communicate Findings
- Steps to be taken to report findings to InsuranceforAll's Senior management
- Long Term Consequences of your actions/recommendations on
 - Actuarial Profession's Reputation
 - Organization's Credibility
 - Successful Execution of M&A

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Professional Considerations



Actuary's Rulebook

- The Actuaries Act, 2006
- Professional Requirements
 - Professional Code of conducts -> Professional Conduct Standards
 - APS 21 -> Appointed Actuary and GI Business
 - APS 34 -> General Actuarial Practice
 - APS 33 -> Peer Review of Appointed Actuary in GI Insurance

Professional Considerations



General Professional Standards

PCS 1.3 : A member who has any doubt about the interpretation of professional guidance or its application in particular circumstances should normally seek advice from an actuary who has relevant experience in the first instance. If this would be inappropriate or if, having consulted such an actuary, the member has residual doubts about the course of action to be taken, **the member must seek guidance from the professional body.**

PCS 1.4: The Professional Conduct Standards should not be interpreted as imposing any constraints which would limit a member's freedom to provide actuarial services. **A member must, however, avoid arrangements which inhibit the member's ability to conform to the standards of behaviour, integrity, competence and professional judgment which other members or the public might reasonably expect of a member** (including, but not limited to, the requirements of professional guidance).

Professional Considerations



Appropriate Practices - Acceptance of assignment

APS 34 2.1.2: In accepting an assignment for actuarial services, the actuary shall:

- a. Be qualified to perform the services from accepting the assignment till completion of the assignment;
- b. Be satisfied that the assignment can be performed under the applicable code of PCS, relevant APSs and relevant GNs; and
- c. Have reasonable assurance of time, resources, access to relevant employees of the principal and other relevant parties, access to documentation and information, and the right of the actuary to communicate information, as may be necessary for the work.

APS 34 2.2: Knowledge of Relevant Circumstances - The actuary should have or obtain sufficient knowledge and understanding of the data and other information available, including the relevant history, processes, nature of the business operations, law, and business environment of the subject of the actuarial services, to be appropriately prepared to perform the actuarial services required by the assignment.

Professional Considerations



Conduct

PCS 2.1: The actuarial profession has an obligation to serve the public interest within the context of building and promoting confidence in the work of actuaries and in actuarial profession. Collectively it seeks to do so by informed contribution to debate on matters of public interest and by influencing those with power to protect and enhance the public interest. **Individual members must maintain and observe higher standards of conduct.** The standing of the actuarial profession depends on the judgement of individual members.

Professional Considerations



Integrity and Honesty

PCS 2.2: Members have a duty to the actuarial profession and clients and must always act honestly and with integrity.

PCS 2.3: Clients are entitled to have absolute confidence in the skill , objectivity and integrity of any member.

Professional Considerations



Confidentiality

PCS 3.1: As a matter of law, information acquired by an actuary in the course of professional work is frequently confidential to the actuary's client. As such, any information that is governed by confidentiality between the actuary and actuary's client should not normally be disclosed unless consent has been obtained from the actuary's client.

Professional Considerations



Independence and Standard of Advice

PCS 4.1: An actuary is expected to use best judgment in formulating advice and must have proper regard to any relevant professional guidance or other guidance.

PCS 4.2: In accepting an assignment and when performing the assignment, an actuary must ensure that he or she is qualified to do so as per requirements of professional guidance and other guidance.

Professional Considerations



Compliance

PCS 5.1: Non-compliance with the Act and Rules & Regulations made thereunder, professional guidance and other guidance shall constitute misconduct as per section 31 of the Act and could attract initiation of disciplinary procedures as per the Act and the relevant Rules. **Members therefore have a responsibility to familiarize themselves with, and comply with the Act and Rules & Regulations made thereunder, professional guidance and other guidance** as ignorance or lack of proper understanding cannot be grounds for justifying any misconduct.

PCS 5.4: **A member found guilty of misconduct will be liable to disciplinary actions as specified in sections 30, 37 and 38 of the Act.**

Professional Considerations



Impartiality

PCS 6.1: Actuaries must ensure that their professional judgement is not compromised, and is not seen to be compromised, by any bias, conflict of interest or the undue influence of others.

PCS 6.3: In the event of any such conflict or apparent conflict of interest, the client or clients involved must be notified at the earliest opportunity and if any actuarial services provided to a client is, or will be, influenced by interests other than those of that client or by any constraint other than that imposed by professional guidance or other guidance, this must be disclosed in the output of the actuarial services.

PCS 6.4: If there might be a conflict between the interests of different clients or previous clients of the actuary or of the actuary's firm, the actuary must have proper regard to their respective interests and in particular must not communicate information within the actuary's firm which the actuary has reason to believe might harm the interest of any client or previous client.

Professional Considerations



APS 21 Section B

Point 5: As regards guidance **to actuaries - external to a particular company** - who are asked either by the company or someone with a legitimate interest in it to comment on either a valuation carried out by the Appointed Actuary or a report he / she has made to the company, the guidance for such actuaries is that, although there is room for difference of opinion with regard to actuarial advice and judgment, **they should always take care to respect the status of the Appointed Actuary.** This does not though stop them from making properly reasoned comments on the work of the Appointed Actuary, if need be.

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Impact on Key Stakeholders

Internal

- Board of Directors
- Senior Management
- Employees
- Shareholders

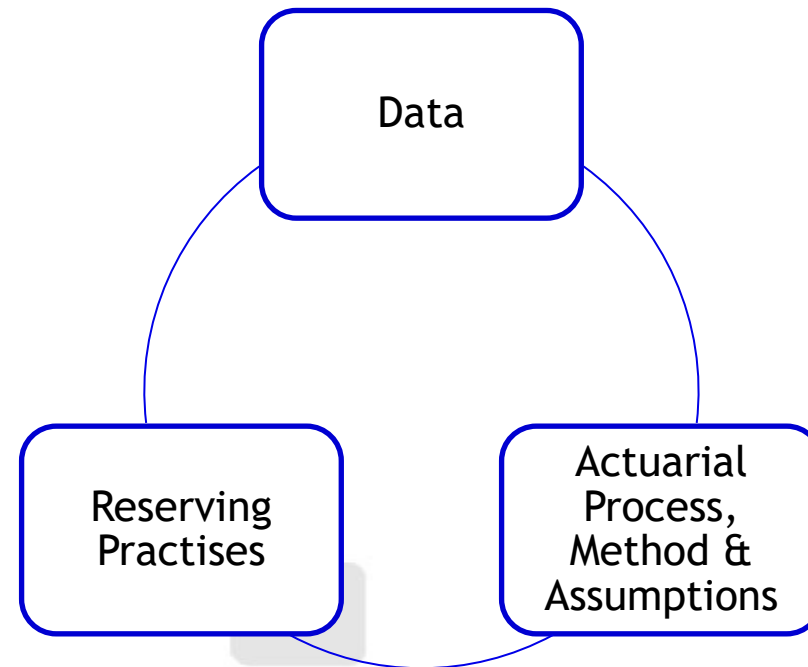
External

- Customers/Policyholders
- Regulators
- Creditors/Third Parties
- Suppliers
- Actuaries/Consulting Firms

Due Diligence Process-Assess the Actuarial Practice

Per APS 34,

- Thorough scrutiny of the method, assumptions and process to be employed
- To Assess whether the discrepancies or inconsistencies have a material effect on decision making process



Due Diligence Process-Data Related



Data Quality

Due Diligence Process- Actuarial Model & Assumptions



Selection of Assumption and
Methodology

Due Diligence Process-Reserving

(Assets, Liabilities, and Solvency Margin of General Insurance Business,2016) Regulations

Determination of Liability



Potential Risks with Impact



Protection of
Stakeholder's Interests

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Possible Breaches Leading to Professional Misconduct

Schedule(s) to the Actuaries Act, 2006

- Failure to disclose facts which either appear to have an impact or have an impact & are known to us in our capacity
- Failure to obtain sufficient information to warrant the formation of an opinion with regard to this project
- Failure to invite attention to any material departure from the generally accepted principles
- Grossly negligent in the conduct of our professional duties

Suggested Next Steps

- Re-initiate a discussion with Mr. XYZ to understand their point of view
- Cross Verify vs any previous actuarial investigations /past audit reports
- Draw references from the historical regulatory valuation reports
- Re-assess/Re-validate the offsetting impact
- How Material is the Offsetting impact?
- Request for a discussion with InsuranceforALL's Company

- Seek independent views of any other Senior Actuary in the team
- Request for an Independent team to re-assess the offsetting impact
- Seek guidance from IAI(PCS 1.3)
- Seek Internal Legal Opinion on possible Conflict of Interest
- Consider withdrawing from taking on this respective project
- Document observations in formal draft for future references

Guiding Principles for Communication w.r.t APS 34



Communication and Reporting

APS 34 3.1: General principles including

- 3.1.1: Form and content
- 3.1.2: Clarity
- 3.1.2: Timing of Communication
- 3.1.2: Identification of Actuary

APS 34 3.2: Report including relevant disclosures

- 3.2.1 Content
- 3.2.2 Disclosures
- 3.2.3 Authorship
- 3.2.4 Form
- 3.2.5 Constraints

Written Report/Communication of Key Issues

Own Company's Leadership

- Highlight potential difference of opinion
- Alternate remedies adopted to resolve the differences, if any
- Any possible regulatory, legal and professional consequences as a Firm/Individuals
- Possible impact to organization's credibility and possible reputational risk
- Recommend internal Senior Management to have meeting with the InsuranceForAll's Board.

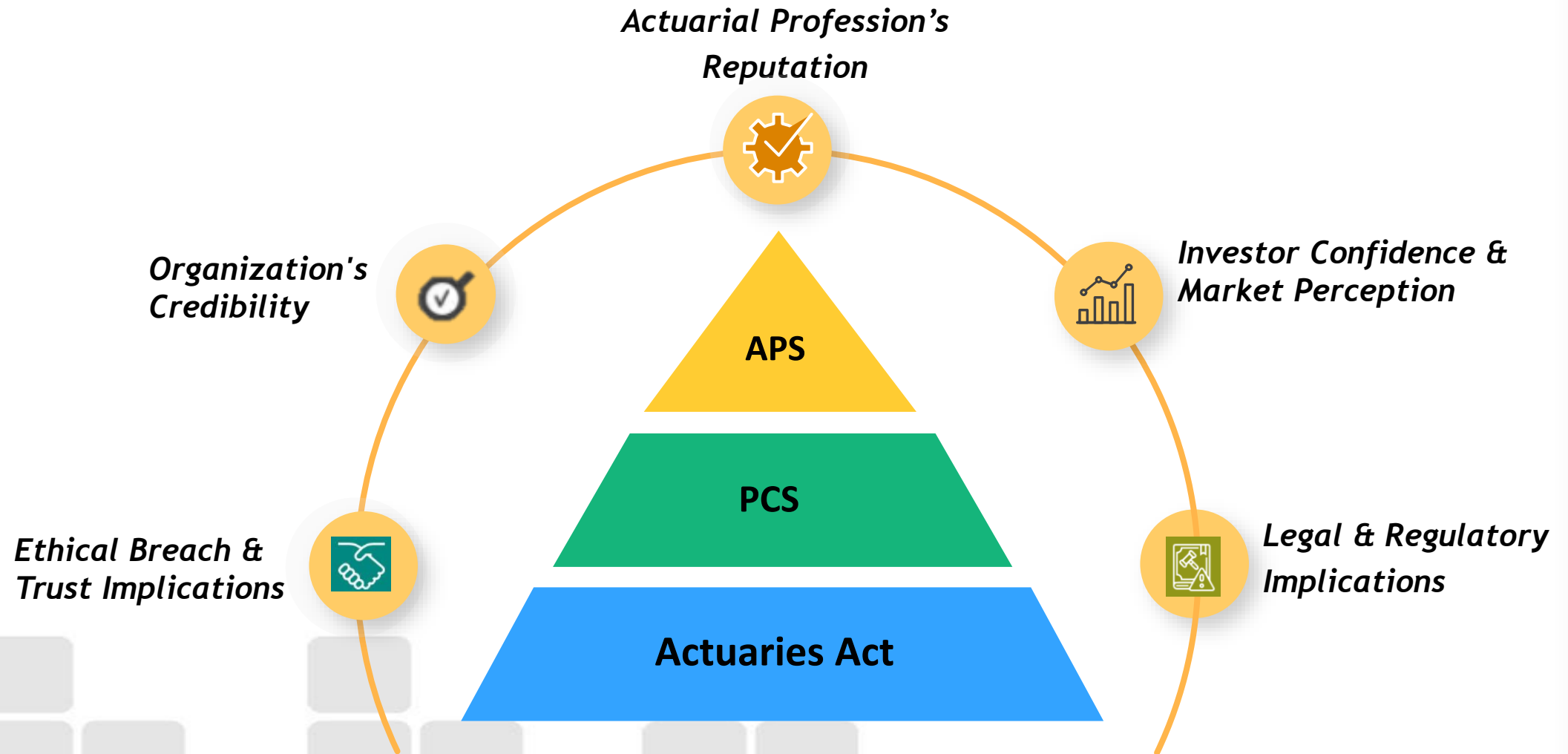
InsuranceForAll's Leadership

- Disclose prior appointments of the All Insured's Senior Mgt
- Detail the Due Diligence Process to give assurance of the established Chinese Walls in this project
- Conclusion
 - Impact of Materiality of Offsetting Impact
 - Any reliance & limitations of the exercise
 - Any Uncertainties in the process of work
- Request for a meeting to communicate our conclusion and seek their formal views

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Possible Long-term Consequences



Actuarial Profession's Reputation



Professional Integrity

- Integrity is the bedrock upon which the actuarial profession's trust, reliability, and credibility stand
- Upholding the highest standards of integrity is fundamental in the actuarial profession
- Compromise towards profession's reputation for accuracy and diligence
- Shadow impact on entire profession's reputation
- Specific interests leading to impartial analysis could damage the objectivity



Trust & Reliability

- Stakeholder's reliance on unbiased and precise assessments
- Negligence to address issues could undermine trust
- Violations of ethical standards such as data manipulation or dishonest reporting can severely undermine trust
- Actuarial profession's reputation within the broader financial and insurance industry

Organization's Credibility



Credibility in the Industry

- ABC Pvt. Ltd.'s credibility hinges on its commitment for thorough and unbiased analyses
- Failing to address identified irregularities will tarnish the firm's reputation
- Loss of confidence in the firm's capabilities
- Long-term client engagements and potential referrals in future



Ethical Standing

- Adhering to ethical principles is crucial for ABC Pvt. Ltd.'s standing
- Compromise on firm's reputation for ethical conduct
- Influencing assurances based on past affiliations
- Breach of respecting confidentiality



Regulation & Legislation

- Regulatory non-compliance & repercussions
- Violating of regulatory standards can lead to penalties, fines
- Misrepresentation or omission of material information
- Legal action against both individual actuaries and the firm

Impact on Successful Execution of M&A



• Financial Health Evaluation

- Flawed assessment of financial health will potentially lead to inaccurate projections and decisions
- Deliberate inaccuracy in valuation will lead to financial losses affecting operations, market standing & shareholder's value
- Inappropriate advice can negatively impact policyholders, shareholders and other stakeholders
- Misleading public disclosure will have impact on market's perception of merging entities and investor's confidence



Risk Management

- Overlooking irregularities will impact risk management strategies and stability post-merger
- Future operational disruptions will impact the successful integration of merged entities
- Assessments resulting from fraudulent or misrepresented data will make companies vulnerable to unforeseen risks
- Inaccurate risk assessments lead to misinformed decisions on risk tolerance, mitigation strategies, and resource allocation

Impact on Entities

ABC Private Limited



Conclusion

In summary, deliberately giving incorrect advice in an M&A process has significant legal, financial, reputational, and ethical implications, impacting decision-making, regulatory compliance, stakeholder trust, and the long-term success of the merged entity

Ensuring comprehensive and accurate valuations is crucial for responsible and successful M&A transactions

Instances of flawed advice can affect the actuarial profession's credibility and trust, influencing future industry practices and standards

To mitigate these risks, ongoing efforts in maintaining data integrity, reinforcing ethical guidelines, ensuring compliance with regulations, embracing technology responsibly, improving communication, and adapting to industry changes are crucial

THANK YOU!!!!

We are open for discussion!